International
Labour
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GOOD PROCUREMENT PRACTICES AND SMEs IN GLOBAL SUPPLY CHAINS:
what do we know so far?

A literature review

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May 2016

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First published 2016

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ILO Cataloguing in Publication Data

Navas-Alemán, Lizbeth; Guerrero, Tamara

Procurement practices and SMEs in global supply chains: what do we know so far? : A literature review / Lizbeth Navas-Aleman, Tamara Guerrero; International Labour Office, Enterprises Department. Geneva: ILO, 2016

ISBN: 9789221311683; 9789221311690 (web pdf)

International Labour Office Enterprises Dept.

procurement / enterprise development / value chains / small enterprise / production networks / state intervention / developing countries

12.07.2

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Printed in Switzerland

SME development and decent work

This literature review looks at what we know so far about the procurement practices from small and medium enterprises (SMEs) in global supply chains and what strategies actors in these market systems can take to improve these practices. So far little attention has been paid to this specific question, even though micro, small and medium enterprises (including farms) in many cases (i) supply many of the jobs in global supply chains and at the same time (ii) face the biggest challenges in terms of decent work deficits. Based on peer-reviewed academic resources and material of a similar technical quality, this study provides a first overview and will be complemented by 5 case studies that specifically look at good practices.

The report is part of the response to a request that came out of the 2015 International Labour Conference (ILC) discussion on SME development and decent work and aims at informing the 2016 ILC discussion and the role of SMEs.

The target audience of this publication are ILO constituents, policy makers, academia, and development practitioners, as it informs about what we know so far and provides new insights on the role of SMEs and possible upgrading strategies related to some of the core aspects of decent work.

We would like to thank the authors, Lizbeth Navas-Alemán and Tamara Guerrero as well as the ILO team working on the publication under the guidance of Merten Sievers, including Markus Pilgrim, Callie Ham and Carlo Delu, of the SME Unit. SECTOR, ACTEMP and ACTRAV also contributed comments, both to the initial terms of reference as well as to the final report.

More feedback still needs to be received by ILO constituents to distil key aspects that the ILO should work on in the future. We think, however, the report constitutes an important milestone on the role of SMEs in global supply chains. Please contact Merten Sievers (sievers@ilo.org) regarding any further comments you might have.

Sincerely,

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Global Coordinator, Value Chain

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1.1 Introduction to global value chain analysis

Global value chains (GVCs) have brought about a new way of thinking concerning the organisation of trade and production around the world. Most trade and production worldwide take place within networks of firms that are not formally owned by each other and that have interactions determined by other dimensions beyond price, including ease of cooperation with suppliers, flexibility, reliability, etc. However, prices and costs still matter for competing with other networks[1] and one way to reduce costs has been to relocate and outsource some stages of the production process to firms in locations with lower costs and increasingly (in recent times) with comparable levels of skill and competences as those found in the so called 'advanced economies', thus enhancing the participation of firms from developing countries in global value chains.

Many of those firms are small and medium enterprises (SMEs[2]), and although much has been written in the GVC literature about how firms from developing countries upgrade (or not) when supplying to lead firms in these chains, there is still an important task to be done, namely the analysis of how operating in GVCs affects **SMEs** given their importance for employment.

SMEs make up the majority of firms in the world and are responsible for a large portion of its employment. According to some estimates, SMEs constitute up to 95% of the world's firms (ITC, 2015) and between 80-90% of total employment in the developing world (OECD, WTO and World Bank Group, 2014). However, not all that employment takes place within formal establishments. An estimate by ILO suggests: "…there are 420 to 510 million SMEs worldwide, of which 9 per cent are formal SMEs (excluding micro-enterprises)" (p. 5, ILO, 2015). Thus the effects in the present document are of two types:

- those linked to the development and growth of these SMEs by improving their market access and the added value of their products (included in the concept of economic upgrading); and
- those linked to improvements in labour practices (included in the concept of social upgrading).

1 From a purely academic point of view, GVCs, GPNs (Global Production Networks) and GCC (Global Commodity Chains) are distinct concepts; however, with regard to how they affect SMEs from developing countries they can be used interchangeably as it is done in this literature review.

2 For the purposes of this document, SMEs will be understood as firms with less than 250 employees. However, when the sources reviewed make no mention of the number of employees needed to qualify as an SME, those findings ascribed to SMEs will be assumed to be of relevance for the present literature review.

The literature on how firms from developing countries upgrade in GVCs has become more sophisticated from the initial optimism of the late 1990s (when joining GVCs was thought to produce an 'almost automatic' upgrading pathway for firms in developing countries (Humphrey, 1995; Schmitz, 1995; Gereffi and Korzeniewicz, 1994; Gereffi, 1999). IIn the 2000s it became clear that not all types of upgrading were equal and that some types of upgrading (usually those limited to improvements in the production process) could lock developing country firms into poorly remunerated activities and even 'inmiserizing growth'[3], a notion initially proposed by Bhagwati in 1958 and brought by Kaplinsky (1998) to the GVC discussion. It was also acknowledged that other types of upgrading into higher-remunerated functions (design, commercialization, branding, etc) did increase opportunities for self-reliance and increases in income. Upgrading, it has been shown, requires 'a certain defiance of the concept of comparative advantage' (Millberg et al, 2013), as conventional economic wisdom would recommend that developing countries with an abundance of cheap labour continue to produce manufactured products and that developing countries with an abundance of natural resources continue to export unprocessed commodities. Both routes are limited by deteriorating terms of trade (cheap manufactured products suffer from worsening terms of trade and unprocessed exports of commodities provide a poor basis for a development strategy) (Marin et al, 2013). Different types of upgrading were linked to the different ways in which GVC where organised internally or their *governance* (See Humphrey and Schmitz, 2002; 2002 and Gereffi et al, 2005 for full discussions on this relationship).

Nevertheless, even with the acknowledgment of the weak relationship between joining a GVC and the prospects of upgrading for a firm, there was still the assumption that when upgrading of production and processes took place, this would be accompanied by increased wages and improved labour practices. This second assumption was questioned early on by Barrientos and Smith (2003, 2007) as well as others using extensive case study material from the way lead firms created and monitored their codes of conduct in GVCs. One of the earliest challenges that Barrientos and Smith (2003, 2007) identified was the creation of two different types or 'tiers' of workers: those that had long-term or permanent jobs and those that were hired seasonally. The first type of worker would generally enjoy better working conditions including a formal contract, a higher salary and increased job security when the firms that employed them joined GVCs. This top tier employee also tended to be male, whereas those workers that were hired seasonally were more likely to be women or from lower social strata and were not likely to have a contract nor be considered as part of the firm's workforce. Lead firms and their suppliers are often adamant that their codes of practice are implemented, but this means only the first tier of workers enjoys this protection.

In 2013, Berhardt and Milberg in further challenged the association between upgrading and improvements in labour practices with a large quantitative study of

3 This phenomenon is characterized by an increase in the output and even exports of a country but with deteriorating terms of trade (lower prices for the product and/or higher costs to produce it) for the product, which makes the country poorer as it increases its participation in this type of trade.

GVCs across several sectors (garments, electronics, agriculture and others) within the research programme 'Capturing the Gains'.[4] There was, again, no 'automatic' link between increasing incomes for suppliers that joined value chains and improvements in labour practices.

Having established that: a) joining value chains *may* bring about upgrading for firms in developing countries but does not guarantee it, and b) that successful upgrading *may* be linked to some improvements in labour practices but does not seem to be the widespread result, the main innovation for this literature review was to look into whether there is any recent evidence on 'good' procurement practices by lead firms in global supply chains to have an explicit SME focus (i.e. to have explicit objectives geared towards improving market access and labour practices within SME suppliers in the chain) and whether those good practices also lead to improvements in labour practices.

The remainder of this literature review is structured as follows: **Section 2** explains the relevance of the concept of GVCs for SMEs in developing countries, including opportunities as well as challenges that have been associated with SME development. **Section 3** reports on the examples of good procurement practices found in the literature within four labour-intensive sectors of importance to ILO: floriculture, tourism, electronics and garments. **Section 4** concludes by highlighting the main findings from the literature review and pointing at possible sectoral differences, policy recommendations and questions to keep in mind when designing pro-SME procurement practices in GVCs.

1.2 Approach

In order to carry out this literature review, we interviewed a number of ILO stakeholders working on SMEs including this report's commissioning department, the Small and Medium Enterprises (SME) Unit and also a number of procurement experts from private and public organisations. These conversations helped refine working definitions of what a 'pro-SME' procurement practice should look like, even though it was agreed that systematic evidence on the effectiveness of procurement practices by lead firms in supply chains from the *point of view of SMEs* is still elusive.

From the ILO meetings, a number of documents were obtained (and others suggested), which were analyzed with a view to assess their suitability for inclusion in this study alongside the peer-reviewed journal articles, which are the core source of evidence in this document.

