

**DOMESTIC CAPABILITIES AND GLOBAL PRODUCTION  
NETWORKS IN THE CLOTHING INDUSTRY: A COMPARISON OF  
GERMAN AND UK FIRMS' STRATEGIES**

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**Abstract**

In this paper we examine the sourcing strategies of clothing firms in the developed economies of the UK and Germany in the context of their national institutional framework. We argue that, as a result of their embeddedness in divergent national structures, these firms pursue different sourcing strategies and make different locational choices. We place particular emphasis on the different mix of arms' length and relational contracting that firms develop, and on the divergent degree of control over the manufacturing process and the product that they retain. We suggest that the construction of global production networks and control over supplier firms is mediated by co-ordinating firms' product strategy and the degree of dependence on national retailers this engenders. In the UK and Germany, firms and their networks differ from the US case which is normally taken as representative of the industry.

**Keywords:** clothing industry, global production networks, capabilities

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## 1. Introduction

Although production networks in the clothing industry are correctly characterised as highly global (Dicken, 2003), the national institutional context of individual clothing firms is an important factor in the construction of these networks. It shapes both the competences that firms develop and the strategies they adopt (Lane and Probert, 2004). The global production network (GPN) literature (e.g. Gereffi, 1994, 2002; Palpacuer, 2000) views the clothing industry's supply chains in terms of its impact on developing countries. We learn much less about the internal capabilities of clothing firms and how these shape network governance.

We examine the sourcing strategies of clothing firms in the developed economies of the UK and Germany in the context of their national institutional framework. We argue that, as a result of their embeddedness in divergent national structures, these firms pursue different sourcing strategies and make different locational choices. We place particular emphasis on the different mix of arms' length and relational contracting that firms develop, and on the varying degree of control over the manufacturing process and the product that they retain. We further suggest that the construction of GPNs and control over supplier firms is mediated by co-ordinating firms' product strategy and the degree of dependence on national retailers this engenders.

The developed countries of Europe and the United States have for decades sought to protect their domestic textile and clothing industries from competition by newly industrialising countries, where low wage rates favour the development of low capital, highly labour intensive industries, such as clothing, that resist technological rationalisation. The measures taken have significantly distorted global trade in textiles and clothing and sustained the current division of labour between developed and developing countries. Through the Multi-Fibre Arrangement (MFA) of 1974-1994, governments imposed quotas on garments imported from developing countries; these restrictions were phased out in 1995-2004 under the Agreement on Textiles and Clothing (ATC). Regional agreements, meanwhile, granted certain countries privileged access to EU markets by lifting quota restrictions and reducing or eliminating tariffs. Among the most important of these was the 1982 preferential agreement on Outward Processing Traffic (OPT), which permitted the temporary export of fabric from EU countries to another customs area for processing and subsequent re-import (Dunford and Greco, 2005 Ch.6). Trade with Central and Eastern European (CEE) countries was almost entirely liberalised in 1998. All these arrangements have had a significant impact on the selection of both foreign

manufacturing sites and of suppliers, as well as precipitating changes in such arrangements over time.

The phasing out of the MFA/ATC and implementation of the various regional agreements have sharply increased global competition. The data we present for the UK and Germany show that conditions for the clothing industry in developed countries have significantly worsened during the last decade or so. Although the full impact on western firms of quota removal since 1 January 2005 is not yet clear, co-ordinating firms welcomed the expected effects of a reduction in both financial and transaction costs (Interview Notes 2003). Nevertheless, the dismantling of trade barriers threatens to undermine the ability of clothing firms to remain the lynchpin of retailer-supplier networks, as retailers increase the proportion of clothes they buy directly from low-cost producers in developing countries. This will undermine the *raison d'être* of western clothing firms that have not built their own brand and are active in lower-quality segments.

Our analysis of domestically anchored firms, inserted into a network of national, international and global relationships with customers and suppliers, is informed by and seeks to integrate three sets of theoretical literature. We link the strategic management literature on the development of capabilities within firms with the political economy literature, which shifts the analytical focus to global chains/networks. We argue that the degree of power/control exerted by clothing firms within networks is decisively shaped by their domestically developed capabilities. Last, our emphasis on co-ordinating firms' embeddedness in contrasting institutional environments is informed by a critical reading of the Varieties of Capitalism (VoC) literature, particularly the work of Hall and Soskice (2001).

The paper has the following structure. Section II outlines the theoretical framework adopted. Section III describes and analyses the German and UK clothing firms in their global and national contexts. Section IV analyses sourcing strategies and modes of third party contracting and examines qualitative aspects of supplier relationships. The Conclusion highlights our main findings and the theoretical insights developed, emphasising their relevance to the global commodity chains/production networks literatures and to the wider debate on the interaction between globalisation and national varieties of capitalism.

The data draw on analysis of 50 in-depth interviews conducted by the authors in 2003-4 with high-level managers/owners of British and German firms and associations in the textiles, clothing and retail industries. For Germany we used the Klartext rankings to identify the major players in the clothing industry. In the absence of equivalent listings for the UK, we consulted several leading company, industry and general news databases to compile our own lists. Despite the more ad hoc nature of the UK compilation, we are confident that we identified the most important players. Multiple approaches to firms yielded interviews in 11 British clothing firms (a 35% success rate) and 13 German firms (43%), supplemented by five British retailers (56%) and four German retailers (31%). Supplementary interviews were carried out in textile firms (seven British and four German firms), associations and two clothing and two textile supplier firms in China.<sup>1</sup> We used Atlas.ti software to assist us in a qualitative analysis of the recorded and transcribed interviews. Official statistics and secondary sources from both countries supplement our findings.

## **2. Theoretical Considerations**

### **2.1 The Competence-Based Approach in Strategic Management**

To gain competitive advantage, managers develop organisational competencies/capabilities<sup>2</sup> which facilitate not only innovative responses to market pressures, but also flexible adaptation to unstable and rapidly changing markets (Grant, 1996; Hamel and Prahalad, 1994; Stalk et al., 1992; Teece et al., 1997). Capabilities have been variously defined, but most authors emphasise the development and combination of various types of knowledge which, when embodied in products, are difficult to imitate by competitors and thus ensure a firm's competitive advantage. Such idiosyncratic, value-generating competencies vary between industries and may be connected with high-technology development, or be relatively mundane, such as the 'quick-response' capability of some clothing firms (Richardson, 1996). More often than not they now take the form of 'services', such as styling features, product images and other attributes that only services can create (Quinn et al., 1991: 302). Additionally, the effective co-ordination of internal and external competences may be considered a valuable managerial capability (Teece et al., 1997: 515). Although the knowledge sedimented in competencies often is described as experiential it is clear that it cannot develop unless management and society have laid the foundations in the provision of relevant educational qualifications and skills (Quinn et al., 1991: 301; Teece et al., 1997). Thus, although capabilities are broader than skills and are embodied in organisational processes, they cannot be completely divorced from them. Furthermore, the recruitment and development of employees with high levels of qualifications

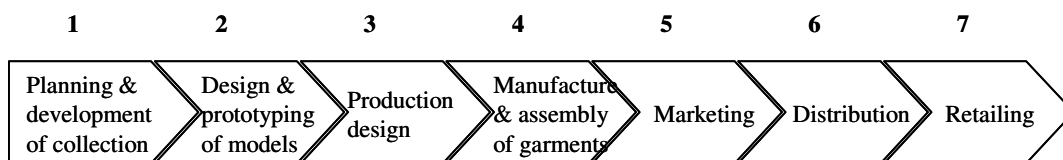
and the ability to continue learning also requires longer-term financial investment in human resources (Stalk et al., 1992: 59).

Managers' competitive strategy has to determine core and non-core capabilities. They have to distinguish between capabilities unique to the firm and fundamental to its competitive advantage, and those which may be externalised, acquired either through market links or in networks (Grant, 1996). In the latter case, closer, trust-based and more durable strategic networks are said to result (Jarillo, 1995), based on relational contracts (Grant, 1996: 383).

