



CORPORATE GOVERNANCE & SUSTAINABILITY OF THE GLOBAL VALUE CHAIN: BANGLADESH READY-MADE GARMENT INDUSTRY

Lilac Nachum
Nazneen Ahmed
Yoshiteru Uramoto

Bangladesh Ready-made garment (RMG) Industry

- Bangladesh entered in the global production chains of ready-made garments (RMG) in the late 1970s
- For last couple of years this is the second largest manufacturer after China.
- The Bangladeshi RMG industry has become the driver of the country's economy, engaging over four million workers, mainly females from impoverished rural areas, contributing 80% of the export and earning over 30 billion US dollars per annum.
- Bangladesh's garment industry has played a major role in the economic development of the country through job creation and poverty reduction.

Background of the study: Sustainability of RMG industry of Bangladesh after Rana Plaza tragedy

- After the Rana Plaza collapse tragedy in April 2013, several concerns spiraled around this tragedy--
- The Rana Plaza tragedy and the subsequent reactions of global brands led many stakeholders to question whether they ought to continue doing business in Bangladesh;
- Others took the tragedy as a wake-up call and sought to recover the reputational damage to Bangladesh's garment industry. For all stakeholders, Rana Plaza was a wake-up call for the need to improve human and labour rights as described in the UN Guiding Principle on Business and Human Rights.
- Few, however, have given thought to the sustainability of the value chain and the extent to which social and governance-related issues in the supply chain were discussed.

Theoretical framework of the Study

- In this study, we seek to address —theoretically and empirically— the relationships between value creation and value appropriation in global supply chains.
- We have developed and evaluated empirically a theoretical framework that treats value creation and value appropriation in a unified manner and establish a means to compare contributions of respective participants .
- Our approach is based on a broad view of value creation and conceptualizes social value and governance issues as intrinsic aspects of value creation on par with the economic, production-related dimensions usually considered to constitute value creation.

Value Creation and Value appropriation

- Value creation is the value-added contribution made by each participant in the chain towards the creation of the final output. Value appropriation is the share of the combined value created by the chain that is captured by each participant.
- The Fair Wear Foundation (2012) presents a breakdown of a €29 T-shirt to suggest that the three major players involved in this chain—the manufacturers, the wholesalers and the retailers—get respectively 17%, 24% and 59% of the retail price.
- Moazzem and Basak (2015) has provided a review and discussion of other studies of the garment supply chain that have reached similar conclusions.

Value appropriation	High	(1) Lead firms/ Entrepreneurs/ mid- level buyers	(2)
	Low	(4)	(3)
		Low	High
Value creation			



Value Creation and Value appropriation (continued)

- The findings of different studies mentioned above are used to claim that the low-skilled labour employed in global supply chains does not appropriate fair shares of the combined value it helps create and is being exploited by the large multinational companies who use their global market power to maximize their shares (Anner, Bair and Blasi 2012; Clean Cloth Campaign 2015).
- Put differently, these critics suggest that value creation and value appropriation are misaligned, corresponding respectively to cells 1 and 3 in the earlier figure, and hence are morally distorted and economically unsustainable.
- global supply chains can only succeed in the long run if value is appropriated in an equitable manner among the participants, that is, when value creation and value appropriation are aligned, in correspondence with cells 2 and 4 in the Figure.

Value Creation and Value appropriation (continued)

- Value must be created for it to be appropriated, but anticipated value appropriation affects the participants' incentives to create value, and might be the major determinant of their contribution to the joint effort that leads to value creation by the entire chain (Adegbesan and Higgins 2011).
- We embrace a broad view of value creation to encompass both economic activities and social and governance ones, and view the latter as an intrinsic part of value creation.
- We further suggest that governance failures represent a major threat for the creation of economic value in supply chains, and should, therefore, occupy a central part in value creation.
- We examine the value creation activities undertaken by the participants in alignment with social values, such as international labour standards, safety of work environment, and protection of labour, as well as the appropriation of adequate shares of the value created.