The next step consisted of a review of the global value chain (GVC), global production networks (GPN) and global commodity chains (GCC) literature in order to summarise their main findings with regards to how SMEs from developing countries fare when they join these international networks. These three bodies of literature are firmly hosted with-

4 See www.capturingthegains.org

in the international development and development studies literature, and this ensures a concern with upgrading and improvements for suppliers from developing countries.

A review of the literature on supply chain management, subcontracting, and procurement was also carried out by searching for articles that mentioned SMEs from developing countries as suppliers. This literature is usually associated with the wider business studies or international business fields and its main concern is the welfare and competitiveness of the lead firm in the value chain. The literature on business ethics and sustainable supply chain management (both 'hybrids' between the business and development studies literatures) were also consulted.

The main criteria for the source/article to be included in the review consisted of:
a. being peer-reviewed or being of a quality approaching that standard;
b. being explicitly concerned with SMEs from developing countries;
c. pertaining to an international network led by a large firm, and;
d. clearly depicting procurement practices involving SMEs from developing countries.

The authors searched for articles in international journals to which the Graduate Institute of International and Development Studies in Geneva (Switzerland) and the University of Sussex (UK) are subscribed. The potential research field was thus comprised of several thousands of relevant sources. Some of the keywords (and combinations of keywords) used in order to narrow down these searches included: 'procurement and SMEs', 'supply chain management in developing countries', ' international subcontracting', 'large buyers and SMEs', 'sourcing practices in value chains' and others. The references section only shows the sources that were cited in this work, although the number of documents read and considered was much higher.

In order to circumvent difficulties with regards to SME definitions across studies that cover a variety of industrial sectors and countries, we have followed these conventions: when the source specifically mentions that the suppliers are SMEs, this review will include them as SMEs. In all other cases, the definition of SME will be the one provided by ILO for this assignment: firms with up to 250 employees.

Finally, given the paucity of recent evidence for good procurement practices in GVCs aimed to benefit SMEs in the developing world, specifically and deliberately in the terms specified for this literature review, we carried out a validation exercise: the initial findings of this literature review were discussed with private sector development and GVC experts from a number of organisations (USAID, ACDI/VOCA, IADB, UNIDO, FAO and others) in Vienna in December 2015 and in Washington DC in February 2016. From those conversations, we obtained anecdotal evidence of practices that are beneficial to SMEs but usually in small-scale (CSR) projects and/or at the behest of donors and NGOs (i.e. not out of the lead firms' own volition). In addition, discussants confirmed the dynamics that make these practices difficult to find and almost as difficult to scale up: downward pressure on prices and the relentless demand for cheaper, faster and at the same time, higher-quality products and services.

2

What is the importance of GVCs for SMEs from developing countries?

Given that SMEs represent the bulk of all companies in the developing world (OECD, WTO and World Bank Group, 2014), it is expected that they will be found in large numbers as suppliers to GVCs. The international literature has not provided reliable estimates on the percentage of SMEs from developing countries that operate in GVCs, and this could be linked to a common characteristic amongst SMEs in the developing world: informality (OECD & World Bank Group, 2015). Nevertheless, even though the exact data on the percentage of SMEs from developing countries (formal and informal) operating in GVCs are not available, it is possible to distil from the international literature which aspects of GVCs are especially relevant for these small firms' prospects.

2.1 Opportunities and obstacles for economic upgrading

In its origins, the GVC approach was mainly concerned with how suppliers from developing countries could upgrade their positions and increase their gains from globalisation (Schmitz 1999, 2006). Given the large proportion of SMEs amongst the total of firms in the developing world, researchers and policy makers often stated the relevance of the GVC approach for SME development (e.g. Kaplinsky and Morris, 2001; Giuliani et al, 2005).

The assumption was that developing country firms (including SMEs) would join value chains as suppliers and then learn from the lead buyers (typically based in developed countries) how to improve the quality of their products (product upgrading) and/or how to make them in a more efficient manner (process upgrading) as well as how to acquire new functions beyond manufacturing, such as design or marketing, which are better remunerated (functional upgrading) and how to apply everything they learned to other industries (intersectoral upgrading) (Humphrey and Schmitz, 2002; Kaplinsky and Morris, 2001).

It was observed that suppliers would experience fast process and product upgrading when joining GVCs. This is to say, suppliers would improve the quality of their products as well as optimize the processes that led to their production upon (or shortly afterwards) joining value chains. Functional upgrading, however, remained elusive in most cases (Humphrey and Schmitz 2002; Schmitz and Knorringa, 2002).

It became clear to most GVC researchers that functional upgrading was the most controversial of all given its potential to turn a supplier into a competitor by encroaching on the lead firms' core competences (Schmitz and Knorringa, 2002; Bazan and Navas-Aleman, 2004). It could be argued that a similar situation could take place between an SME who is a subcontractor to a first tier supplier in a value chain. The first-tier supplier could become suspicious of any attempt by the SME to acquire skills into higher value added functions, therefore making it unlikely for the first-tier supplier to support the SME in that regard. Additionally, one of the main reasons for a first-tier supplier to subcontract an SME in the developing world is to lower costs, and functional upgrading requires investments that would make the SME's products/ services more costly.

However, as many firms (including SMEs) operate in several value chains with different buyers simultaneously, it is possible to harness the profits and the skills learned from one value chain (where a lead firm or 1st tier supplier only supports or allows the less-threatening product and process upgrading) to other markets where buyers actually expect the firm to have its own designs or market its own products and hence can functionally upgrade (Navas-Aleman, 2011).

It is also widely observed that large lead firms in value chains 'demand higher quantities, compliance with more sophisticated standards and lower unit prices' (Altenburg et al, 2016), which makes it more difficult for SMEs from developing countries to become their suppliers and adds additional challenges to the path towards upgrading within them.

When an SME joins a GVC, there are often one or several layers of firms that separate it from the lead firm. It is usually a first-tier supplier or even a second-tier supplier that mediates the inclusion of the SME into the GVC. The literature on GVCs has covered in detail how all tiers of suppliers are under constant pressure to lower their unit prices for the lead buyer in order to remain competitive (see, amongst many others: Kaplinsky, 1998; Gereffi and Korzeniewicz, 2004; Barrientos et al, 2011; Milberg and Winkler, 2011; Rossi, 2013), which in turn creates incentives for suppliers to subcontract smaller and cheaper firms. These subcontracting arrangements are common entry routes for SMEs into GVCs, and they are not determined by the lead buyer's interest to hire SMEs from developing countries per se but by the top suppliers' needs to continue lowering prices and staying competitive. During our interviews with researchers and policy makers, the consensus was that the reason it is so difficult to find evidence of large firms in GVCs 'deliberately' designing procurement policies to include SMEs in their value chains is because this inclusion is rarely led by the interest of the lead firm.

This issue of 'distance' between the lead buyer and the SME bears much importance when considering the opportunities and obstacles SMEs face for economic upgrading in value chains. Often the GVC/GPN/GCC literature refers to upgrading opportunities with regards to a generic category of 'suppliers' from developing countries, and the effects from participating in value chains are described as applicable to all suppliers, regardless of their size, or even their 'distance' from the lead buyer in the value chain.

Arguably, the further down in the value chain a firm is located, the more distorted or indirect the influence from the lead buyer tends to be (Barrientos, 2013). This is not to say that downward pressures on prices diminish down to the 3rd or 4th tier of suppliers, but that these pressures are also mediated by intermediaries and first tier suppliers who tend to be larger firms themselves. Indeed, one aspect that is still understudied in the literature is the issue of how power is exerted by the first tier of suppliers in a developing country over their subcontractors and suppliers, which are usually smaller and fit the definition of SME that is being used throughout this study.

Similar to the two tiers created when formal employees and seasonal/informal employees are treated differently with regards to benefits, salaries and job security in order for the firm to be more nimble and respond to the downward price pressures from their buyer (as described by Barrientos and Smith, 2007), the 'tiers' of suppliers in GVCs may indicate a process of increasing deterioration of economic and social conditions of production as additional layers of smaller and cost-driven firms (usually SMEs) are added at the lower rungs of the GVC.

Evidence from tourism and horticulture SMEs operating in GVCs suggest that one way to counter downward pressures on prices and capture higher profits by SMEs located further down in the value chain consists of joining sector associations or producer organisations (World Bank, 2015). This can reduce transaction costs, provide some market power, and increase representation in national and international policy forums (World Bank, ibid). This can also help the SMEs to diversify its customer or product base, thus reducing dependence on one product. Additionally, SMEs participating in these associations can increase their competitiveness, which can provide them with bargaining power in the value chain (ITC, 2015). One example of this type of alliance is the Confederaçao dos Trabalhadores na Agricultura (CONTAG) in Brazil, which reunites trade unions and small farmers' organisations (ILO 2008, WTO 2014). Recently, Wignaraja (2015) corroborates traditional findings from the GVC literature whereby SMEs that form clusters are able to offset difficulties in achieving economies of scale and afford large fixed costs in the initial phases when joining a GVC (Schmitz, 2004). It is important to note, however, that these measures are not necessarily good procurement practices per se, but a reaction to the downward pressures generated by the lead buyer; nevertheless, they are mentioned in this review because of their relevance for policy making.