## 2.2 Organisation of the Value Chain and Firm Types

In this sub-section we derive several different types of clothing firm from the mixture of functions/capabilities required to execute the various steps in the value chain both efficiently and effectively. (The following adapts and develops ideas from Dunford, 2002:1-2.) The value chain in the clothing industry embraces several different sets of activity, roles and occupations (Figure I).

**Figure I. Steps in the Clothing Value Chain**



- 1) Development and planning of the entire collection involves several skilled activities including knowledge of market trends and of fabric availability, the integration of both into development of product lines, and the costing of the planned collection.
- 2) Design and prototyping of new models requires both creativity and technical aptitude in addition to understanding market demand and cost structures.
- 3) Production design and sample-making concerns the most cost-efficient means of producing the item, bearing in mind quality standards and fit. Decisions on manufacturing location are also brought into consideration.
- 4) The actual manufacture and assembly of garments, or CMT (cut-make-trim), involves mainly semi-skilled sewing and assembly operations, using simple machines and requiring elementary skills.

- 5) Marketing seeks to match retail outlets to the quality and character of the clothes, and to achieve the broadest possible market access in a given segment.
- 6) Distribution entails an increasingly sophisticated logistics operation often based on computerised order tracking and inventory control systems.
- 7) Finally, the garments reach consumers through various retail channels.

In principle these seven steps can be separated from each other and performed in different locations, since they involve clearly identified costs as well as different sets of capabilities and occupations. The manner of fragmenting the value chain and its distribution of functions across different locations depends not only on available competencies and cost considerations, but also on the nature of the final product. In addition, and parallel to processes of de-verticalization, processes of functional integration have been notable, particularly in the retailing function.

Our analysis leads us to identify at least five different types of clothing enterprise, each with its own way of organising the clothing value chain (table 1).<sup>3</sup> Each type, as section IV demonstrates, involves different decisions regarding the activities to be externalised through markets or within networks, as well as their geographical location.

**Table 1. Five Types of Clothing Firms<sup>+</sup>, Based on Different Combinations of Steps in the Value Chain\***

	Type of Firm	Steps combined	Type of Product and Market	Competencies Utilised	Costs incurred
Type 1	Branded marketers	High emphasis on steps 1-3 and 5-6	High quality brands, co-ordinated collections	Creative and technical design; technical preparation of production; marketing	High
Type 2	Domestic suppliers to large retailers	Same steps as type 1, but steps 1,2 and 5 receive low emphasis	Standardised, made to order for retailers	Lower design, technical and marketing capability than type 1	Low
Type 3	'Cut, Make and Trim' firms ***	Step 4**	All types	Managerial co-ordination of semi-skilled operators	Medium
Type 4	Forward-integrated branded / high fashion marketers	A. Steps 1-3, 5-7 B. Steps 1-7	As in type 1	A. Combines competencies of type 1 with retailing capability. B. As A, plus manufacturing	Very high
Type 5	Retailers, with backward integration into design and supply chain organisation	Steps 1, 2 and 6	Standard clothing, full package or imported	Mainly retailing competencies, combined with some design and direct sourcing skills	Medium

<sup>+</sup>Includes retailers

\*Steps in value chain: 1. Development of collection; 2. Design; 3. Prototyping of models; 4. Manufacturing; 5. Marketing; 6. Distribution/logistics; 7. Retailing.

\*\* If 'full package' suppliers, also buy fabric and trim.

\*\*\* Located in developing countries or in informal sector of developed ones.



These five types of clothing enterprise evidently differ in the capabilities and capital invested, in the resulting products and hence the markets they can enter, and consequently in the degree of autonomy and network power they develop. But power relations are not of primary concern to strategic management theories, which are mainly focused on the firm. For an understanding of network governance and power relations, we turn to a second theoretical perspective, the political economy literature on global commodity chains (GCCs) and GPNs.

### **2.3. Power and Control in Global Commodity Chains/Production Networks.**

Gereffi's work (1994) on GCCs in the clothing industry centres on the analysis of power around a dichotomy of 'drivers' in the chain. But his focus mainly on buyer-driven chains and large retailers gives insufficient attention to the co-ordinating or 'middleman' firms which, if they are branded marketers, may develop a countervailing power to retailers. Moreover, an in-depth consideration of different types of co-ordinating firms illuminates the bases of their power and the differing ways they can deploy it in the network. Furthermore, his predominant focus on US firms and insufficient consideration of firms' institutional embeddedness limits development of a general theory.

Some of these aspects are better understood by Henderson et al (2002). Their detailed theoretical specification of the concept of the GPN permits the identification of sets of firms, linked together in complex, variable and multi-level (in spatial terms) relationships. Their definition of power as 'the capacity of the lead firm to influence decisions and resource allocations – vis-à-vis other firms in the network – in its own interests' (Henderson et al., 2002: 450) informs this paper. Last, in common with the authors of this paper, Henderson et al (2002: 441) explicitly recognise the importance of national institutional contexts, out of which all firms arise and in which – albeit to varying degrees – they remain embedded.

Adopting the term GPN, we focus on shifts in control over the organisation of the value chain, and over the gains and losses from it that accrue to the three main parties involved – the co-ordinating firm, its supplier(s) and retailers, with a particular emphasis on the two former.

We concur with Gereffi (1994) that, in many developed countries, large retailers are important actors in the network of relationships, and current developments are augmenting their power. But, as we show in section III, they are not invariably the dominant network actor. Based on managerial and employee

capabilities, together with financial resources, co-ordinating firms can shape the triangle of control by developing their own power resources. Two sets of capabilities are particularly important. The first is the development of a high-quality, high-fashion, branded product, which makes it possible to cultivate a large and highly diversified retailer base in both domestic and export markets while also permitting forward integration into retailing. The second is the skilful management of the GPN and the constituent supplier firms, in order to retain a high degree of control over the final product.

## **2.4 Explaining Cross-National Differences**

The Varieties of Capitalism approach (Hall and Soskice, 2001: 6ff.) suggests that the comparative advantage of firms in differing industries has its origin in the institutional foundations of their home nations. Following Teece et al (1997), Hall and Soskice (2001) conceive of firms as developing competencies in interaction with other actors, compelling them to solve a number of co-ordination problems central to the development of their core competencies. Of the five areas of such interaction they outline, vocational training and education is of particular importance for this paper. But reference will also be made to regulatory regimes regarding entrepreneurship, modes of inter-firm contracting, and employment relations, as well as to aspects of corporate governance and finance.

Hall and Soskice (2001) further suggest that different national political economies resolve these co-ordination problems in contrasting ways. Firms in different national economies, they argue, will gravitate towards the mode of co-ordination for which there exists institutional support. They develop two basic types of political economy, based on the way in which co-ordination problems are resolved: in liberal market economies, markets and hierarchies are the most prevalent co-ordinating mechanisms, whereas in co-ordinated market economies, firms depend more heavily on non-market mechanisms, entailing more extensive relational contracting.

This theory will inform the analysis of the divergent behaviour of German and UK firms in section III. In section IV, when we turn to outsourcing and the building of global production networks, however, their mainly national focus has to be amended. The impact of international rules systems, particularly those relating to trade, needs to be incorporated into the analysis, as does a consideration of the changing international division of labour and the opportunities and constraints it creates. It has to be recognised that, in the clothing industry, firms create global production networks to escape constraints exerted by national institutions, particularly those shaping the cost of labour.

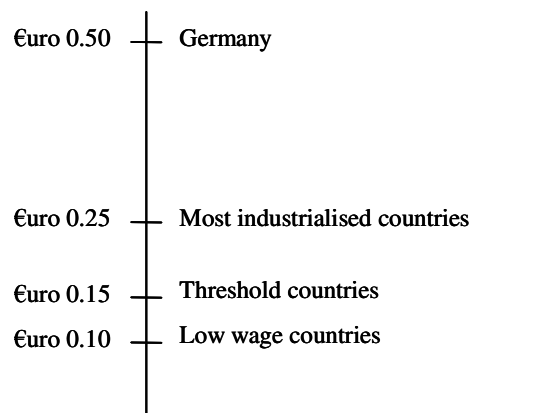
Finally, it is necessary to consider supplier capabilities in different geographical locations and the way this shapes the shifting contours of GPNs. The kinds of networks developed and their governance therefore will be a hybrid arrangement. They combine behaviours supported by domestic institutions with behaviour responding to global opportunities, as well as being influenced by suppliers' national environment and the capabilities it fosters.