Value Creation versus Value Appropriation

	Value Creation	Value Appropriation
Definition	Net value added to a supply chain	Share of the value created by a supply chain
Measure	Sales - purchases	Profitability = total income - total costs
Determinants	Quality and efficient utilization of factors of production	Bargaining power (Differentiation, position in the supply chain)
Relationships between participants	Collaborative (win/win); Interdependencies	Competitive (zero sum game)

The Participants in Value Chains

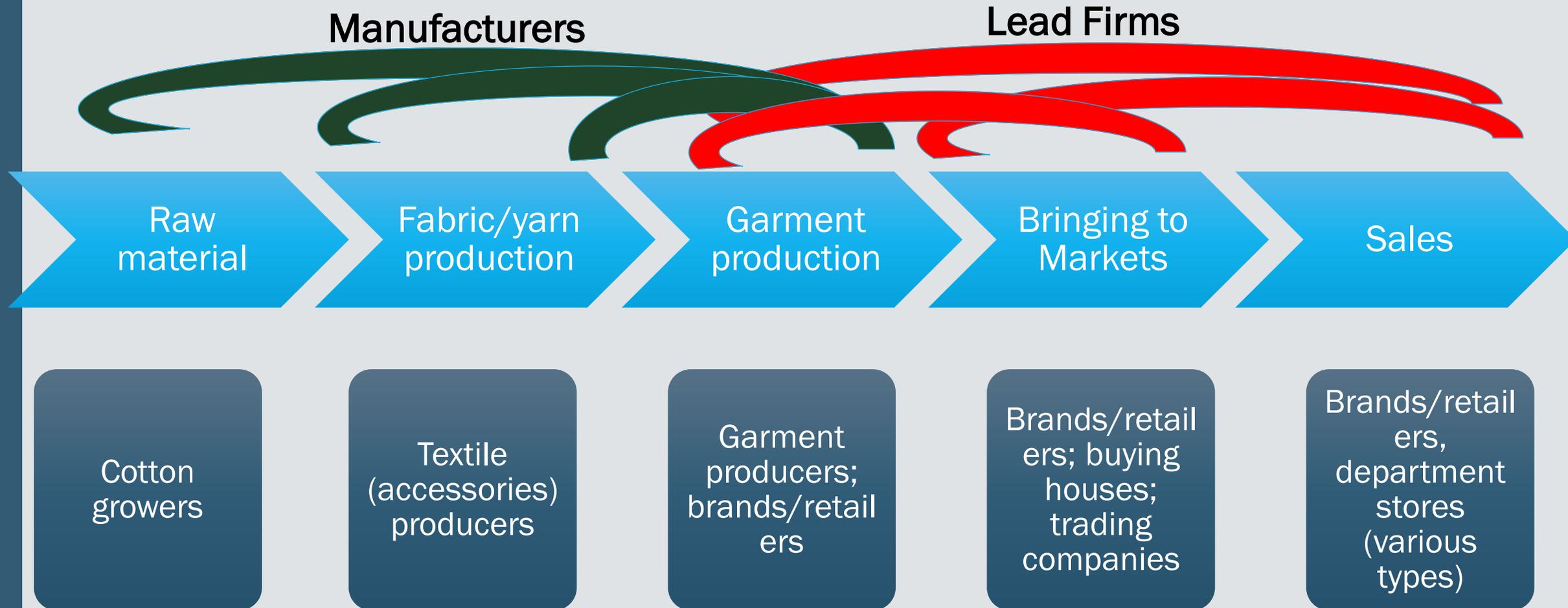
	Lead Firms	Others
Sources of value creation	Specialized expertise; Construction/management of the supply chain	Specialized expertise
Geographic scope/ reach	Global	Local (mostly)
Customers	End users (external to supply chain)	Other participants in the value chain (internal to supply chain)
Market	B2C	B2B