In the case of the garment industry value chains, first-tier suppliers are reported to have an important position of power and growing influence in the value chains (Pickles, 2012). With this power, they wield strategic importance on the recruitment and management of SMEs down the value chain. Some of these first-tier suppliers might explore ways to vertically integrate certain sub-contracted firms, such as input providers, many of them medium and small local companies (McKinsey and Company 2011, p.18), which could make the transfer of know-how and business practices learned from lead buyers easier. Vertical integration is not the solution for all SMEs, as some of them may prefer to keep their independence, and some first-tier suppliers prefer to keep the flexibility to hire and fire SMEs depending on the volume of orders they receive. Vertical integration may not even be the preferred solution from the point of view of first tier input suppliers either. In their review of the literature on vendor selection strategies in developing countries Oke et al (2009) explain how keeping a selection of vendors available and competing with each other for the buyer's attention is a way to keep suppliers from negotiating better prices with their clients. Other authors in the GVC literature have suggested that keeping a number of suppliers (instead of choosing just one) is seen as a risk-reduction strategy in case of supplier failure (Humphrey and Schmitz, 2000*).*

Similarly in the garment industry, first-tier suppliers usually have the capacity to provide more structured on-the-job training for workers and subcontracted SMEs and also to improve management skills amongst middle management. This would improve their businesses capabilities but would have a positive impact on the industry in terms of productivity and raising workers' skills and capabilities, benefiting the whole industry. Further research is needed in order to assess the extent to which first tier suppliers engage in capacity-building activities with their subcontracted SMEs and the incentives that would make these practices more widespread if they were shown to be effective.

2.2 The importance of greater market access for local suppliers and skills development

The aim of reviewing this evidence is to distinguish procurement practices that help increase market access (mostly linked to economic upgrading) from those that provide or incentivise skills development (which can be linked to both economic and social upgrading). This subsection serves the purpose of presenting this 'hybrid' practice: skills development programmes, which despite having a primary role as a complement to economic upgrading, tend to have an important role in opening up opportunities for social upgrading amongst the beneficiaries (SMEs and their employees) of such programmes.

An often-mentioned benefit for SMEs linking up to value chains led by large firms is the potential for better market access as well as learning from the experience and perceived 'superior' practices from lead buyers. The GVC literature abounds with examples of this process. In Bangladesh, new Japanese lead buyers operating in the garment industry are acknowledged as having profound impacts on local suppliers: "Exports to the Japanese market from Bangladesh have been rising very fast during the past few years. The interest of Japanese buyers in the RMG (Ready-Made Garments) products of Bangladesh has immense implications for economic and social upgrading in supplying factories. In order to ensure quality, Japanese buyers usually bring a total package, specifying not only design and materials but also the technologies to be used, to their sourcing countries. Thus, Japanese buyers have set up local offices to monitor quality at the production stage and to ensure the use of the right technology. They also invest in the skills development of workers."(Ahmed and Nathan, 2013, p. 13). The Japanese market is renowned for its exacting standards and demands high quality products, which usually can command higher prices. The fact that Bangladeshi exports to Japan are increasing shows that Bangladeshi suppliers have increased their market access and their compliance with quality standards. Unfortunately, the benefits from providing high quality products to these new markets seem to be restricted to those firms that interact directly with the lead firms and not to the second and third tier firms (where SMEs are more likely to be represented).

Participating in both national and global value chains provides major learning opportunities for local firms in developing countries to upgrade in various aspects of production as well as the higher-valued activities in the value chain (Navas-Aleman, 2011). In their analysis of the garment and electronics industries in Indonesia (Kadarusman and Nadvi, 2013, p.1025) they also found that local producers and firms operating within GVCs can gain better market access opportunities and skills by servicing both export markets and their own domestic markets. Smaller firms such as SMEs are thus well advised to engage in both domestic and international networks for improving both market access and skill-development potential instead of being driven to solely seek exporting within GVCs as the 'golden standard' (Navas-Aleman, 2011).

Lead firm-sponsored programmes aimed at developing skills, or on-the-job training may result in positive outcomes for the strengthening of local firms (SMEs) and improvement of working conditions (Ingram and Oosterkamp, 2014). This association has been based on two positive consequences from training: the perceived commitment from the lead buyer to the supplier and the increased opportunities that training opens up for workers, such as the option of switching jobs (linked to increased bargaining power to negotiate better working conditions).

2.3 Opportunities and obstacles for social upgrading in GVCs

Much research has been done on the analysis of firms operating in global supply chains, moving into higher added value activities, and reaching different types of economic upgrading, (Gereffi and Kaplinsky, 2001; Kaplinsky, 2000; Gereffi, Humphrey and Sturgeon, 2005), but less emphasis has been put on the link between economic upgrading of local firms operating in global production networks and its effects on working conditions that could translate into social upgrading, characterized by "better wages, work conditions, economic rights, gender equality and economic security standard of living" (Milberg and Winkler, 2011, p. 341).

This topic of economic upgrading and its potential for promoting social upgrading was recognized as a critical one in recent years. An international programme of policy research entitled Capturing the gains: Economic and social upgrading in global production networks, was carried out under the auspices of ILO, in which a network of researchers from a diversity of disciplines and from different parts of the world studied the connection between trade, production and employment in the context of GPNs[5]. This section draws heavily on their results as well as other studies seeking to understand this connection.

Social upgrading remains a contested concept, but it generally consists of the improvement of labour conditions, more gender equality, increased wages and job opportunities for workers that are operating in a given firm (Bernhardt and Milberg, 2011; Milberg and Winkler, 2011; Rossi, 2013). It is relevant for those interested in the developmental aspects of GVCs, as it has been an expectation amongst researchers and policy makers that joining value chains will bring economic upgrading (as a first

5 For more information see www.capturingthegains.org

step) and social upgrading (as a second step) to suppliers from developing countries. The section above explained the nuanced perspectives on the attainment of economic upgrading by firms from developing countries and this section will show that the relationship between expectations and reality with regards to social upgrading is equally (or more) complex and contested.

Bernhardt and Milberg (ibid) observed that social upgrading occurred in most cases when economic upgrading took place in the following sectors: horticulture, apparel and mobile telephone value chains. They did not find evidence of social upgrading in the fourth sector they studied—tourism. However, social 'downgrading' was observed, even in the presence of economic upgrading. Whether SMEs experienced more or less social upgrading than first tier suppliers (in the presence of economic upgrading) was not clearly stated. The main conclusion so far from the research about the links between economic and social upgrading is that it is not 'automatic'.

Although there has not been a consensus on whether product/process upgrading or functional upgrading are the best ways to increase incomes, there has been more consensus (particularly since the results from the 'Capturing the Gains' research programme has published their results) that it is actually the less controversial types of upgrading (product and process) that are more likely to bring about changes in the social aspects of a firm, particularly on the labour conditions of its workers (Rossi, 2013; Lund-Thomen and Lindgreen, 2014). Skills development efforts by lead firms attempting to train more competent suppliers (avoiding the risk of supplier failure) has been suggested to be a good practice that helps suppliers attain higher levels of social upgrading. As mentioned above, there is less evidence on the training efforts by first-tier input suppliers with regards to their subcontracted SMEs in developing countries.

Another consensus in the literature has emerged around the idea that GVCs/GPNs have indeed contributed to the creation of jobs (Barrientos et al, 2011; Bernhardt, 2013), as well as increases in income (Shingal, 2015). However, these gains have not been homogeneously experienced by all workers. Different types of jobs have been created—those classified as highly skilled or specialized with good pay, and those which require minimal or low skills and are associated with poor working conditions and low wages. (Barrientos et al. 2011, Rossi 2013).

In Asia, from the year 2000 onwards, especially in labour-intensive manufacturing sectors such as the garment industry, it is possible to see a trend of massive employment generation (World Bank, 2012), as shown by Bernhardt (2013) in his analysis of the performance of 15 countries from Africa, Asia and Central America and the Caribbean with operations in the global apparel industry: "Vietnam, China, Jordan and Bangladesh were the biggest winners in terms of apparel employment creation (+227 per cent, +108 per cent, +107 per cent and +94 per cent between 2000 and 2009, respectively)" (Bernhardt, 2013, p. 7).