### **3. The National Industries and Firms in their Changing Global and Domestic Contexts.**

#### **3.1 National industry structure and capabilities of firms**

The competitive pressures caused by huge discrepancies in wage levels between developing and developed countries, shown in Figure II, have forced developed country firms to reorganise their value chain, usually by outsourcing some or all of their production operations to lower-wage countries. Semi-skilled jobs like sewing have almost disappeared from developed countries, and yet governments and firms are not prepared to abandon these industries to firms in developing countries.

**Figure II. Clothing Industry Costs per Working Minute in Different Countries (in Euros)**



Source: Volksbanken / Raffeisenbanken 2003

The UK and German clothing industries were important contributors to both employment and GNP for most of the post-war period but in recent decades have experienced a precipitous decline in the face of developing country competition. In Britain, employment fell by over 40 percent to 127,000 in the period 1995-2000, and production value declined by 40 percent to £4.8 billion in 1996-2002 (BATC, 2003, estimates from ONS data). Some 1,600 firms (-19 percent) disappeared during this time (Euratex, 2002). Employment in Germany started declining earlier, because of earlier relocation of production, but again the strongest overall decrease was in the 1990s. By 2000, both employment and the number of firms remaining had fallen to around one-third of their 1990 level (Groemling and Matthes, 2003). According to IHK Bielefeld (undated), in 1995-2002 employment among firms with over 20 people declined more sharply (-49 percent) than turnover (-19 percent).

Table 2 shows the extent of the UK productivity deficit with Germany: higher turnover in the German industry is achieved by a significantly lower number of employees. Significant differences in firm size, indicative of lower capital resources, partially explain the poor UK showing. In the German industry, 85 percent of turnover is generated by large and medium-sized firms employing 100-999 people (Euratex, 2002). Only a handful of firms are very large, yet some 20-30 brands are globally traded (BBI, 2002: 11). The top 100 firms are internationally competitive. Each achieves more than Euro 25 million in sales and, according to Volksbanken Raiffeisenbanken (2003: 2)<sup>4</sup>, together they generate nearly two-thirds of the sector's annual turnover. Since the end of the 1990s when the two giant public companies, Coats Viyella and Courtauld, were broken up, the UK industry comprises a small number of large and medium-sized firms and a large number of small firms (CAPITB Trust, 2001: 8). Nearly three-quarters of clothing manufacturers are reported to turn over less than £250,000 per annum (Warren, 2003: 233). Ethnic minority owners are prominent in this latter group (around 35 percent, according to CAPITB Trust, 2001: 5), some of which constitute an informal, regionally based sector. No equivalent informal sector is apparent in Germany, despite regional concentrations of ethnic minorities, due to greater regulation of both entrepreneurship and the labour market (Donath, 2004; Rath, 2002: 16), thus preventing the development of an informal low-wage sector.

**Table 2. Structure of the German and UK Clothing Industries, 2001/2**

	No. of firms	Turnover (€ billion)	No. of employees
German industry (firms with >20 employees)*	560	9.65	53,901
German industry (all firms)**	6,159	14.4	-
UK industry (all firms)*	5,820	8.92	127,000

\* Data for 2002; \*\* Data for 2001

Sources: VR2003; IHK Bielefeld data, 2002; ONS Annual Business Inquiry 2001 and BATC estimates

Our own interview data reveal how divergent firm size, capital bases and ownership profiles affect firms' ability to invest in capability building. Table 3 summarises the characteristics of our 11 UK and 13 German firms discussed in the remainder of this section.

Due to the differing modes of raising capital in the two economies (Hall and Soskice 2001), we found total or substantial family ownership to be widespread in Germany, even among large firms, while in the UK inherited family firms are more rare and some stock market listing exists. But since the late 1990s de-listings/acquisitions by private equity funds and break-ups of large firms resulting in management buyouts have occurred, often leading to very high gearing for the latter. Whereas several German firm owners emphasised that, after paying their own salaries, all profits are reinvested, in the UK priority goes to investors and only thereafter can profits be reinvested.

The impact on training and skills acquisition of these different financial models, together with national institutionalised practices of and facilities for vocational training, is significant. British managers' capabilities and skill profiles were considered by industry insiders to be 'generally of very low calibre' (e.g. UK-C-6). With a few exceptions, education levels and specialist expertise appear to be significantly lower than those of their German counterparts. Whereas graduate recruitment is problematic for the UK clothing industry as a whole (PSS, 2000), the German managers we interviewed mainly were graduates. Designers in British firms are not rated highly on technical and commercial understanding, although they may score well on creativity (EMDA, 2001: 29; TCSG, 2000: 12), and large retail customers usually employ their own design teams (Interview Notes 2003). German designers also appear better at integrating creative and technical design, and our impression was that German firms employed more – and better-qualified – technical specialists than the mere 4 percent of technical employees that CAPITB (2001: 16) identified in British

firms. Industry statistics on skill levels at supervisory and operative level indicate that employees in British firms generally have low to non-existent qualification levels and few opportunities for formal training (Warren, 2003: 232). The German industry, by comparison, boasted a trainee to employee ratio of 7.5 percent in 2001, and many of them were learning tailoring skills (BBI, 2002). Following the decline in domestic manufacturing, skilled production work no longer holds great importance in either country. But operatives at the technician level have become the backbone of production organisation and quality monitoring in foreign production sites of both third-party suppliers and within company subsidiaries (Interview Notes 2003, Faust, 2005).

**Table 3. Co-ordinating firm characteristics**

	Firm size		Ownership <sup>++</sup>	Product Range	Firm type <sup>+</sup>	Exports <sup>***</sup>
	Turnover*	Employment**				
UK-C-1	very small	small	private	middle	2	none
UK-C-2	small	large	private equity backed	middle	1	low
UK-C-3	small	large	family	low-middle	2	none
UK-C-4	small	large	MBO	low-middle	2	none
UK-C-5	small	small	MBO	low-middle	2	none
UK-C-6	small	medium	listed	low-middle	2	none
UK-C-7	very small	large	family	middle	1+2	medium
UK-C-8	very small	medium	family	high	1	high
UK-C-9	small	large	MBO	low and middle	2	low
UK-C-10	large	large	family	low-middle	2	none
UK-C-11	small	medium	private	high	4	yes
GER-C-1	large	large	listed	high	4	high
GER-C-2	small	medium	private	middle	4	high
GER-C-3	very large	large	listed	middle	4	high
GER-C-4	very large	large	family	middle	2+4	high
GER-C-5	medium	large	family	middle	4	medium
GER-C-6	small	medium	family	high	1	medium
GER-C-7	small	medium	family	low-middle	2	high
GER-C-8	small	medium	family	middle	1	medium
GER-C-9	very small	medium	family	middle	1	medium
GER-C-10	medium	large	family	middle	2+1	medium
GER-C-11	small	large	family	middle	4	medium
GER-C-12	small	large	family	low	4	none
GER-C-13	small	medium	family	high-middle	1	high
* very small = <€50 million turnover, small = €50-249m , medium = €250-499m, large = €500-999m, very large = >€1,000m						
** small = <100 employees, medium = 100-499, large = >500 ; includes staff in directly owned foreign subsidiaries						
*** low = <10% of turnover, medium = 10-49%, high = >50%						
+ 1 = Branded Merchandiser, 2 = Domestic Supplier to Large Retailers, 3 = Cut-Make-Trim firm (none here), 4 = Branded/High Fashion Merchandiser. See Table 1 for detailed descriptions.						
++ 'family' refers to at least second generation family management; MBO = management buy-out, usually with private equity backing						

We have identified divergent patterns of institutional complementarity, corresponding to the Liberal and Co-ordinated Market Economy types of Hall and Soskice (2001), where differences in firm size, ownership and investment horizons are accompanied by stark contrasts in levels of employee qualification and skill. These striking differences between the UK and German clothing industry indicate that UK managers face much greater constraints in capability building. This suggests that the product and market strategies open to each industry will be quite different. Some capabilities, like the combination of creative and technical competencies to develop brands, together with the financial resources required to market them, have been achieved only in exceptional cases in the UK industry.