Implications for Value
Creation and
appropriation

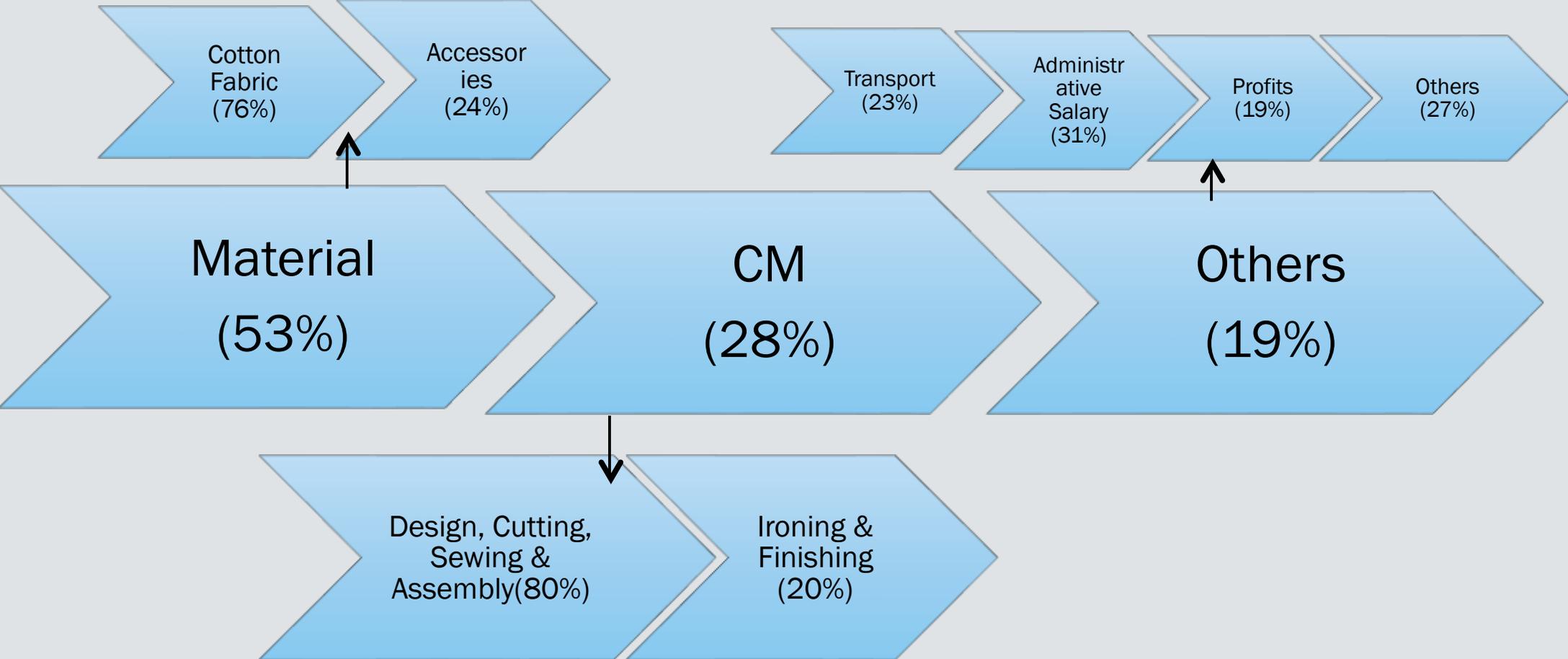
Corporate Governance in Global value Chain- governance of the lead firm

- Corporate governance of lead firms as they are the primary leader and manager of the global supply chains manufacturers.
- Lead firms have responsibilities, and their “good” governance plays a pivotal role in many aspects of the global value chains, in particular, sustainability.
- Without their good leadership and corporate governance, the Bangladesh garment industry will not be able to sustain itself.
- However, this study does not explore multilateral initiatives such as the UN Guiding Principles on Business and Human Rights (UNGPR), the Guidelines for Multinational Enterprises of the Organization for Economic Co-operation and Development (OECD), the ILO Multinational Enterprises (MNE) Declaration, the UN Global Compact, and several EU initiatives through directives or other policy-making mechanisms due mainly to the abundance of literature on the subject.