Another example of positive consequences from the point of view of increased and rapid access to new markets via GVCs is that it has provided more job options for workers (particularly women) in labour-intensive sectors such as garments in countries like Bangladesh. These options, provided by the influx of different lead companies, allowed for increased mobility as labour supply became relatively scarce. Labour shortages usually tend to incentivise workers to compare pay and conditions with each other and move in search of a better deal. A similar phenomenon took place in China as the number of migrant workers coming from the central parts of the country to coastal cities decreased over the last decade.

Most research on GVCs is based on case studies, which makes it almost impossible to reach more disaggregated information on internal firm performance through international trade data (Shepherd, 2013). This is confirmed by Bernhardt: "Simply improving export competitiveness and upgrading says little about how the gains are distributed and thus how social welfare is affected. Yet, as Barrientos et al. (2011a) emphasize, social upgrading depends strongly on the distribution of gains from industrial upgrading in global production networks" (Bernhardt, 2013, p. 27).

Measuring impact on labour standards is one of the main difficulties researchers experience when studying firms' development prospects while operating in GPNs and its impact on labour standards. The most common indicators researchers look at are employment generation and increases of real wages:

> *Milberg and Winkler… drawing upon national level data from a sample of 30 developing countries to assess "strong", "weak" and "relative" upgrading, find that only nine of the countries had achieved even weak economic upgrading, and most of these countries were located in rapidly growing East Asia. Milberg and Winkler find that social upgrading – measured very simply by employment growth – is quite limited. However, they acknowledge that their approach is insufficient to capture the full relationship between economic and social upgrading, especially if the latter is conceptualized in terms of a broader "decent work agenda" that goes beyond employment and wages alone.*
>
> (Barrientos, Mayer, Pickles and Posthuma, 2011, p. 304).

The definition of decent work includes many variables which are difficult to assess with the data that is usually gathered for trade purposes: employment opportunities; adequate earnings and productive work; decent working time; combining work, family and personal life; work that should be abolished; stability and security of work; equal opportunity and treatment in employment; safe work environment; social security; and social dialogue, employers' and workers' representation (ILO 2012, p. 15).

A potential good practice that lead firms could champion as well as encourage down the GVC is to increase prices per product and wages for employees. However, the usual concern amongst private sector and host government actors alike is that by raising wages, suppliers in developing countries will become less attractive to lead firms in GVCs. Nevertheless, analysis of different authors found that progressive increases in wages of workers within GPNs resulted in a positive impact on firm productivity without losses in competitiveness. (Ahmed and Nathan, 2013).

Throughout the 2000s, increases in wages of low skilled workers in the garment industry in countries such as China, India, Nicaragua and Jordan seem to have brought some improvement in working conditions (Bernhardt 2013). Complementary to this idea, a positive relationship is observed between compliance with labour standards and wage payments:

> *ILO Better Factories Cambodia (BFC) programme, Warren and Robertson (2010) find that compliance with wage payments has increased alongside compliance with labour standards, suggesting a robust positive relationship between wages and working conditions and casting doubt on the predictions of the compensating differential theory*[6]*.*
>
> (Barrientos et al. 2011)

GVCs in developing countries have been massive generators of female employment, particularly in the garment industry. Gender equality is a very important aspect of social upgrading. In developing countries, female work in GPNs has brought an enormous transformation in terms of the composition of labour. In Bangladesh, the number of workers in the garment industry grew from 0.1 to 4 million between 1985 and 2014 (BGMEA, 2015). In Bangladesh, women comprise 70 per cent of the labour force (Barrientos et al, 2011, Ahmed and Nathan, 2013) and are primarily youth coming from rural areas. They may be earning low wages, but the alternative is to stay at home carrying out unpaid work. An important consequence of women integration in the labour force, as exemplified in the Bangladeshi garment industry, is that women have increasingly obtained better negotiating capacity and bargaining power, both in work and domestic spheres. (Ahmed and Nathan, 2013). Similarly, but in another region, women constitute 64 per cent of the labour force in the Moroccan garment industry (Rossi, 2013). In Vietnam and Cambodia, about 80 per cent of workers are women. Data also show that a sizable number of women are supervisors in the apparel industry worldwide (World Bank, 2015).

In spite of these gains for women, low wages and poor working conditions are features that have accompanied these processes. Unfortunately, in all parts of the world, women are largely paid low wages. Female workers often tend to be young and have low levels of education (ILO, 2013, p. 30), but it is widely reported that deeper gendered socio-cultural practices contribute to discrimination and unequal payments for women across the manufacturing industries (Barrientos, 2007; Giuliani, 2016). Some authors have referred to a recent trend of decreased female employment in manufacturing as firms move into higher value-added production and require more medium skilled workers for certain functions in East Asian countries such as Indonesia and Malaysia, but a continuous increase in female employment in Latin America, especially in larger countries such as Brazil, Mexico and Argentina (Tejani and Milberg, 2010).

6 Wage differential is the amount of extra money/compensation that a worker needs to be offered in order to undertake an undesirable job. It works in the opposite direction as well: A worker may accept less compensation if the task is particularly desirable.

The connection with economic upgrading is often made to explain this variation in patterns. Therefore, in order for economic upgrading to benefit women's pay and working conditions (social upgrading), skills building and training are key (Barrientos, Mayer, Pickles and Posthuma, 2011, p. 304).

On a more sectoral level, looking specifically at the garment industry, it is widely accepted that the continuous growth of the industry over the last 20 years has brought positive outcomes related to the acceptance of labour standards, progressive increases in wages, and improvements in working conditions, but not enough to fulfil the complete notion of "decent work" by ILO. For instance: "…in Bangladesh [the minimum wage] is not yet a living, family wage, but there can be no doubt that these are 'Better Work' conditions. Even after the increases, the Bangladesh minimum wage is less than half that in competing countries – $39 per month against $80 in Cambodia, $71 in India, $79 in Pakistan and $78 in Vietnam" (ILO 2013, quoted in Ahmed and Nathan, 2013, p. 14). It has been reported that in the Moroccan garment industry, local suppliers operating in GPNs admit that low margins do not allow them to carry out the required investments to grow steadily in the long-term, which in turn prevents them from improving working conditions that can be translated into social upgrading (Rossi, 2013).

Within the garment industry, some first-tier suppliers are thought to have the capacity to pursue a more proactive approach with regards to monitoring and compliance. Instead of reacting to lead buyer and NGO demands, they could consider implementing their own monitoring and compliance programmes aimed at measuring workers' satisfaction and better production systems, and find ways to share better practice with lead buyers and NGOs (McKinsey and Company 2011, p. 18). From our conversations with policy makers and researchers, the question of how compliance and monitoring requirements (and codes of conduct) become 'diluted' as they are adapted to the cost-cutting needs of first-input suppliers was a concern. This confirms the importance of the notion of 'distance' between the SME and the lead buyer in the GVC with regards to both the influence the GVC actually exerts on the SME and the accountability of the lead firm for the behaviour they encourage amongst their SME suppliers via downward pressure to lower prices.

In the flower and cuttings sector, Everts et al. (2013) found that economic upgrading correlated positively with social upgrading, as workers of these farms appeared to be better trained and receive more substantial benefits as the firms grew. Higher earning potential for workers in cuttings vis-à-vis workers in the flowers GVCs was linked to longer-term employment relationships. Lead buyers reportedly invested in skills-building in the cutting GVCs, which in turn supported both economic and social upgrading for these workers.

Social upgrading does not necessarily follow economic upgrading, as can be seen in the tourism industry as mentioned above. In a study supporting similar findings reported by Bernhard and Milberg (2011), Christian and Nadev (2013) found that in six countries—China, India, Indonesia, Kenya, Uganda and South Africa—economic upgrading took place for both Asian-based and African-based suppliers (although Asian suppliers' improvements were far greater than those of their African counterparts). However, with respect to social upgrading, a common finding for all cases analyzed was that there was an overwhelming prevalence of employees working on a 'casual' basis; very few had permanent contracts with good salaries and benefits. "We found that tourism providers, regardless of their upgraded status, varied in their rates of casualization, but are almost all employed as casual workers." (Christian and Nadev, 2013).

The promotion of workers' organisations with the purpose to unite hotel workers and individual or own-account service providers might constitute a mechanism to obtain more stability and better salaries, and thus social upgrading. "The hospitality union in Africa played a crucial role in ensuring permanent hotel workers' benefits." (Christian and Nadev, 2013). Again, this shows that many social upgrading gains do not come as a consequence of economic upgrading or the explicit action of a lead firm (or the government), but as a result of collective action by workers.