### **3.2 Product and Market Strategy**

Steedman and Wagner (1989: 41) pinpoint differences between German and British clothing firms in technical design (greater complexity in Germany), as well as in fabrics and trim used (higher quality in Germany). German firms cater mainly for the upper middle market, with an emphasis on quality, fit and, often, brand. Their competitive advantage in international business rests on specialisation in niche products (Groemling and Matthes, 2003: 69), a market strategy dependent on high skill levels at the upper end of value chain and on a high level of control over suppliers (BBI, 2002). In the UK, only a small number of firms concentrate on high-end brands. The majority have abandoned brand-building attempts in favour of the apparent security of manufacturing under retailers' labels for the middle to low market segment. Relationships with powerful retailers remove the need for substantial investments in design and, more so, marketing (Owen and Cannon Jones, 2003: 56). Under-investment is partly responsible for the failure of many UK textile and clothing manufacturers to develop brands and high levels of marketing expertise (TCSG, 2000: 9).

As predicted by the VoC approach, the contrasting patterns of institutional complementarity in LMEs and CMEs have an impact on performance and competitiveness. This is reflected in the divergent export performance of the two national industries. German firms have a relatively high export ratio of 32 percent (Volksbanken Raiffeisenbanken, 2003). Germany accounted for nearly one-fifth of the EU's sales to non-EU countries in 2000 (Euratex, 2002: 86), and its 6 percent export growth rate since 1995 exceeds that of the UK, the US and even Italy (Groemling and Matthes, 2003: 77). British exports, by contrast, were only half the German level in 2000 (Trends Business Research, cited by EMDA, 2001: 21), and trade with both EU and non-EU countries is below the EU average (Euratex, 2002: 105-6). The majority of UK firms we interviewed, even at the higher-quality end, had low or non-existent exports. Exceptions are

brands such as Paul Smith and Burberry, and firms making medium- to highly-priced men's suits.

Although both Germany and the UK have powerful retailers, the index of market concentration in the UK, at 75 percent, is the highest in Europe (Retail Intelligence 2000a: 4, quoted by Baden and Velia, 2002: 62). The spread of large clothing multiples such as Marks & Spencer, the Arcadia group and Next, all of which have powerful own labels, has virtually eliminated UK independent retailers, the remainder of which concentrate strongly on foreign brands (many of them German). In Germany small independents, although in decline, still represent around 38 percent of clothing outlets (Baden and Velia, 2002: 58; BBI, 2002: 3). In both the UK and Germany, supermarkets have rapidly increased their share of the clothing market during the last 20 years (Faust, 2005; Oxborrow, 2005; Wrona, 1999). Both supermarkets and department stores are creating their own labels/brands and are increasing the share of garments sourced directly from foreign suppliers (Faust, 2005, Interview Notes 2004; Oxborrow, 2005; Volksbanken Raiffeisenbanken, 2003). Last, in both countries the seizure of considerable market share by foreign high-fashion and moderately-priced 'New Verticals', particularly Zara and, in Germany, Hennes and Mauritz, poses a strong additional challenge to co-ordinating firms.

In both countries, retail margin pressure has increased strongly during the last decade or so (Retail Intelligence 2000, cited by Baden and Velia, 2002; War on Want, 2001: 8), and retailers have sought cost reductions from suppliers to compensate. However, the negative impact on British clothing firms' margins is much greater because of the high level of buyer and low level of seller concentration (Warren, 2003: 233). Verticalisation, i.e. opening their own shops to gain independence from powerful retailers, was rare in our UK sample. Where firms have tied themselves to only one or a handful of large domestic multiples, they have no significant control over their market. The durability of the relationship is always at risk, since retailers give no procurement guarantees for any one season. German clothing firms, in contrast, can sell their branded products through a variety of domestic and foreign distribution channels, including their own retail outlets.

To sum up, the two national clothing industries clearly contain very different populations of firms, with divergent capabilities, strategies and market ambitions. In the German industry – an example of the 'diversified quality production' associated with CMEs – branded marketers (type 1, according to the typology introduced above) predominate, and 'new verticals' or forward-integrating producers (type 4) are emerging. In the UK, most firms are suppliers to retailers (type 2) and, in the informal sector, we also find CMT firms (type 3)



– a pattern congruent with the strategy of diversified mass production more prevalent in LMEs. Type 5, the backward-integrating retailer, is growing in both countries. Although retailer-buyers are also increasing their market power in Germany, the countervailing power of clothing producers prevents the overwhelming dominance that Gereffi (1994) identifies in the US. The next section examines how the contrasts in capabilities and market strategy between German and UK co-ordinating firms are translated into the organisation of their production networks, with a particular focus on the type of sourcing strategy adopted and the degree of control obtained.

#### **4. Development of Global Production Networks**

The clothing industry is a highly labour-intensive industry in which wages for relatively lowly skilled workers account for a significant share of the production costs. With intensification of competitive pressures from low-wage countries, felt much earlier in Germany than in the UK (see sections III.1 and III.2), the manufacturing function has relocated to countries in Asia-Pacific, the Mediterranean Rim, and Central and Eastern Europe (CEE). In addition to considerations around labour costs, the cost and availability of quota (until January 2005), tariffs, shipping times and the location of fabric producers have shaped the geographical focus and control of GPNs. As fabric is the largest component of final product cost and additionally influences the garment's quality and fashion value, the proximity of good fabric producers to final garment assemblers is a much more important determinant in the construction of GPNs than hitherto realised. Cost calculations then interact in complex ways with considerations around quality and lead time reduction, as well as the reliability of suppliers, to determine the overall sourcing strategy, including the mix of locations. Finally, we suggest that the institutional environment of the home country, due to its strong influence on the level of co-ordinating firms' capability, financial resources and hence their general market strategy, becomes a very important factor influencing sourcing strategy and the nature of the resulting GPNs. Notwithstanding the fact that off-shoring partly serves to escape domestic institutional constraints, their influence still remains notable.

Bearing in mind this complex mix of influences, this section first considers general sourcing strategies of German and UK firms and, second, explores the nature of supplier relationships, along a number of important largely qualitative dimensions. Our analysis of GPNs draws partly on available survey data for the larger picture, and partly on our own interview data to both supplement and expand currently available information. Our data afford an unprecedented insight into the reasoning behind strategy and the quality of relations with suppliers, including such aspects as selection and control, length of relationship

and degree of commitment and reciprocity. This analysis also illuminates the imbalance of power between co-ordinating firms and their suppliers. The resulting configurations are not static. The elimination of quota, together with more incremental developments in both developing countries and domestic clothing markets, necessitate also a brief exploration of recent changes, particularly in general strategy.

The competencies externalised by co-ordinating firms may be described as fairly standard. In principle, they facilitate easy substitution of one supplier firm by another. But suppliers must nevertheless be considered as having complementary capabilities. The quantitative co-ordination of output volume and the qualitative co-ordination of product features, all under intense time pressure, could not take place through purely market links. Supplier relations are subject to contradictory pressures and hence are informed by an incongruous mixture of attitudes and expectations on the part of co-ordinating firms. On the one side, there is the need for close co-ordination to develop acceptable product and process standards and the resulting cultivation of longer-term and in some ways cooperative relations. But on the other side, co-ordinating firms constantly endeavour to hold or preferably reduce the level of product cost – compelled by the relentless pressure for price reduction from retailers, especially those in the competitive lower to middle market segments. Therefore in many ways a purely transactional mode of contracting is practised, with little acceptance of mutual obligation. While this paradoxical make-up was identified within many relationships, we also found differences in weight given to each element between different co-ordinating firms and countries of origin, depending on the products manufactured.