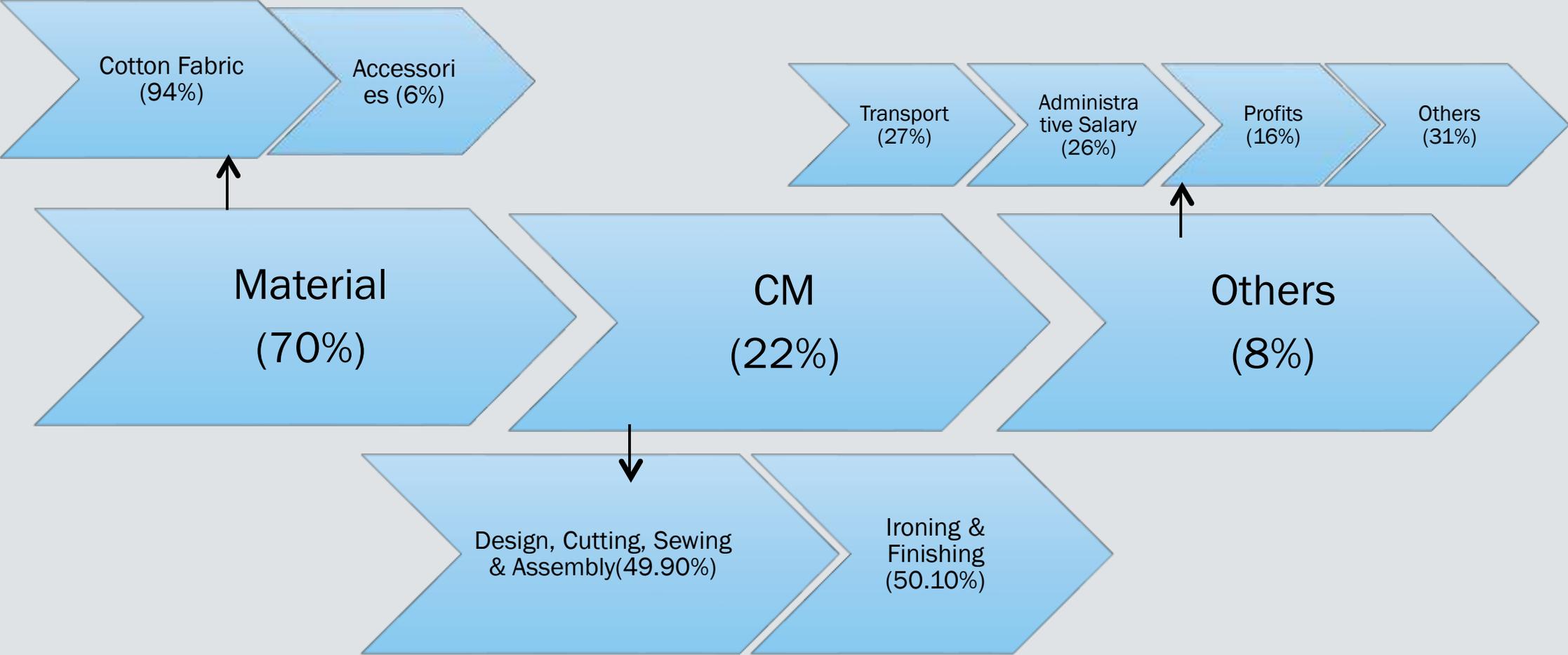
Ready-made Garment Supply Chain



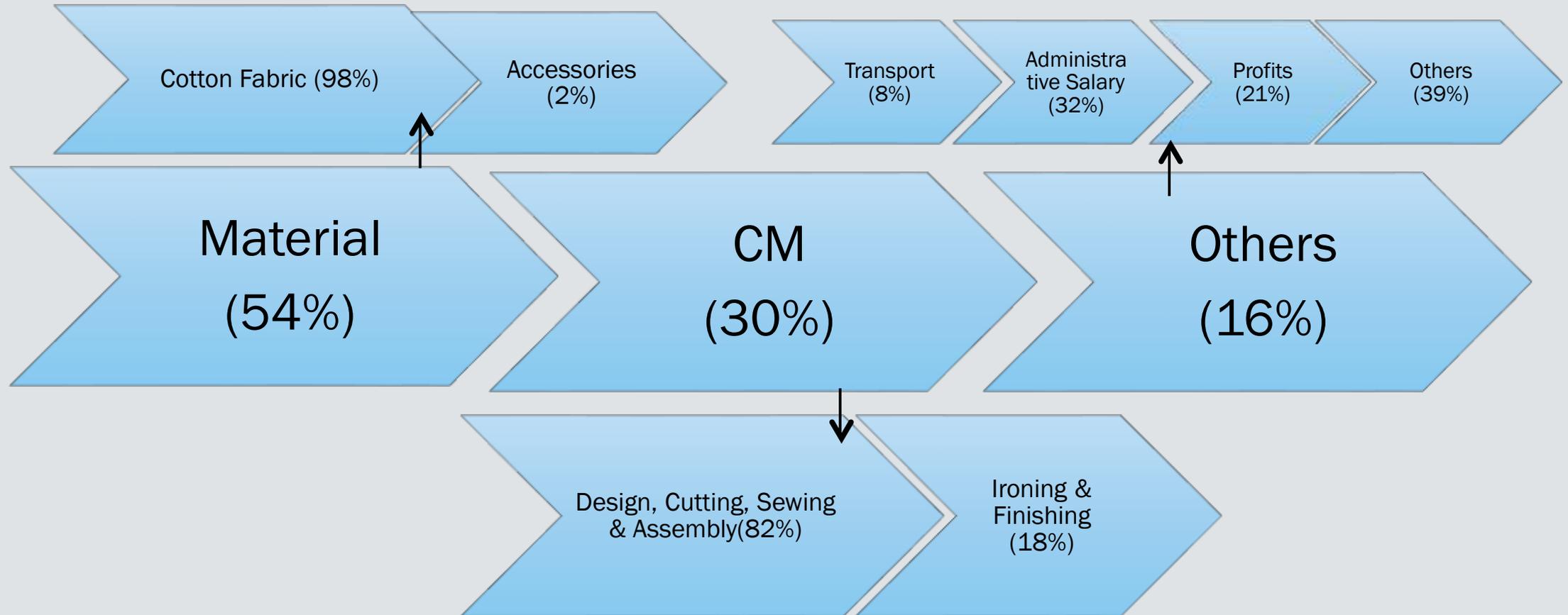
Value Creation Activities by the Manufacturers in Bangladesh: Denim Jeans (FOB \$3 to \$6.5)