From the analysis of GVCs in the tourism industry, it appears that in spite of the prevalence of unstable and seasonal jobs, working in the tourism GVC is better than other traditional alternatives such as agriculture: "case studies in China and India showed that tourism can have a substantial poverty-reducing impact. Tourism is often the only non-agricultural economic activity that is possible in upland economies and in rural locations in Africa." (Christian and Nadev, 2013). Non-agricultural jobs have been increasingly associated with higher incomes and possibilities for longer-term upgrading for workers (Hertz et al, 2009). This association has proven controversial in the field of development studies, but as more studies appear to provide evidence in this regard (e.g. ACDI/VOCA 2015), it becomes less surprising that even informal jobs in the tourism sector provide better economic and social upgrading alternatives for workers than staying in agriculture.

From the review of the literature and the examples mentioned above, it would seem that Anner et al (2013) have successfully summarised what should be the principles or guidelines to support suppliers in GVCs (including SMEs) to upgrade in value chains:

> *The trinity of 'stable orders, fair prices and safe factories' (Anner et al. 2013, p. 1) sums up the manner in which vertical and horizontal relations interact in the GPN. Without the first two, the third becomes difficult, if not impossible. Without overlooking the culpability of local employers and governments, who cut corners supposedly to remain competitive, poor prices and unstable orders certainly contribute to the poor safety situation. Improving safety requires investment, and that is constrained by low prices and unstable orders.*
>
> Ahmed and Nathan, 2013, p. 20

The previous quote comes from analysing the garment industry, but it has a much wider relevance to other industries and firms based in developing countries and operating in GVCs, and although these general principles do not specify whether those suppliers are SMEs or not, it can be inferred that these normative guidelines would go a long way towards supporting the participation of SMEs in value chains. It should be noted that our interpretation of this quote does not imply that 'stable orders and fair prices' will lead to 'safe factories'. From the analysis of the literature, these three conditions are separate and must be achieved on their own because of their own individual merit in bringing about better labour conditions for workers. These three conditions, however, reinforce each other in order to create a virtual cycle which could be much more difficult to maintain otherwise.

2.4 Expectations and results from the business literature on 'good' (pro-SME) procurement practices

Given that economic and social upgrading are not necessarily linked, and that the literature on value chains has produced some general principles with regards to what constitutes good practice by lead firms in their engagement with suppliers from developing countries (summarized in the 'trinity of stable orders, fair prices and safe factories' suggested by Anner et al, 2013), this section will now aim to explore whether lead firms can actively promote social upgrading for their suppliers, and whether they actually want to do it.

Beyond those general principles, the GVC, GPN and GCC literature offer few systematic descriptions of the actual procurement practices from lead buyers that can be considered favourable to SMEs in developing countries. More often than not, these bodies of literature focus on pernicious practices by lead firms that damage the upgrading prospects (both economic and social) of SMEs and their workers. The temptation would be to select each one of the practices described as pernicious or unhelpful and simply 'revert' them to suggest what would constitute 'good' practices from the point of view of SMEs. However, even by following such a simplistic approach, the fact remains that those 'good' practices would have not been monitored and evaluated to assess their impact on their intended beneficiaries (SMEs from developing countries).

Thus, this section turns to the business literature and, in particular, peer-reviewed journal articles on supply-chain management, operations management and subcontracting given our concern with the core operations of lead firms in value chains. For this reason the extensive literature on CSR (corporate social responsibility) was not included unless there was a clear link to supply chains, subcontracting and SMEs from developing countries. The expectation was to find clear depictions of procurement processes that are considered beneficial both for lead firms in terms of ensuring the availability of inputs for their core operations, and for their supplying SMEs based in developing countries.

We found that most publications concerned with procurement and subcontracting were geared towards improving the efficiency of the supply chain from the point of view of the lead firm, not the supplier. Several searches with different combinations of keywords were attempted, including 'procurement', 'supply chains' and 'SME' as well as 'developing countries', etc. One article called 'Criteria for sourcing from developing countries' was particularly interesting, as it was published in 'Strategic Outsourcing' (an international journal) (Oke and Maltz, 2009). This article was emblematic of the type of issues covered by the business literature dealing with supply chain management, procurement and outsourcing in value chains. Based on a literature review of the main articles in the field of 'vendor selection', it explained how to optimize the choice of suppliers and locations in the developing world from the point of view of increasing efficiency in delivery and quality of inputs, as well as reducing manufacturing costs of the lead firms' products.

The main reason for looking for suppliers in developing countries, according to 30% of the studies reviewed by Oke and Maltz (ibid), was lowering costs; the second was a convenient geographical location. Capacity and competence followed, with the recognition that first tier suppliers were expected to take over the tasks of controlling quality, cost and delivery times to a larger extent when compared with previous decades. The more complex the product, the less important cost is reported as a reason to select a supplier in the developing world. The size of the firm, however, did not figure as part of the criteria for selecting a supplier, nor did it become part of an engagement strategy with the developing country to foster local development or increase the sustainability of the lead firm's operations in the host country.

The tragedy of Rana Plaza in Bangladesh marked a turning point for those promoting social responsibility and sustainability in traditional supply chain management research and practices. Anisul Huq et al (2014) published their research on why developing country suppliers would engage (or not) in socially sustainable procurement practices in four garment factories in Bangladesh. These authors confirm our findings with regards to social sustainability being severely understudied in the supply chain management literature, and when it is covered, it tends to be from the point of view of the lead firm, not the supplier's (ibid: 612), and typically in a developed country context.

The four garment factories studied by Anisul Huq et al (2014) in Bangladesh are not SMEs according to the definition used in this paper; rather the smallest firm in their study has 700 employees. All participating firms are 1st tier suppliers that must adhere to the lead buyers' codes of conduct or have a third-party certification, probably from WRAP (Worldwide Responsible Accredited Production) or SEDEX (Supplier Ethical Data Exchange). Some of the positive experiences they encountered with the implementation of socially responsible practices as a result of lead firms' requests include: a) the buyers' code of conduct is displayed prominently around the factory, so workers know their rights and can contact the buyer directly in case of any violations; b) suppliers must instruct their employees about their rights and provide them with a handbook (auditors check whether the employees understand their rights through interviews); c) these measures are reported to have improved the working conditions for the most vulnerable groups (usually low skilled workers and low paid women) and eliminated child labour. The four firms reported increases in productivity and linked them to the socially inclusive measures imposed by the lead firms; they also improved their standing vis-à-vis their buyers and increased the number of orders received (ibid:624).

Another sub-group within the business literature that was reviewed in order to identify insights into what constitutes good procurement practices by lead firms that benefit SMEs was the literature on business ethics. This body of literature is, by definition, normative as it proposes alternative views on how practices in value chains should be. It is generally critical of the role of value chains, even when the lead firms in those chains are aiming to comply with codes of conduct dealing with labour issues. Some of the points raised by this literature highlight the mismatch between the compliance demands put on suppliers with regards to those codes of conduct (e.g. 'pay higher wages') with procurement demands to lower prices and increase delivery speed. It is often reported that different departments from the same lead firm may visit the supplier on separate dates with these contradicting demands (Lund-Thomsen and Lindgreen, 2013).

Tension between these conflicting demands has given rise to auditing fraud, which is widely recognised as a problem in certain locations (notably, but by no means limited to, China, see Oxfam 2013) and industries, like those covered in this report. This body of literature also looked at compliance with labour standards from a human-rights point of view (see Giuliani, 2016) and come to a similar conclusion: demands from the procurement side of the supply chain run against expectations of compliance from the point of view of labour standards and social upgrading in general. Although none of the articles reviewed explained how this would affect SMEs differently from other firms, one may infer that when put under pressure, SMEs are even less likely to prioritise labour standards over the financial pressure exerted by their clients.

Lund-Thomsen and Lindgreen (ibid) say a new, more cooperative paradigm for working with CSR in GVCs was emerging before the financial crisis of 2008, but that now such an approach seems to be less popular amongst lead firms, and when they do practice it, they tend to be with only a few 'preferred suppliers', while the rest persist with the regular standards that are less favourable to upgrading. This new approach entails lead buyers offering higher prices to their preferred suppliers so that they can afford to invest in the improvements needed to socially upgrade the situation of their own workers and own subcontractors. These investments are to be shared by the lead buyer and the suppliers in order to acknowledge that it is a collective responsibility and not only the supplier's. The approach also calls for better production planning to reduce last-minute bouts of frantic overwork to fulfil orders and improve coordination between the CSR departments of a lead firm and its procurement department in order to avoid sending conflicting messages to the suppliers. Workers are to be involved in the decision-making processes linked with the application of codes of conduct, fault-finding in the production area and general efforts to increase productivity and improve labour conditions. Likewise, this approach is presented as feasible only if both the procurement staff and the CSR staff within the lead firm have trusting and frequent interactions (Locke and Romis, 2007) with each other. Another aspect of this cooperative approach consists of ensuring that auditors use participatory methods instead of a punitive approach when carrying out inspections and providing corrective advice. To this end, and to discourage auditing fraud, it is recommended that auditors speak the local language (Auret and Barrientos, 2004) and be flexible and proactive in interviewing workers off the factory floor and outside of working hours in order to obtain less 'scripted' answers (Harney, 2008).