#### **4.1 Types of Strategies and Modes of Sourcing**

To understand the sourcing strategies of co-ordinating firms and the nature of resulting GPNs, we briefly consider two basic elements: 1. the varying combinations of in-house and third party manufacturing, either domestically or off-shore; and 2. the mode of third-party contracting, with each mode implying not only different cost structures and lead times, but also variation in the degree of control over the final product and in the nature of the supplier relationship.

Three basic variants of the make-or-buy decision may be utilised by co-ordinating firms, practised in either pure or dominant form or, more often, in some combination:

- a. Retaining production in the home country, either in self-owned production facilities or by engaging in domestic outsourcing;
- b. Retaining the manufacturing function in fully or partially owned production facilities, through FDI/joint ventures in lower-wage countries;
- c. Manufacturing to order by third-party contractors, with or without an agent as intermediary, usually in low-wage countries in CEE, the Mediterranean Rim or the Far East.

When we examine the mode of third party sourcing, at least three important distinctions have to be made.

I. Cut-make-trim (CMT) – this mode leaves the buying of fabric and trim in the hands of the co-ordinating firm, together with other pre-assembly operations, such as producing sample products and managing the technical aspects of constructing the garment. It is also often described as Outward Processing Trade (OPT) in the context of overseas sourcing, in reference to its (now defunct) implications for customs duty. The disadvantage of the CMT mode is that it requires substantial pre-manufacturing investment in fabric buying and also lengthens the total lead time. More positively, it gives the co-ordinating firm greater input in determining the look, quality and final fit of the product. It relieves the supplier of considerable investment risk but also deprives him of the skill of assembling all the elements of the final product.

II. Full Package (FP) – here the co-ordinating company no longer buys the fabric and trim, although it may retain a greater or lesser degree of influence over purchasing and supplier choice. The fabric is paid for by, and goes directly to the supplier, cutting out one level of mediation and thus reducing lead time. But it also increases the supplier's capital investment and risk, as well as broadening his expertise. As this mode implies some transfer of control over the final product from the western co-ordinating firm to suppliers in lower-wage countries, it paves the way towards the re-integration of steps in the value chain in the hands of the latter. It thus presages the eventual redundancy of western firms' co-ordination function and the full-scale migration of the global clothing industry to newly industrialising countries. Last, the 'full package' mode, where fabric is bought as close as possible to the manufacturing process, favours those countries in the international division of labour which have both viable textiles and garment-assembly industries. Hence an emergent trend towards a stronger adoption of this mode (Adler, 2003, Interview Notes 2003/04) foreshadows significant shifts in order flows between supplier countries and brings about a reconfiguration of GPNs. It is

facilitated and further amplified by the end of the quota system, although suppliers' growing capabilities and financial resources must also be implicated.

III. Direct Buying – direct buying of the finished product without prior input by the western firm is currently used mainly by co-ordinating firms either for very basic garments or for 'filler' items in collections, often as accessories to products designed and developed in house. It is, however, a more prevalent strategy among large retailers.

Although there exists a good deal of commonality in the way German and UK co-ordinating firms utilise and combine these two elements of strategy – make-or-buy and mode of sourcing – the following account predominantly highlights the more interesting contrasts. These, it must be reiterated, are primarily differences between providers of own-brand garments, on the one hand, and suppliers of domestic retailers' own label or standardised garments, on the other, which result from and may be mapped onto two different varieties of capitalism. In the sole UK example of an exclusively 'own-brand' marketer with a high export volume, the sourcing strategy does not fundamentally differ from that of its German competitors. Conversely, the strategy of the only German firm to co-ordinate production solely for retailers' 'own label' garments had something in common with that of several UK firms. But the German firm's substantial export volume nevertheless distinguished it from the highly dependent position of its British counterparts. It gave the firm greater leeway to choose the more cost-effective and flexible option of using third-party suppliers, rather than setting up in-house manufacturing in foreign subsidiaries, as many M&S suppliers did. Table 4 summarises the stance of each of our firms along various dimensions of the supply chain relationship.

**Table 4: Supplier networks and relationships**

	Mode of sourcing	No. of third party suppliers	Importance of firm to supplier(s)' business	Production locations	Length of relationship	Means of control over suppliers
UK-C-1	100% CMT	1	takes 90% of output	Turkey	7 years	on-site QC staff
UK-C-2	some FDI, some FP, some buying in	7-8	takes around 20%, definitely would not want 100%	China, Turkey, Morocco, S.Europe	mix of long and more transient relationships	use agents, roving technicians
UK-C-3	60% foreign JVs, 35% FP, small remaining domestic in-house mfg after recent closures	3	aims for 20-25% of output, be biggest single customer	Turkey, Sri Lanka, Bangladesh, UK	long term, not 'factory-hopping' or 'country-hopping'	occupy designated section of supplier factory
UK-C-4	60% FDI, rest FP/CMT	8	wants at least 50% of output	China, SEAsia, Morocco, CEE	longest is 12 years, but also regards own factory closures as 'core skill'	regular visits from nearby owned factories
UK-C-5	100% CMT	4	takes 100% of output	CEE	10 years	on-site QC staff
UK-C-6	100% FP	14	wants to be sole UK customer; US firms are usually bigger customers	China, some India	about 10 years	low, some technical visits
UK-C-7	mostly FDI; some FP; direct buying of one product. Domestic in-house mfg recently closed	few		CEE; Far East for direct buying	a few years; haven't been mfg outside UK very long	technicians visit regularly
UK-C-8	100% domestic in-house mfg	n/a	n/a	UK	n/a	n/a

UK-C-9	mostly FP, some CMT, tiny residual domestic mfg (recent closures of rest)	many	wants to take 30-40% of output	CEE, China, Egypt	prefers long term	sometimes places technicians with supplier to raise standards
UK-C-10	80% FDI, some CMT	10		China, Sri Lanka, SEAsia, Morocco	longest is 20 years	daily/weekly reporting
UK-C-11	100% CMT		aim not to be sole customer	Italy, China, Morocco	longest is 15 years	regular visits by production staff
GER-C-1	one JV, rest CMT	10 key suppliers, plus >50 others	exclusive customer in many cases	mostly CEE, 10% Germany (but declining), tiny part from Asia	long term	tight control by travelling technical staff; use JV to train others in best practice
GER-C-2	100% FP		no particular policy	China, SEAsia, Turkey, S.Europe	20-35 years	uses agents
GER-C-3	100% CMT	>100	seeks mutual dependence	SEAsia, Turkey, S.Europe, CEE, but strong shift towards China	15-20 years	local offices in Asia; exercises strict control over fabric sourcing
GER-C-4	FDI, CMT, small amount of direct buying, small residual domestic mfg	30-40 key suppliers, plus many others	sometimes 100%		10-30 years (depends on garment)	regular visits by technical staff; local offices
GER-C-5	CMT in CEE, FP in Asia	reducing (prev. high) number	exclusivity in CEE	60% Asia (esp. China); CEE, S.Europe, Turkey	10 years	frequent visits from local office, checks at many stages of mfg
GER-C-6	100% of one process is domestic in-house mfg, but garment assembly is 100% outsourced	19	100% with many	CEE	6-8 years	tech staff based on-site in one country, otherwise trained freelancers
GER-C-7	100% CMT	8 in Asia, unspecified in	normally the biggest customer	China, SEAsia, CEE, Russia	long term	own technicians on-site

		CEE				
GER-C-8	mostly CMT, some JV mfg, 5% domestic in-house mfg		never 100%	mostly CEE; Turkey, Tunisia	7-8 years	German Meister employed as independent controllers
GER-C-9	50% CMT (all in CEE), 50% FP	16	exclusive in one case, takes small share of others' output	CEE, Turkey, S.Europe; Asia (via agents)	aim for long term	roaming technicians, uses some agents
GER-C-10	mostly CMT, 25% FDI, FP in Turkey only, closing residual domestic in-house mfg			40% CEE; Turkey, SEAsia, China (increasing)	long term	own technicians on- site
GER-C-11	mostly CMT, small FDI, some remaining domestic in-house mfg	20	rarely seek exclusivity	mostly CEE, some Turkey, a little HK	10 years	own tech staff on-site, rigorous info-sharing required
GER-C-12	100% domestic in-house mfg	n/a	n/a	Germany	n/a	n/a
GER-C-13	100% CMT but moving towards FP		sometimes demands exclusive use	China, SEAsia, Turkey, CEE	some evidence of moving countries	exclusive use of HK agency for Asian suppliers
CMT = cut-make-trim, FP = full package, FDI = foreign direct investment, JV = joint venture						