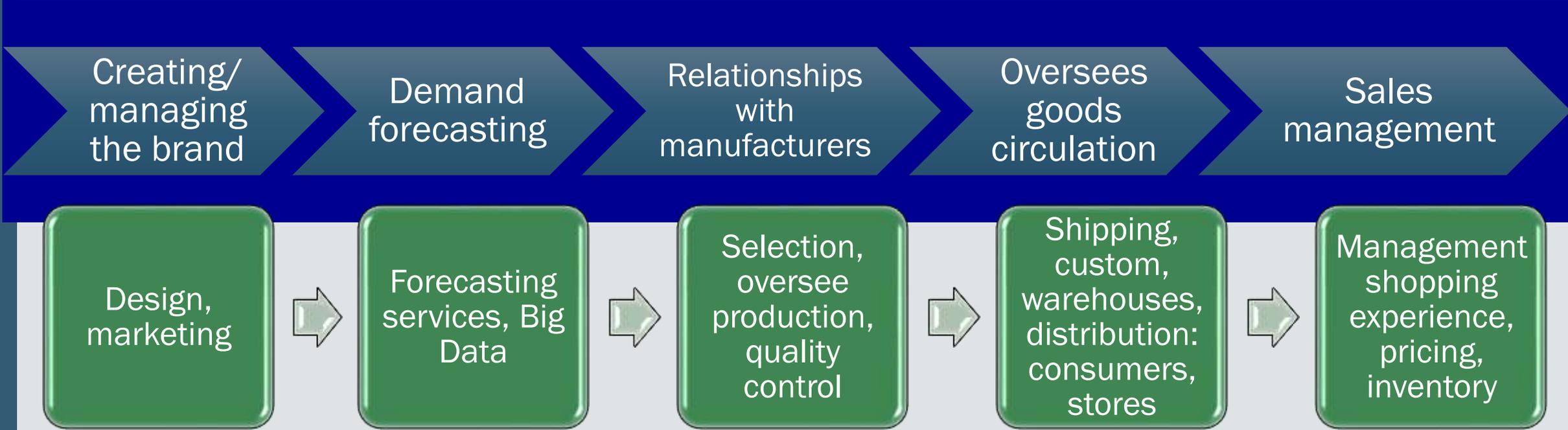
Value Creation Activities by the Manufacturers in Bangladesh: Cotton T-Shirt (FOB \$2 to \$3)