From the business ethics angle, an interesting research agenda emerges whereby the study of practical trade-offs faced by lead firms in supply chains is considered. Lund-Thomsen and Lindgreen (ibid) propose that 'researchers would need to ask when and why 'classical' purchasing practices seem compatible or conflict with social and environmental sustainability criteria. Research attention might also help resolve the sustainability dilemma, including better understanding the strategies that purchasing managers already employ when they face multiple and conflicting requirements' (ibid:20).

The present study is aimed at complementing a series of case studies that would be analysing exactly those instances. However, as long as different representatives/officers from different departments within the lead firm have separate responsibilities, it is our hypothesis that the "conflicted procurement manager" remains a purely theoretical construct – they have no conflict based on reconciling different aims, because the responsibilities remain separated.

From our review of mostly peer-reviewed sources, that seems to be the most likely outcome. However, when one reviews corporate reports as the main source of evidence on good practices, results may look more positive as shown below.

A promising compromise emerges from articles dealing with the notion of 'sustainable supply chain management' or SSCM (about 120 mentions in our search). Closer scrutiny shows that most articles concern environmental and commercial sustainability, but one article in particular dealt with SSCM in the fast-fashion industry. One article by Turker and Altuntas (2014) reviews the corporate reports of 9 global buyers (Calida, Mango, C&A, H&M, Inditex, Marimekko, Oberalp, and Puma and Switcher) in search for patterns in the way these firms deal with the competing demands of lowering costs and ensuring their suppliers comply with the lead firms' codes of conduct.

Largely positive about the efforts made by these lead firms, the authors recognize that their study suffers from sample bias given that the research material is provided by corporate accounts authored by the firms themselves. However, the authors note that the practices (including procurement practices) mentioned in those reports seem to be highly effective in fulfilling the original objectives of the lead companies. The difficulty comes when considering the issue of scale. Lead firms admit that this level of engagement can only be maintained with a small number of trusted suppliers in developing countries, usually their first tier of suppliers or even a sub-segment of those first tier suppliers. This leaves SMEs from developing countries excluded from direct capacity-building efforts embedded in the (procurement) practices of these lead buyers.

2.5 Proposed typology of lead firms based on their procurement approach to SMEs

After reviewing the literature on GVCs and the business literature on procurement and looking for evidence of good (pro-SME) procurement practices, some patterns emerged with regards to how the organisation of the value chain (both governance as well as 'distance' between lead firms and SMEs) and their brand focus (customer-orientated, higher-value added product, purpose-driven or not) might be linked to the level of effort lead firms are prepared to undertake when supporting SMEs in developing countries via procurement practices.

Figure 1 proposes a typology of firms based on the analysis of drivers and motivations for lead firms in GVCs to offer different levels of support to SMEs via procurement practices. This typology is useful because by combining elements from the GVC and procurement literature it may help design policy interventions geared towards leveraging the right incentives and structures that are likely to matter to different lead firms dealing with SMEs in their value chains. Ideally, this typology would also provide an aspirational trajectory for lead firms by portraying examples of globally competitive firms at the top of the 'staircase'.

Figure 1 Lead firms' drivers to support SMEs via procurement

0 No support for SMEs via procurement

1. Firms are not in the business of helping SMEs
2. Purely market based relationships

1 Minimal support for SME suppliers

1. Lead firm likely to have relatively low customer brand value
2. Legal protection against lawsuits ensures minimal 'reasonable' compliance
3. Securing a reliable supply chain requires some investment in SME relationships
4. Likely to have programmes for supply chain auditing and risk assessment
5. Value chain governance based on modular approach

2 Medium support for SME suppliers

1. Lead firm likely to value its brand
2. Potential loss of brand value through scandals forces firms to commit to more than the bare 'reasonable' minimum
3. Likely to have programmes for supply chain improvement, CSR and compliance (e.g. SEDEX)
4. May map value chain risks (e.g. child labour) against priority issues (e.g. global competitiveness)
5. May participate in NGO or collective supply chain programmes (e.g. Better Work)
6. 'Network based' relationships with some suppliers

3 Strong support for SME via procurement

1. Firms are 'purpose-driven' and have it within their strategic planning to support social development and SMEs
2. Firm derives a positive association from its value/supply chain (e.g. fair trade)
3. Marketing and product positioning requires demonstrable support for SME suppliers
4. Likely to have strong, dedicated programmes for SME supply chain improvement and CSR driven by value chain mapping
5. Network / captive relationships with suppliers

Source: Authors' analysis; References to Value Chain governance adapted from Schmitz & Humphrey 2002 and Gereffi et al, 2005.

Based on our review of the available literature, we contend that a large number of lead firms are still found in **stage zero** whereby no interest is shown to support SMEs or adapt procurement practices to make them more supportive of SMEs. These firms are unlikely to have adopted or created codes of conduct to govern their supply chain.

Stage 1 belongs to lead firms that are large and heavily invested in their operations in developing countries so are likely targets for lawsuits in case wrongdoing is proven at any stage of the value chain, which could disrupt/risk operations. Without a strong brand, the damage to its image is not the main concern, but rather the legal and financial repercussions of any disruption in the supply chain.

Customer-facing (and branded) lead firms can be found in **stage 2**, whereby fear of any scandal makes firms more likely to develop sophisticated codes of conduct for their supply chain, invest in monitoring (particularly of first tier suppliers) by own and/or third-party organisations and generally commit to much more than the bare 'reasonable' minimum with regards to compliance.

Finally, **stage 3** is reserved for a small number of firms that do not need pressure from governments, NGOs or the press to engage in SME-development programmes within their core operations. These are part of the so-called 'purpose-driven' firms or social enterprises. These lead firms actually have within their strategic planning to support social development and SMEs in developing countries. At the very top end of this category, firms would have developed a detailed set of guidelines with regards to applying their social principles to their procurement decision-making in a way that acknowledges the dilemma faced by the 'conflicted procurement manager' described by Lund-Thomsen and Lindgreen (2013).

This typology could also be used to devise specific mechanisms to identify firms that can engage in different levels of support to SMEs and flesh out the reach and limitations of that support at each stage. One step further would be to use this typology to try and understand what would help bring these lead firms to commit to move to the next step in the staircase, using a bottom-up approach. A different approach (top-down) would involve showcasing a number of highly SME-committed firms at the top (stage 3), ideally with a stellar global reputation, to become role models for other firms below the staircase.

3 Examples of pro-SME procurement practices in GVCs identified across sectors

The review of the different bodies of literature highlights the abundance and variety of definitions given to the notion of procurement and associated practices. Some authors use the term ‘sourcing’ and ‘outsourcing’; others, ‘purchasing’ and ‘subcontracting’ or simply ‘buying’, etc. Some of these terms are included within the general concept of procurement found in business study sources, and others are more commonly used in the domain of international development documents, particularly those using the GVC framework.

The literature on value chains has produced some general principles with regards to what constitutes good practice by lead firms in their engagement with suppliers from developing countries. These general principles have been summarized as ‘stable orders, fair prices and safe factories’ (Anner et al, 2013:1). Although these general principles do not specify whether those suppliers are SMEs or not, it can be inferred that these normative guidelines would go a long way towards supporting the participation of SMEs in value chains.

In this analytical section we will use the ‘trinity’ of principles by Anner et al (2013) plus an extra category—skills development & training—in order to assess the presence of good pro-SME procurement practices in GVCs. From the literature review, these four categories seem to be the most representative of good procurement practices, although they are implemented in different ways depending on the lead buyer, the industry and the host country where the SMEs are located.

IIn order to make this document more focused, it was agreed with ILO stakeholders that the literature review should focus on four relevant sectors for the work of ILO: garments, electronics, tourism and floriculture value chains. These are sectors with varying levels of SME presence and different value chain organisation structures. Some of these sectors have little ‘distance’ between the lead firm and the SME (e.g. floriculture), whereas others have several layers or tiers of suppliers between the lead firm and any given SME (garments, electronics).

A number of pro-SME procurement practices were identified across the 4 different sectors. These are summarized in table 1.

Some insights that can be gleaned from the consulted evidence on these four sectors show that the most common pro-SME practice is the establishment of long-term relationships between lead firms and their suppliers which is linked to stable orders. These relationships are usually established with first-tier suppliers, and since most first-tier suppliers tend to be larger firms (more than 250 employees, which is the cut-off limit for our definition of SME), it is rare for SMEs to benefit directly from this practice. Only in sectors like floriculture, where first-input suppliers are smaller firms, can SMEs experience first-hand the benefits of long-term relationships with lead buyers and stable orders.