## 4.2 Sourcing Strategies of German Co-ordinating Firms

German firms, due to high domestic wage costs and more stringent employment regulation, already began to abandon strategy a. (production in fully-owned or third-party manufacturing facilities in Germany) from the 1970s onwards (Froebel et al., 1980). Nevertheless, several firms in our sample withdrew from Germany very gradually, and some were in the process of relinquishing their last fully owned domestic operations only at the time of our interviews. Two firms (one a fully vertically integrated textiles and clothing manufacturer), for strongly held sentiments of social obligation to their locality, either continued a fully-owned, exclusively domestic production facility or continued to produce a small part (16-18 percent) of output in that way. A third was contemplating closure of its remaining relatively large German factories and since then has executed this plan (GER-C-10). Additionally, a large multinational firm with a decentralised structure and market strategy continues to manufacture in subsidiaries spread over three continents, but retains only a small, somewhat symbolic amount of production at its original German site. Domestic sourcing for short runs and re-orders in Germany, presumably due to the absence of an informal sector and a segmented labour market, is said to be infrequent and instead occurs mainly in neighbouring CEE countries (Donath, 2004). However, a small number of our German respondents mentioned replenishment and repair activity in the home country. Data from a larger interview sample (Adler, 2003: 74, Table 1) put the proportion of turnover from in-house, domestically produced garments in 2002 at 17 percent.

Strategy b., setting up fully owned or joint venture (a rarer choice) manufacturing facilities in lower-wage countries, had been adopted by only a small minority of our German interviewees. No firm adhered solely to this strategy – a result that corresponds with Adler’s finding (*ibid*). In these cases, CEE was the main destination of FDI. While one hands-on owner-manager had no illusion that the only advantage of this strategy was lower costs, another interviewee on the financial side of a large company deemed its East European (EE) enterprise every bit as good as, if not better than, the former German manufacturing operations. The strategy of manufacturing in fully-owned subsidiaries was motivated either by a reluctance to relinquish control or by a wish to utilise the substantial machine park from now-closed German facilities. A foreign facility was viewed as a competence centre, utilised to train third-party suppliers and to work out cost-efficient ‘best practice’ for suppliers to follow. On the debit side, this strategy was widely seen to seriously restrict flexibility of geographical movement and of response to new fashion trends, as well as entailing maintenance and employment costs during quiet periods in the fashion and production cycles.



Strategy c., use of third-party suppliers, is by far the most frequent among German firms. These strategic trends were evident not only in our own sample but also in larger-scale and more quantitative studies (e.g. Adler, 2003). The popularity of the foreign sourcing option rests on the following reasons. It offers a high degree of flexibility; sufficient, even if not complete, control; and a low tie-up of capital. Flexibility here often refers to the possibility of moving on from one supplier to another. Because German firms have, on average, a much higher turnover than their UK counterparts and also retain less in-house foreign production, they had significantly larger supplier networks, encompassing up to 100 very big suppliers and many additional speciality ones in the case of one of the largest firms. Such large and far-flung global production networks require a well honed managerial capability in supply chain management.

Concerning the mode of third party contracting by German co-ordinating firms, we draw on the results of both others' quantitative and our own qualitative studies. Cut-make-trim, and specifically outward processing (OPT) has been by far their most prevalent strategy, and one that has gained in importance since the end of the 1980s (Adler, 2003: 74, table 1). In 1998, Germany had by far the largest share – in terms of value – of outward processed clothing among major European countries (Dunford and Greco, 2004). As this involves co-ordinating firms in the buying of fabric and trim, the making of sample garments and the specification of the more technical aspects of garment sizing and construction, it affords control over the appearance, fit and quality of the garment. This is a course of action congruent with an emphasis on all-round quality and branding, but also entails a longer lead time. In distant second place have come both the 'full package' and the 'direct buying' strategies (Adler, 2003: 74, table 1). Our own data broadly confirm this picture. They additionally show that German firms are less likely than UK firms to use agents to source either fabric or garments. Their stronger capital base presumably enables them to set up the fully-owned bureaux several maintained in the Far East, rather than ceding control and paying the cost premium of using another middle man. Our own data also indicate that 'full package' was significantly more important than 'direct buying' – which, if used, was only to supplement the main strategy in a small way. One large German firm, whose owner-manager had for a long time worked in the US, was unique in using the mode exclusively, as well as being one of only two firms to use agents. Last, the 'full package' strategy seems to be destined for further increase in future, particularly in the Far East. Whether resorting to FP supply will entail some surrender of control over garment quality and appearance will depend on the degree of involvement that firms manage to retain in the selection (rather than buying) of fabric and trim. This overview of the sourcing strategies of German firms still shows the imprint of

the German VoC, but the surrender of ownership control and the preparedness, in some cases, to move between locations in search of lower wages are more consistent with a liberal-market approach.

### **4.3 Sourcing Strategies of UK Co-ordinating Firms**

In the UK, systematic studies of make-or-buy decisions and associated strategies about location and mode of sourcing are not available, and we rely mainly on our interviews to present an account. In contrast to Germany, outsourcing of manufacturing to low-wage countries started very late, from the mid-1990s onwards (BATC, 2003), and during our interviews in 2003 the last vestiges of domestic in-house production were being/had just been surrendered. Hence strategy a. (retaining manufacturing domestically in either fully-owned or third-party facilities) was even more underdeveloped in our British than our German sample of firms. The only fully in-house manufacturing firm was a producer of higher-end knitwear products, where automated machinery is more important than labour. The owner of another longstanding family firm, who had closed most sites only in 2002 and still held on to one small operation, justified these decisions in the following terms: ‘you can’t abandon everything overnight...it’s not all about chasing the dollar’ (UK-C-3). Unfortunately, he has since ceased to trade.

But this picture of the end of domestic production is a partial one. Industry sources reminded us that domestic manufacturing is by no means uncommon in the UK, particularly among the smaller, often ethnic minority-owned firms in the informal sector, to whom we gained no access. The prevalence of this sector, together with the late surrender of the ‘buy British’ policy by Marks & Spencer, is one reason why this strategy continued so much longer in the UK. Using domestic suppliers still is the strategy of some British large retailers (e.g. New Look), and firms in the informal sector are also used for replenishment and experimental short runs. These firms often have several tiers of their own suppliers and use home work (Warren 2003). Pay at or even below the minimum wage, plus few social payments, sustains this practice, which explains the large and continually shifting population of micro firms in a predominantly informal sector (KFAT et al, 2000; Ram et al., 2002; Warren, 2003).

FDI in lower-wage countries (strategy b.), in order to retain an in-house sewing facility, was more prevalent than in Germany. It was found to be the dominant strategy mainly among the firms that supply exclusively to M&S. The rationale for this course of action is best expressed in the words of one CEO: ‘If we didn’t own the factories I’d be sitting here and I’d be worried...Otherwise what value do I add if I am going to a third party? I am only a middleman, so why

doesn't the customer [M&S] go direct?' (UK-C-10). The positive side of ownership was deemed to be the possession of greater control, for example over making factories suddenly alter a line to meet changing demand, and never having the fear of being relegated to the end of the queue to make way for a customer with a bigger order. One firm also mentioned the possibility of influencing governments and establishing good labour relations (UK-C-10). When asked about the negative aspects of ownership, namely being tied to a location where wage levels could rise, two respondents declared their preparedness to move again – 'Closing things down is a core skill, unfortunately' (UK-C-4) – betraying their earlier protestations of favouring longer-term relations.