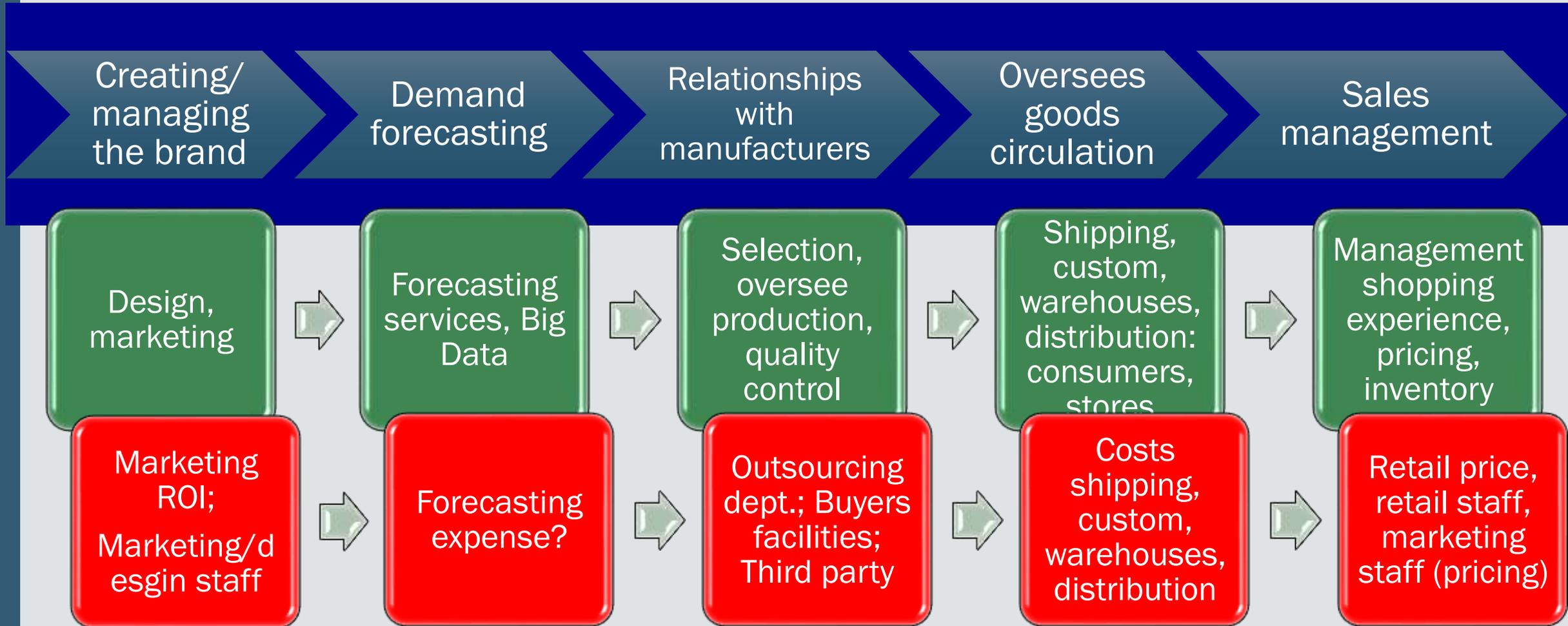
Value Creation Activities by the Manufacturers in Bangladesh: Woven Shirt (FOB \$4.5)



Value Creation Activities by Lead Firms



Measures and Data



Value Appropriation: Profit Margins

Bangladesh Manufacturers

- 1-3% (FOB). BGMEA estimates.
- Given the data we got the profit margin could be 11%

Lead Firms

- Top 50 most profitable public US apparel companies, sales > \$100mil:
 - *Average 5.2%*
 - *Std.Dev. 3.34%*
 - *median 4.9%*
- Polo Ralph Lauren 9.21%
- GAP 7.7%
- Levi Strauss 2.2%. The Apparel Magazine Top 50, July 2015 issue.
- Given the data we got the profit margin could be 10%

Implications and Recommendations



- Manufacturers
- Government



Increasing Bangladesh Value Appropriation

Manufacturers: Differentiation

- Governance and transparency
- Speed and flexibility!
- State-of-the-art technology
- Reducing cost via productivity and efficiency
- Assembling industry knowledge → benefits to buyers.

Government:

Attractive Bangladesh in a global perspective; Supportive environment

- Bangladesh dearth of regional/bilateral agreements
- Trade policy impact on brands/retailers – reported responses to the TPP:
 - *72% outsource more from TPP countries*
 - *48% redesign supply chain based on TPP. US Fashion Industry Assoc. 2015 survey*
- Facilitate consolidation! Modify industry structure
 - *Differentiate Bangladesh by firms' size and scope*
- Provide resources for upgrades – avoid the 'commodity trap'

Increasing Value Creation: Lead Firms

- Relationships with Bangladesh manufacturers
 - *Partners rather than suppliers*
- Capabilities in creating value via relationships with others
 - *The supply chain as a source of advantage*
- Facilitate/manage information flow in the supply chain.