Nevertheless, in sectors such as garments and electronics, where there is a longer history of lead firms establishing monitoring systems either individually or collectively, it can be observed that the influence of the lead firms' codes of conducts carries down further to the second and even third-tier suppliers. This is not something that happens without an explicit and deliberate commitment from lead firms that are prepared to let go of first-tier input suppliers that do not adhere to their principles. Unfortunately, this type of commitment is still not widespread and can be found only amongst a reduced number of firms at stage 3 of the typology presented in Figure 1.

Both in garments and electronics (and according to our consultation/validation interviewees, the food industry) lead firms in stages 2 and 3 of our typology have been known to join forces and hire the services of third-party agencies, such as SEDEX, which monitor compliance with standards by the 'shared' suppliers of these lead firms in developing countries. This is a way of externalizing the responsibility for monitoring but also to deepen its scope and include second and third-tier suppliers that are more likely to be SMEs.

With regards to fair prices, the main insight from this review is that suppliers (and SMEs in particular) are more likely to be supported in their investments for economic and social upgrading by lead firms that are concerned/involved with high-value added products that require high levels of quality specification. These lead firms are less concerned with a constant downward pressure on prices and more interested in reducing risks of supplier failure and increasing the competences of the supplier, offering more fair prices than those competing on price in the market. Lead firms with brand identities linked to 'unique', 'niche', 'artisanal' or 'personalised/tailored' products and services are also more likely to nurture their relationships with smaller companies to ensure that level of extreme customization and uniqueness on which its brand value is based.

Table 1: Summary of good procurement practices identified – Explanation of its application in each GVC

Category	Floriculture, cut flowers and cuttings (Uganda & Tanzania)	Tourism (Global)	Garments (Bangladesh and Cambodia)	Electronics (Asia)
Stable orders	• Joint ventures between lead firms and SME suppliers ensure stability in the cuttings VC • European retailers and supermarkets establish long-term relationships with suppliers • Short distance between lead firm and SMEs promotes long-term relationships	• Lead buyers (TOs) foster trusting, long-term relationships with small tourism service providers, particularly for community-based tourism, tailor-made tours and specialists tourism (i.e. areas perceived as risky)	• Bangladesh: Most lead firms reported having 'long-term' relationships' with their suppliers (unclear whether SMEs are included) • Global: When the garment's brand identity depends on the product being 'niche', 'tailored', or 'artisanal' the incentive to develop stable, long-term relationships with SMEs is greater	• Most lead firms reported to have 'long-term relationships with their suppliers (unclear whether SMEs are included).
Fair Prices	• Auction system in Europe • European buyers more interested in quality than in pushing down prices from their SME suppliers (although this trend is reported to be changing)	• No evidence	• Bangladesh: Japanese buyers are more concerned with quality and are willing to pay higher prices to local suppliers (including SMEs) to obtain the level of quality they require.	• European and Japanese lead firms are more concerned with quality and are willing to pay higher prices to local suppliers (including SMEs) to obtain the level of quality they require

Category	Floriculture, cut flowers and cuttings (Uganda & Tanzania)	Tourism (Global)	Garments (Bangladesh and Cambodia)	Electronics (Asia)
Standards and monitoring ('safe factories')	• Strong use of standards by lead firms (in response to European consumer markets) such as the Private Social Standards (PSS) which focuses on securing rights at the workplace. • Stricter standards for the cuttings VC, but lead firms provide finance and training to their SME suppliers to meet them.	• Standards exist (such as the Global Sustainable Tourism Council), but monitoring is weak	• Global: One of the industries where lead buyers are most committed to monitoring labour conditions amongst suppliers • Bangladesh: Japanese buyers set up local offices to monitor quality at the production stage and to ensure the use of the right technology. • Bangladesh: Starting to deepen supply chain audits to include tier 2 supplier audits (more likely to reach SMEs) • Cambodia: Lead buyers collectively auditing a pool of shared suppliers via a programme such as 'Better Factories Cambodia'	• Proliferation of standards, however few, concerning social sustainability or SME support • Electronic Industry Code of Conduct (EICC) is monitored down to tier 2 firms • Hewlett Packard (HP): Audits down to tier 2 firms in their value chain (likely to be SMEs)
Skills & Training	• Requirements for minimum education attainment for workers • Training opportunities for graduates of MOMU, a specialised university in floriculture • Cuttings: Lead buyers directly involved in the whole production process; provide investment in equipment, finance and technical assistance, including management skills	• Large hotel chains and other TOs that make it part of their brand to provide 'authentic' experiences tend to invest in training small local providers on how to present their products/services in more appealing ways	• Bangladesh: In order to ensure quality, Japanese buyers train their suppliers (including SMEs), specifying not only design and materials but also the technologies to be used and their sourcing countries • Bangladesh: Japanese buyers invest in skills training for local SME workers	• HP reportedly trains and monitors first-tier suppliers to govern and audit their (second-tier) suppliers • Nokia, HP and Dell are reported to have initiated pilot programmes with suppliers located in China (unclear whether they include SMEs), focusing on training and labour rights, freedom of association and supporting workers' representation (De Haan, 2012)

Source: Authors' analysis; References to Value Chain governance adapted from Schmitz & Humphrey 2002 and Gereffi et al, 2005.

4 Conclusions and Policy recommendations

4.1 Conclusions

The main research question about which procurement practices by lead firms in value chains are beneficial for SMEs can only be partially answered. The consensus appears to be that the most beneficial procurement practices should centre around delivering **the 'trinity' of offering fair (higher) prices, stable orders and ensuring safety within factories or through monitoring of standards. In addition, the provision of sectoral training and skills development appears to be of particular importance**. However, firms do not disclose the precise detailed guidelines on how to carry these out, as they are concerned with competitive information being copied by other firms.

Another emerging consensus is that the implementation and monitoring of codes of conduct (with regards to economic and social upgrading) by large global firms creates a situation in which the first tier suppliers operate in better conditions than the second and third tier suppliers. Hence **most SMEs in the second tier and further down are excluded from the benefits of good procurement practices** that may be advantageous for first tier suppliers. There is less agreement on whether this improved situation for first tier suppliers is a result of lead firms' practices or is a case of self-selection by the most competitive suppliers that invested in upgrading (both in the area of productivity as well as their compliance with labour standards) in order to be 'eligible' to become a supplier or even to continue to work in a particular supply chain. It is also not clear what is the percentage of first tier suppliers with which a large lead firm can maintain the type of close relationships that foster upgrading and effective (cooperative) monitoring of labour conditions and compliance to a high degree. In addition, unless explicit auditing of standards takes place, **there is little evidence that the supportive practices used by lead firms for their first tier suppliers can be expected to flow down through their own SME subcontractors**[7]. Therefore it is difficult to claim that any second order positive influence is generated from the 'good' procurement practices the lead firm may have with the first tier supplier.

It is also clear that it is not from the benevolence of the lead firm in a GVC that support for SMEs can be expected, but rather from the lead firms' regard for their own self-interests[8]. **There appears to be no solid evidence that lead firms have developed procurement practices with the principal aim of supporting SME development**. When procure-

7 The exception is if this is specifically part of a supply chain auditing process that covers the full value chain. However, this remains relatively rare; even for the subset of companies using transparency approaches (e.g. SEDEX), less than a third of global companies seek transparency at scale below the first tier (SEDEX, 2013).

8 It appears that not much has changed since this quote was written in Adam Smith's The Wealth of Nations: "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages." (Chapter 2).

ment practices do support SME development, it is usually as part of a wider attempt to strengthen, improve or secure the interests of the value chain's lead firm. Alternatively, procurement practices that are explicitly SME-oriented come at the behest of local governments (supplier development programmes, minimum local procurement requirements, etc.) and are treated as a (minimum) requirement to fulfil in order to operate in the host country, and not as an integral part of the lead firm's competitive strategy.

Investments in process and product upgrading seem to have more direct effects on labour condition improvements within first-tier suppliers, and it is therefore conceivable that similar investments could have a similar effect for SMEs down the value chain. Unfortunately, there was not any evidence available to support the second half of this hypothesis (effects on second-tier SMEs further down the value chain). Further research would be needed to validate this claim.

The increase in supply chain transparency is the one aspect of supply chain management that could have strong potential benefits for small firms. Increased transparency benefits firms with reputations to protect and to a lesser degree may improve the lot of SMEs operating in the value chain. It seems to work well when groups of lead suppliers are motivated to work together (e.g. joint audits of shared suppliers). The way it may be linked to improvements for SMEs would be for those audits to include questions and verifications regarding how those first tier suppliers select and engage smaller firms as their subcontractors and to include those subcontractors (usually SMEs) in the audits.