Strategy c. (outsourcing to independent third-party suppliers in lower-wage countries) was favoured by a majority of UK firms as either the dominant or a supplementary strategy. In contrast to the German situation, the number of each firm's third-party contractors, with one or two exceptions, was much smaller, ranging from only one supplier to at most ten. There also was a greater tendency to use agents, particularly in the Far East, because the greater shortage of capital and human resources did not allow the same degree of professionalisation of supply chain management. The reasons for choosing outsourcing differed subtly from those given in Germany. Some firms simply did not want the financial and organisational burden of having in-house manufacturing: 'I am not in the business of trying to run offshore manufacturing. It's hard enough trying to sell, you know' (UK-C-6) or '[We] don't have the overheads, the warehousing, the headaches, the staffing' (UK-C-1). Others welcomed the flexibility this mode implied, such as being able to accommodate a sudden increase in capacity (UK-C-4). In sum, the two dominant strategies of UK firms were also shaped by domestic institutional influences and market demands. Whereas suppliers to M&S felt compelled to invest in their own production facilities to retain the level of control their exclusive buyer requires, most other firms retained comparatively low indirect control over the final product – consistent with diversified mass production for low-to-middle market domestic retail customers.

Firms that used mainly third-party contractors utilised a mixture of CMT and full package (FP), with slightly higher recourse to FP than among German firms. Lower use of OPT is indicated by more general statistics: outward processing of clothing in 1998, to the value of 444 million Euros, was small compared with Germany's 3,196 million Euros (Dunford and Greco, 2004). Several firms still in the CMT mode indicated that they wished to move towards FP in the future. The reasons for the growing popularity of this mode were

varied, but the fact that it reduced the necessity of longer-term capital investment weighed heavily (e.g. UK-C-9).

#### **4.4 Geographical Locations of German and UK Firms' GPNs**

According to larger-scale surveys of German co-ordinating firms' locational choices, four fifths of outwardly processed clothes came from central and east European states (CEE), plus Turkey (Groemling and Matthes, 2003: 80). Poland and Romania were by far the two most important sources. According to BBI (2002: 24), in 2001, only eight countries among the 23 largest German suppliers were not from CEE, namely Tunisia, Turkey, Morocco, Portugal, Greece, Vietnam, Malaysia and China. Among Asian countries, China is the most popular, with about 4.1 percent of clothing imports having come from Chinese firms during the decade 1990-2000 (Groemling and Matthes, 2003: 49, figure 13b). Our own data broadly support this distribution of supplier locations. Most firms in our sample source exclusively or predominantly from CEE, and practically all have some suppliers in CEE, mostly for reasons of proximity to German design centres and west European markets. But the underdevelopment of the native textiles industry in CEE is now seen by some as a locational disadvantage. Turkey, in contrast, scores highly for the presence of a well developed fabric industry, together with good manufacturing; the absence of customs duties; and the short lead time its proximity to Europe makes possible. But for some of our respondents, China has become or is becoming one of the most important locations, having most of Turkey's advantages, but much lower costs. China widely is considered as having very skilled, flexible and efficient suppliers which, combined with the easy availability of fabric for FP production, makes it the favourite supplier country in Asia. These changes in perceptions about locational advantage are expressed in a marked shift from CEE locations to China since 2002 (Faust, 2005: 37). Because of longer lead times, however, no firm relied exclusively on Asia. One very high-end designer firm even stated it would not consider Asia, 'because of the quality and brand risk', and this firm alone had many of its suppliers in another western European country, Italy.

Information about UK firms' locational choices comes only from our interviewing. It shows a strong focus on countries in Asia Pacific, together with some Mediterranean rim countries. The greater choice of more distant suppliers is consonant with the greater use of full-package, rather than CMT. However, CEE locations were not negligible. A few smaller firms (in terms of turnover) used only CEE locations for either third party contracting or overseas in-house manufacturing, whereas for other firms CEE countries supplemented far-flung locations. Turkey is a popular location for the same reasons as in Germany.

Italy, as was the case with the German designer firm, was highly praised by the one large high-end British designer firm in our sample. Some of the countries where UK firms invested and/or used third party contracting, such as Sri Lanka, Bangladesh, Mauritius and Cambodia, had no evident locational advantages beyond low costs and were rarely, if at all mentioned by our German respondents. As in Germany, many favourable comments were made about China, and several firms intended to increase their presence there.

#### **4.5 The Nature of Supplier Relations**

In this section, we analyse how managers of co-ordinating firms view relationships with their third-party contractors, starting with an exploration of their attempts to mix a purely transactional relationship with elements of relational contracting. In a second step, we highlight the main differences in the ways in which German and UK firms manage the relationship, focusing particularly on the differing degree of control they manage to exert.

The first paradox in building supplier networks and fully-owned facilities is the almost universally expressed wish to build longer-term relationships of around 10 –20 years' duration, while in many, but not all, cases simultaneously expressing the need to retain freedom of movement, to escape feared wage increases. The actual length of relationships – which was much longer for German firms, because of the earlier start in foreign sourcing – showed that footloose behaviour is not rampant in either German or UK firms. But it was nevertheless a strategy that firms in both countries envisaged. 'Every season, we have to work on their quality and on their price level, otherwise we are not married' (GER-C-7), or 'I'd just move again...we only ever plan for seven years in any country, anyway' (UK-C-10). More UK firms seemed intent on chasing price reductions. This must be due to the greater pressure experienced by low to mid-end segment producers from large retailers. Additionally, according to one respondent (UK-C-6), there are financial pressures arising from the high level of gearing accompanying management buy-outs in the late 1990s.

A glance at historical shifts in sourcing locations by firms from both countries confirms a move from countries where labour costs have risen over time, particularly when geo-political transformations have opened up new industrial spaces (Groemling and Matthes, 2003: 80, Interview Notes 2003). But at the same time, there were firms in both countries that had a credible commitment to a longer-term partnership. 'It's a long, very good relationship, we definitely do not move about' (GER-C-7) or 'We do give people the opportunity to put things right...we would not give up a supplier lightly' (UK-C-3).

The reasons provided for cultivating longer-term relations were varied, and, in the case of some UK firms, well illustrate the paradoxical mix of attitudes towards suppliers. Firms in both countries stressed that it can take three or four years to train a supplier to fully understand his western customer's requirements, and two managers with foreign plants claimed that profit is made only in year five (UK-C-10 and UK-C-4). An entirely different reason given by two UK managers was that it is easier to achieve price reductions after a longer association in which trust has been built. 'If you have trust, you get the reduction in price points' (UK-C-2, but also UK-C-9).

Many firms in both countries talked of partnership, give-and-take, trust and gentlemen's agreements. Indeed, many small services were provided by the western firms, and time is granted 'to improve and adapt' (GER-C-11). But, at the same time, most suppliers were given no contract guaranteeing a certain volume of business during a season. Usually they had only promises regarding capacity utilisation and, according to several UK firms, suppliers did not even expect that customer firms kept these promises. 'There is no guarantee, but there is desire and hope, so often they [suppliers] take the risk that they believe us' (UK-C-4). 'They will, you know, reserve production happily for us, but if we don't take it up, it's not a big deal, they'll find someone else' (UK-C-6). Co-ordinating firms receive no guarantees from their retailer customers and hence see themselves as simply passing on the insecurity they are exposed to. Only three (German) firms concluded contractual agreements with firms in CEE, reflecting perhaps the greater juridification of business relationships in Germany (Lane and Bachmann, 1997).

It is clear that, owing to the oversupply of suppliers, co-ordinating firms generally hold the power in their relationships with suppliers. (However, one UK firm pointed out that the power imbalance in relation to retailers was much greater than any power imbalance with their suppliers (UK-C-6).) The degree of leverage enjoyed over suppliers was widely seen as strongly connected to order volume, and many smaller companies were aware that, particularly in comparison with US firms, they do not hold the status of 'preferred' customer. A few firms in both countries attempted to address the issue of volume sourcing by rationalising what had sometimes become an unwieldy supplier base. Hence firms in both countries tried to buy a sufficiently high volume – sometimes (particularly among German firms) 100 percent of any one supplier's capacity – to secure his unfailing commitment. As German firms on average have a significantly larger turnover than UK firms, their ability to achieve control over the supplier through volume buying is bound to be superior.