Fairness of the global chain

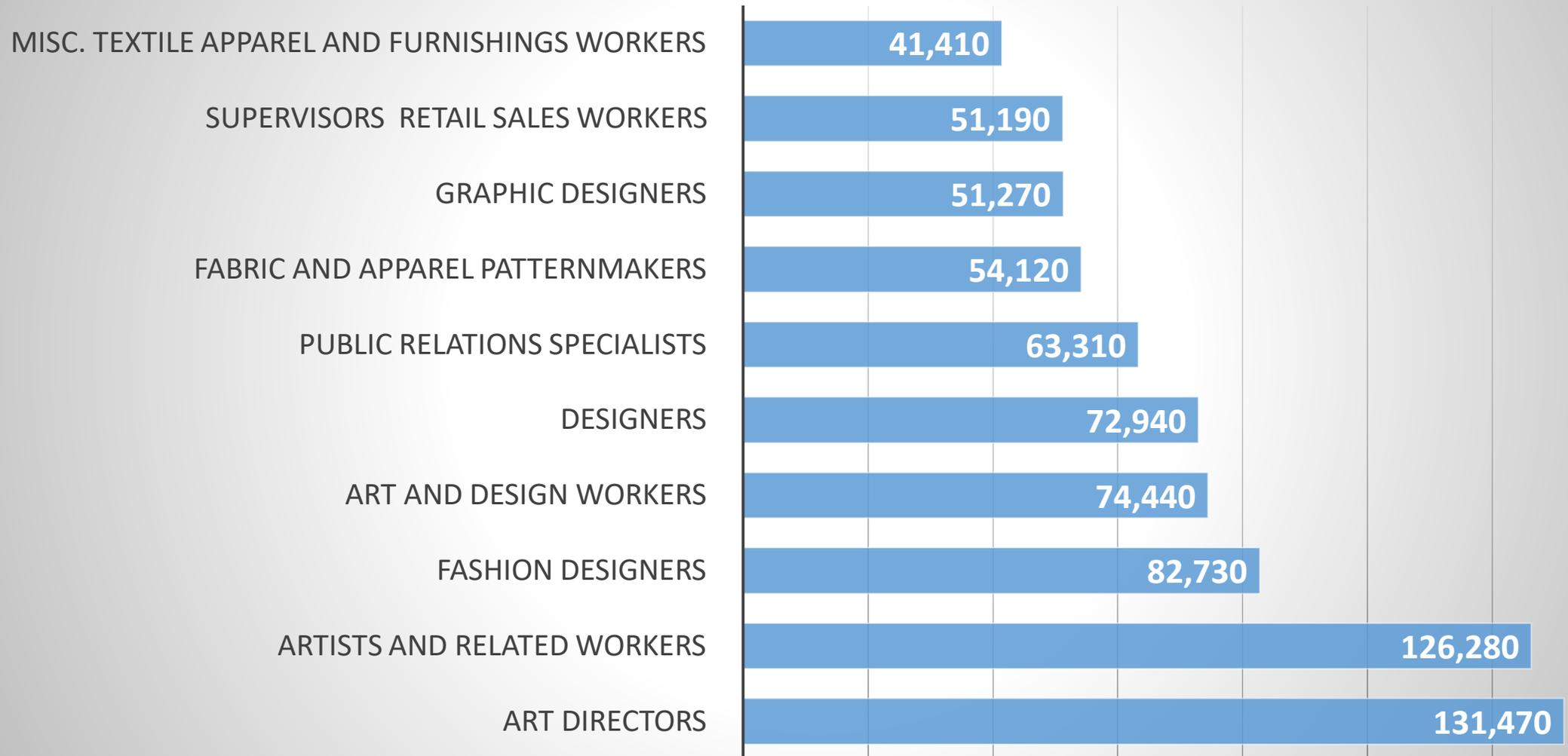
- Our study suggests that on a broader perspective, two major participants in the global garment supply chain, namely Bangladeshi manufacturers and global apparel companies, do not lend support to the claims that value appropriation in the garment supply chain is distorted and unfair, and suggests instead that the relationships between value creation and value appropriation are more balanced than they are often portrayed.
- Our analyses show that, after taking account of the value added by the participants in the chain and their costs, including indirect costs as well as costs originating in social and governance activities, value creation is broadly in line with value appropriation.
- However failure in governance create imbalance in the chain and the workers are the main victim of that failure.
- The balance between value creation and appropriation in relation to labour is less than clear a priori, with indications of market failures of various types originating in information asymmetries and market power, which may challenge value appropriation by labour. Labour productivity has increased much faster than pay levels, with the gap particularly evident in more recent years. But again productivity enhancement is linked to investment by manufacturers.
- Given the limitations of the data available and the constraints that this imposes on the method of analyses, we offer these conclusions as suggestive and indicative, rather than as firm evidence.

Roles of participants in GVC to correct market failures (imbalance between value creation and value appropriation)

- Notable market failure at the domestic level calls for government intervention as market forces alone do not offer sufficient incentives for the manufacturers to correct for it. Regulatory intervention on all manufacturers is needed to ensure change is sustained, lest there is an incentive to avoid compliance in order to gain cost advantage.
- Several alternative constituencies that should assume the responsibility for instilling change, namely international organizations—notably the ILO, global brands, social activists and NGOs.
- Global brands possess the ability to impose change by creating market forces that will incentivize Bangladeshi manufacturers to improve labour conditions, thus correcting for the market failures.
- Global brands should create a market for social compliance and human rights by placing these issues as a central criterion in selecting manufacturers and rewarding manufacturers that adhere to high standards by giving them work.
- While some brands are already implementing this practice, but so far, this has been the exception rather than the standard. Surveys repeatedly show that the dominant selection criteria of manufacturers are costs and speed, and the sustainability of the supply chain receives only marginal weight (Pious and Burns 2015; Lopez-Acevedo and Robertson 2016).