Nevertheless, transparency is not without contention. Branded firms (usually those in stage 3 and 4 of our model) tend to claim greater transparency is taking place along the chain (by making their lists of suppliers public, for instance) but are reluctant to reveal the precise details of their procurement practices due to fear those revelations may fall in the hands of competitors or provide even more fodder for scrutiny and criticism from NGOs. It is not unusual for these firms to ask for NDA (Non-disclosure agreements) to be signed by researchers and NGOs working to support their value chains to become more transparent. Transparency with regards to traceability is firmly on the rise in the food industry, but transparency with regards to monitoring labour conditions is always considered more expensive and 'challenging'.

From a policy point of view, **there is a growing consensus that is it nearly impossible to scale up SME-friendly procurement practices by lead firms in value chains through private codes of conduct alone**. Incentives, monitoring, sanctions and cooperation by other actors such as governments (to take the role of regulators of labour relationships); international organisations (to enforce the body of norms and covenants related to labour standards); and NGOs (to raise awareness about abuses) appear to be essential for lead firms to fulfil society's expectations with regards to their 'mentoring' role for SMEs in developing countries.

Given its link to improvements in labour conditions, there is an argument to be made for lead firms to serve their self-interests and invest in procurement practices that lead to product and process upgrading. We know that lead firms tend not to invest in functional upgrading for their suppliers lest they help 'create their own competitors', but that they tend to invest in skills training for the suppliers within the areas of product and process upgrading in order to obtain better products that are more efficiently made. These two types of upgrading (product and process) align with firms' commercial interests and those of other actors, such as NGOs and governments, to continue advocating for supply chain and procurement transparency. Governments and NGOs should be supported in carrying out supplier impact assessments at lower levels of the supply chain (beyond 1st tier suppliers and into the 2nd and 3rd tiers, where SMEs are usually located), thus leveraging public opinion and consumers' interest in encouraging deep value chain accountability beyond just food security and food traceability, for which consumers are less forgiving.

The general policy recommendation for governments and agencies such as ILO would be to complement the efforts described above by firms and NGOs. Government agencies could a) continue advocating for more education and skills training for workers and b) leverage the learning opportunities of domestic and regional markets (alongside their experience with export-oriented value chains) for suppliers (including SMEs) to engage in functional upgrading. This last point is essential because it is not generally in the interest of lead firms to support their suppliers with their functional upgrading, so it is up to the suppliers themselves and their governments (and supporting agencies) to encourage functional upgrading into the higher value added activities of the value chain.

There is still a gap in the literature on systematic evidence from monitoring and evaluation of pro-SME procurement practices and their impacts on both economic and social upgrading of the intended SMEs. These evaluations should ideally be carried out by independent researchers with methods that allow for academic peer-review processes to be applied in order to give credibility to the results. However, given the competitive value of any commercial information extracted from these reviews, as well as the reputational risks, it is understandable that firms prefer to publicize their pro-SME actions in their own corporate reports instead of engaging with researchers or any other critical third party.

Best practices can be typically expected from stage 2 or 3 firms in our typology (see Figure 1). These are firms with significant brand value which puts them in the position of feeling pressured to demonstrate that they have a benevolent attitude towards their supply chain in line with the ethos that they project to their consumers (i.e. there is a potentially significant reputational risk if they do not engage with their supply chain). This is strongest in the garment and agricultural sectors reviewed as part of our paper.

What follows is a number of suggestions and policy recommendations on how to make GPNs into environments that are more conducive for SMEs to upgrade both economically and socially (labour conditions). These policy recommendations have been gleaned from the studies included in this review:

4.2 Policy recommendations for lead buyers

1. The main recommendation for lead firms in value chains is to make a conscious effort to merge the requirements of their codes of conduct within the procurement guidelines used by their procurement department. Bringing the dilemma of the 'conflicted procurement manager' from being a theoretical construct to a practical reality.
2. Cooperation between lead buyers and NGOs (e.g. Unilever and Oxfam) has often sparked new social upgrading initiatives that have brought improvements across industries. Lead firms could foster this type of cooperation with NGOs.
3. Lead firms should acknowledge first-tier suppliers' improvements and build on them instead of comparing different standards. (McKinsey and Company, 2011).
4. A new level of collaboration is needed with regards to compliance with social requirements in the value chain, in which government agencies, suppliers, lead buyers, and other actors (business associations, unions) can anchor ethical and sustainable practices along the value chain. (McKinsey and Company, 2011; Locke, 2007).
5. "Private governance can have a significant regulatory impact in the form of corporate policies that go beyond statutory minimum standards, negotiated arrangements between firms and labour advocates, and pressure campaigns driven by civil society and consumers. Distributional effects can also be influenced through voluntary or semi-voluntary agreements by firms to pay living wages, or via negotiated wage agreements, voluntary provision of other benefits by firms, and social institutions that provide services to the unemployed and working poor"(Barrientos et al, 2011).
6. For the fast fashion business model (successful in terms of income generation for lead firms), which demands rapid delivery of orders that go beyond the supplier's capacity and can only be met by putting enormous pressure on workers, working at a very fast pace and long hours (Piore and Schrank, 2006; Rossi, 2013):

   a. Lead buyers or multinational firms find that turning to a scheme of stable orders reduces the need for extra hours in their SME suppliers.

   b. Lead buyers' managers must develop new and clear managerial approaches for the fast fashion model as a means to have more structured and better organised production systems, directly affecting their main suppliers. These approaches should entail mentoring first tier suppliers on how to increase the capacities of their SME sub-contractors, so as to have positive effects on production and working conditions in the lower levels of the value chains.

   c. Lead garment firms or buyers should be jointly responsible with local suppliers for improvements both in firm profitability and working conditions. "In the contemporary GPN context, what the above experience means is that buyers need to be brought into the existing tripartite structure of industrial relations. What is possible at the horizontal level, where manufactures and workers, with government, settle work conditions, is constrained by the vertical relations between manufacturers and global buyers". (Ahmed and Nathan, 2013, p. 20)

7. In the horticulture GVC
   a. Engage small service providers to create supplier skills development programmes to support upgrading.
   b. Small service providers, even if they were to upgrade functionally, would not be a threat to the lead buyer as they provide services that are complementary to the 'hiring' firm, and do not stand as direct competitors.
   c. Competent service providers can then become preferred suppliers and train other service providers in different locations where the lead buyer source from.
   d. Lessons learned from the supplier development programmes with service providers on SME upgrading can then be applied to SMEs that supply the core value chain.

8. In the tourism GVC
   a. Support local efforts for destination branding (by governments and NGOs).
   b. Part of the destination branding strategy should focus on small operators and service providers, which also enhances 'authenticity'.

9. In the electronics GVC
   a. Government should invest in skills training for local workers, so as to facilitate upgrading within the value chain.
   b. Lead buyers and their hired auditing agencies should discourage auditing fraud by engaging with the new paradigm of 'cooperative monitoring and auditing'.

4.3 Policy recommendations for governments

Public policy can play a crucial role in supporting SMEs to integrate into GVCs, and this support should be more nuanced so it can strategically and deliberately contribute towards product, process and/or functional upgrading.

1. The importance of education and the government's responsibility in this area was evident in all the sectors reviewed in the study.
   a. Skills building and training development policies are critical for developing countries to help SMEs access GVCs and support workers in adjust to the working dynamics of GVCs. (Shingal, 2015).
   b. Developing countries in their path towards upgrading should focus on technical—and not just university—education and invest in developing managerial and design skills in order to upgrade into higher value pre- and post-production services. (Gereffi et al. 2011).
   c. The need for a collaborative approach to education, supported by government agencies, educational institutions, local training centres, and NGOs is fundamental for the development of firms and SMEs operating in GVCs.

2. Another important recommendation involving government initiatives is to work together with large tourism hotel operators, specifically so that they provide advice and courses that could include hands on training for smaller hotel operators and their staff. This would help them upgrade and improve the management of their hotels and services. Intensive promotion and excellent support services could have a significant influence on the competitive advantage of small and medium hotels. (Jaafar et al. 2011).
3. A recommendation that applies to all sectors reviewed refers to the important role of national governments to enforce labour laws as a means of increasing labour standards and improving working conditions. One of the salient findings from the literature review of Ingram and Oosterkamp (2014) on the labour market impacts of value chain development interventions highlights the important role of business organisations at local level. In the case of local agricultural chains, business organisations are said to have brought positives outcomes for workers through collective bargaining.
4. The typology introduced in **Figure 1** could also be used to devise specific mechanisms for identifying firms that could engage in different levels of SME support and flesh out the reach and limitations of that support at each stage. One step further would be to use this typology to try and understand what would help bring these lead firms to commit to move to the next step in the staircase, employing a bottom-up approach. A different approach (top-down) would involve showcasing a number of highly SME-committed firms at the top (stage 3), ideally with a stellar global reputation, to become role models for other firms below the staircase.

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ISBN 978-92-2-131169-0
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