However, several larger firms made it clear that they would not exploit their power advantage. ‘We do have the leverage, but we tend not to use it to pursue transactional issues’ (GER-C-3). In contrast, one UK manager of a medium-sized firm vividly illustrated the degree of power his firm enjoyed. ‘When I tell them to jump, they only ask “how high”?’ (UK-C-9). A second UK manager recommended to ‘go for the jugular on price’ during quiet periods (UK-C-2).

Another aspect of network management, the criteria for supplier selection, well illustrates some of the different objectives of German and UK co-ordinating firms. When asked for the selection (and retention) criteria, the fairly uniform answer in both countries was ‘price, quality and reliability of delivery’. But the UK managers more often mentioned price first and subsequently re-emphasised the absolute priority of getting a low price/getting down a few price points. This again reflects the high degree of dependence on, and pressure from, large retailers that UK firms are exposed to – ‘every year the opening conversations [with retailers] are always about price, always...Quality comes free’ (UK-C-6). In contrast, several German firms, but only one high-end UK firm, either did not mention price or emphasised that quality was more important than price. ‘Well the most important thing is quality’ (GER-C-5). ‘We do not put cost uppermost, usually we go to countries other suppliers have left, where there is accumulated experience. I do not want them to build experience with our high-end products’ (GER-C-6). Among additional requirements, also illustrating the huge preoccupation with cost saving, was one only mentioned by UK firms – namely, negotiating delayed payment for goods received by up to three months (UK-C-2, UK-C-7, and UK-C-9). A requirement mentioned only by German firms was that the supplier should be well equipped with the latest machinery.

A final important issue to address is how and to what degree vertically dis-integrated firms manage to exert control over their nominally independent third-party suppliers, particularly over the quality of the garments they make. At first sight, it seemed to us that there was no discernible difference between German and UK firms in this respect. Both uniformly expressed themselves highly concerned to safeguard the quality of their supplies and mentioned several similar measures to ensure a high level of control, such as various checking procedures by specially appointed quality control (QC) departments (in large firms) or individual technical employees. QC was particularly stringent among the several suppliers to M&S. But a closer analysis revealed several important differences, indicating more rigorous monitoring by German firms. This was manifested in the following practices: a. unlike FP, CMT sourcing – more prevalent among German firms – gives full control over fabric selection, a critical factor in the appearance and quality of garments; b. more German firms mentioned an iterative process of pre-production control, requiring the supplier

first to send a sample garment for checking and adjustment; c. more German firms conducted double quality checks of garments, both on the supplier's premises and on arrival at their own warehouses; and d. more German firms had permanent technical employees stationed with their suppliers, whereas UK firms more frequently used either roving inspectors or appointed agents to execute QC. Last, but not least, German firms invest considerable effort in training and therefore upgrading their suppliers (Faust, 2005), a practice found less among UK firms. Thus, the remark by Wrona (1999: 161) that production of outsourced garments in reality remains under the influence of the German co-ordinating firm, ensuring virtual vertical integration, is largely confirmed by our research in German firms. 'With our quality control system with production, I think we influence our suppliers heavily, so sometimes they are treated as our own factories' (GER-C-1). For the UK firms, in contrast, such virtual vertical integration did not seem assured, except for those with wholly owned subsidiaries. This well illustrates that the elusive concept of quality may mean different things to different people and that claims of quality assurance should not be accepted at face value.

This overview of the nature of relationships between co-ordinating and supplier firms vividly illustrates the different imprint of the two VoC and of the production paradigm connected with each. Although firms from both countries demonstrated some market-type behaviour, we show that supplier integration and control is significantly more pronounced in German than in UK firms, whereas a search for low costs is more prominent among the latter. These divergent approaches enable German firms to maintain the product standards consistent with diversified quality production and a strategy of branded marketing, whereas UK firms looked more for conditions enabling them to compete on costs. However, the German approach also required greater commitment of effort and cost, obliging them to recreate, in an individualistic way, the level of skill that had been supported by institutional structures in their domestic setting.

## **5. Conclusions**

The paper has advanced a number of theoretical claims and has substantiated them in the light of data on the organisation of the German and UK clothing firms.

It has been shown that, to understand the role of firms in global production networks, one first needs to study them in their domestic context, focusing on their competitive strategies and the different sets of capabilities they have developed to pursue them. We have demonstrated that capabilities shape market



strategies which, in turn, influence the ways in which firms create and govern GPNs. Even though networks are constructed to escape domestic institutional constraints, the latter still structure locational choices and style of network governance.

Our contextualisation of firm strategy has lent support to the VoC framework, confirming the claim that differing financial environments have shaped firm size and ownership, as well as investment behaviour. British firms have been shown to be more atomistic in their development of resources and capabilities. The German institutional environment, in contrast, has facilitated the development of larger Mittelstand firms, with better capital bases and providing more support for skill development, both among remaining higher-level domestic employees and among suppliers' employees.

But we also suggest that the VoC approach may not offer a sufficient explanation for the analysis of cross-border networks. National influences, although important, cannot remain the only explanatory factors. First, global production networks have been established specifically to escape national institutional constraints, such as industrial relations systems and employment regulation. Second, these networks and their constant spatial reconfiguration are additionally influenced by the rules of both global and European trade agreements, which have decisively shaped the industry and firms' networks. Last, these networks are strongly shaped by capabilities in supplier countries, particularly since the end of the 'quota' system has introduced 'freer markets'. We have indicated that locational advantage is particularly strong where a competitive textiles industry and efficient garment assembly facilities exist together, and have explained the increasing drift towards China in these terms. Thus, supplier capability interacts with that of the customer firm, and more work on supplier firms is necessary to examine how institutional effects in developed and developing countries interact in shaping the contours of both GPNs and individual supplier relations.

Our extended study of sourcing strategies of German and UK firms and the nature of the relationships developed with suppliers has focused on notable differences between them. We have shown how different strategic combinations of in-house and third party manufacturing interact with decisions on the mode of third party contracting, as well as with locational choices. We have related these differing patterns to the strategies of 'own brand' versus supply of 'own label' or more standardised goods to diverse domestic and foreign retailers.

The paper has additionally offered an in-depth examination of the nature of network governance, drawing attention to its contradictory mix of relational and ‘market-type’ arm’s length contracting. Although the latter is more developed in the networks of UK firms, German firms do not adhere consistently to more relational contracting. The achievement of lower (than at home) wage costs in both cases motivated the creation of GPNs and, despite a variety of other managerial objectives, remains a strong concern, even if it is not always the dominant one for German firms. However, their considerable investment in training their suppliers (Faust, 2005), while self-interested, also is consistent with a more relational type of contracting.

We have indicated ongoing changes in the construction of GPNs, including a greater shift of responsibility but also of risk to suppliers, and how this is impacting on the international division of labour and the locational shifts within GPNs. Finally, we go beyond Gereffi (1994) and demonstrate that the US pattern of one-sided retailer dominance is only one specific pattern common to firms from LMEs, whereas the market strategy of German firms conforms to the type attributed to CMEs (Hall and Soskice 2001). However, although institutional influences of country of origin remain pronounced even in the construction and governance of networks, GPNs also enable firms to ‘shake off’ some of their constraints and, in a few cases, to develop strategies in a more voluntaristic manner.

## Notes

<sup>1</sup> We maintain confidentiality by disguising clothing company names. Where our observations convey widely expressed views, we refer simply to our ‘Interview Notes’.

<sup>2</sup> Some writers distinguish between the two concepts (e.g Teece et al 1997) but most use them interchangeably as we do in this paper.

<sup>3</sup> Our types differ from those of Gereffi (1994). It no longer makes sense to distinguish between branded marketers and branded manufacturers. Type 2, suppliers of retailers’ own label clothing, is not singled out by Gereffi.

<sup>4</sup> Their report reviews data from the ifo Institute for Economic Research and the Statistisches Bundesamt.

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