US Wages, Selected Fashion and Apparel Occupations

Annual wages, US average \$



Roles of participants in GVC to correct market failures (imbalance between value creation and value appropriation)

- The Better Work programme and others have demonstrated the power of global brands to improve working conditions. Studies of garment factories show that the presence of global brands have a strong impact on governance and local labour conditions.
- Improvements in labour conditions serve the interest of the brands by enhancing their global reputation and are fundamental for the sustainability of their global supply chains.
- Notwithstanding the commitments made by the Bangladesh government to labour unionization—including the ratification of ILO Conventions on freedom of association and collective bargaining and their incorporation in the Bangladesh Labour Law Act—attempts to form labour unions in Bangladeshi garment factories are being blocked by a myriad of obstacles erected by the government and the factory managers (European Commission 2015; Human Right Watch 2016).
- Properly functioning labour unions offer a means to correct for the unfair treatment of labour in garment factories and correct the dissonance between labour productivity and wages, as well as other dimensions of the working environment. However, Bangladesh should move cautiously towards this implementation. Global brands may support the training of labour for effective collective bargaining processes to prevent misuse of union power and conflicts with the factory owners.



Responsibility of Global brands

- Global brands have a moral and ethical responsibility to exercise their collective power to that effect and to improve labour conditions and the broader governance of the factories with whom they have commercial relationships.
- Such actions offer opportunities for global brands to contribute towards the achievement of the broader societal goals summarized in the Sustainable Development Goals (SDG) and to demonstrate commitment to the United Nations Guiding Principles (UNGP).
- In addition to their moral obligations, global brands are dependent on the long-term sustainability of their supply chains, making their involvement with governance and social issues in their own interest as well.

Towards a better and sustainable GVC

- Improving labour conditions and creating positive dialogue between employers and labour would serve the interests of all involved.
- Collective action by all involved should be undertaken to pass on the costs of improvement in labour conditions to the consumers. Our findings show that consumers are major beneficiaries of the surplus value created by the chain, enjoying apparel prices that continuously go down, creating a growing gap with the general consumer price index over time. They are thus the natural candidates to bear the cost of improving labour conditions and wages in Bangladesh's garment factories.
- The government should increase minimum wage levels in return for higher pay by global brands, using its bargaining power relative to the global brands to impose this act.
- The low costs of labour combined with the size of the local industry affords Bangladesh's government considerable clout in dealing with global brands. No other country offers similar benefits, making any exit by the global brands costly and unlikely. Bangladesh's government should use this clout as a strategic tool to increase the value appropriated by the Bangladesh garment industry.

Towards a better and sustainable GVC

We also extend a call for ethical consumption by consumers: to reward in their consumption behaviour brands that follow high governance standards in their supply chains and to express a willingness to pay a premium for such behaviour.

Brands should publicise their governance practices and be transparent in relation to their activities in this sphere. National and international governments, as well as NGOs and social activists, have a role to play in encouraging consumers' awareness of the merits of ethical consumption.

at this stage of its development, the industry will benefit from a change in the policy approach from cost benefits to skills upgrade. Continuing government support in the form of past policies may even arrest a natural upgrade process and harm the future development of the industry.

Some Bangladeshi garment manufacturers have already been investing in human resources, improving workplaces, and raising human resources competencies and manufacturer's competitiveness and productivity, speaking for the benefits of such initiatives for all involved.

Conclusions

- Our findings document that international value creation and value appropriation in the global garment supply chain are largely aligned with the shares created and appropriated by manufacturers and lead firms, and are on par with each other. However, we may question, whether so much investment to be made branding.
- The main distortion we document is in relation to the labour employed in garment production, whose value creation and value appropriation measured respectively by productivity and wages, appear to be misaligned.
- In the absence of market mechanisms to correct for this distortion, we advance a call for policy intervention that will address this shortcoming, and outline policy measures that should be taken to protect labour rights.
- Firms do not create value by themselves but rather through their supply chains; thus, their focus should shift from the development of their own capabilities to the ability to create value in collaboration with partners in the supply chain.
- Our articulation of value creation and value appropriation as distinct yet related dimensions of supply chains serves to identify the capabilities needed to effectively partake in them. By outlining the varying market dynamics of these two dimensions of supply chains, we offer firms and policymakers the means to develop appropriate responses that maximize their gains in a win-win mode.