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COMMODITY CHAINS AND GLOBAL CAPITALISM

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The Organization of Buyer-Driven Global Commodity Chains: How U.S. Retailers Shape Overseas Production Networks

Gary Gereffi

Global industrialization is the result of an integrated system of production and trade. Open international trade has encouraged nations to specialize in different branches of manufacturing and even in different stages of production within a specific industry. This process, fueled by the explosion of new products and new technologies since World War II, has led to the emergence of a global manufacturing system in which production capacity is dispersed to an unprecedented number of developing as well as industrialized countries (Harris, 1987; Gereffi, 1989b). The revolution in transportation and communications technology has permitted manufacturers and retailers alike to establish international production and trade networks that cover vast geographical distances. While considerable attention has been given to the involvement of industrial capital in international contracting, the key role played by commercial capital (i.e., large retailers and brand-named companies that buy but don't make the goods they sell) in the expansion of manufactured exports from developing countries has been relatively ignored.

This chapter will show how these "big buyers" have shaped the production networks established in the world's most dynamic exporting countries, especially the newly industrialized countries (NICs) of East Asia. The argument proceeds in several stages. First, a distinction is made between producer-driven and buyer-driven commodity chains, which represent alternative modes of organizing international industries. These commodity chains, though primarily controlled by private economic agents, also are influenced by state policies in both the producing (exporting) and consuming (importing) countries.

Second, the main organizational features of buyer-driven commodity chains are identified, using the apparel industry as a case study. The apparel commodity chain contains two very different segments. The companies that make and sell standardized clothing have production patterns and sourcing strategies that contrast with firms in the fashion segment of the industry, which has been the most actively committed to global sourcing. Recent changes within the retail sector of the United States are analyzed in this chapter to identify the emergence of new types of big buyers and to show why they have distinct strategies of global sourcing.

Third, the locational patterns of global sourcing in apparel are charted, with an emphasis on the production frontiers favored by different kinds of U.S. buyers. Several of the primary mechanisms used by big buyers to source products from overseas are outlined in order to demonstrate how transnational production systems are sustained and altered by American retailers and branded apparel companies. Data sources include in-depth interviews with managers of overseas buying offices, trading companies, manufacturers, and retailers in East Asia and the United States, plus relevant secondary materials at the firm, industry, and country levels.¹

PRODUCER-DRIVEN VERSUS BUYER-DRIVEN COMMODITY CHAINS

Global commodity chains (GCCs) are rooted in production systems that give rise to particular patterns of coordinated trade. A “production system” links the economic activities of firms to technological and organizational networks that permit companies to develop, manufacture, and distribute specific commodities. In the transnational production systems that characterize global capitalism, economic activity is not only *international* in scope; it also is *global* in its organization (Ross and Trachte, 1990; Dicken, 1992). While “internationalization” refers simply to the geographical spread of economic activities across national boundaries, “globalization” implies a degree of functional integration between these internationally dispersed activities. The requisite administrative coordination is carried out by diverse corporate actors in centralized as well as decentralized economic structures.

Large firms in globalized production systems simultaneously participate in many different countries, not in an isolated or segmented fashion but as part of their global production and distribution strategies. The GCC perspective highlights the need to look not only at the geographical spread of transnational production arrangements, but also at their organizational scope (i.e., the linkages between various economic agents—raw material suppliers, factories, traders, and retailers) in order to understand their sources of stability and change (see Gereffi and Korzeniewicz, 1990).

Global commodity chains have three main dimensions: (1) an input-output

structure (i.e., a set of products and services linked together in a sequence of value-adding economic activities); (2) a territoriality (i.e., spatial dispersion or concentration of production and distribution networks, comprised of enterprises of different sizes and types); and (3) a governance structure (i.e., authority and power relationships that determine how financial, material, and human resources are allocated and flow within a chain).

The governance structure of GCCs, which is essential to the coordination of transnational production systems, has received relatively little attention in the literature (an exception is Storper and Harrison, 1991). Two distinct types of governance structures for GCCs have emerged in the past two decades, which for the sake of simplicity are called “producer-driven” and “buyer-driven” commodity chains (see Figure 5.1).

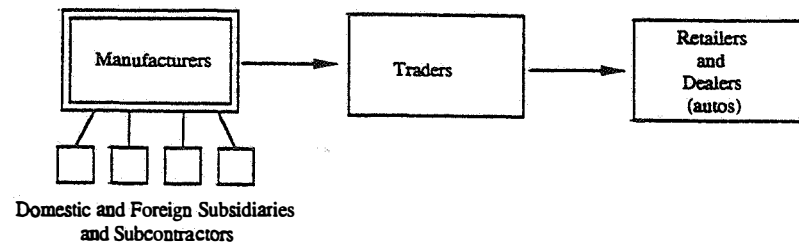
Producer-driven commodity chains refer to those industries in which transnational corporations (TNCs) or other large integrated industrial enterprises play the central role in controlling the production system (including its backward and forward linkages). This is most characteristic of capital- and technology-intensive industries like automobiles, computers, aircraft, and electrical machinery. The geographical spread of these industries is transnational, but the number of countries in the commodity chain and their levels of development are varied. International subcontracting of components is common, especially for the most labor-intensive production processes, as are strategic alliances between international rivals. What distinguishes “producer-driven” production systems is the control exercised by the administrative headquarters of the TNCs.

Hill (1989) analyzes a producer-driven commodity chain in his comparative study of how Japanese and U.S. car companies organize manufacturing in multilayered production systems that involve thousands of firms (including parents, subsidiaries, and subcontractors). Doner (1991) extended this framework to highlight the complex forces that drive Japanese automakers to create regional production schemes for the supply of auto parts in a half-dozen nations in East and Southeast Asia. Henderson (1989), in his study of the internationalization of the U.S. semiconductor industry, also supports the notion that producer-driven commodity chains have established an East Asian division of labor.

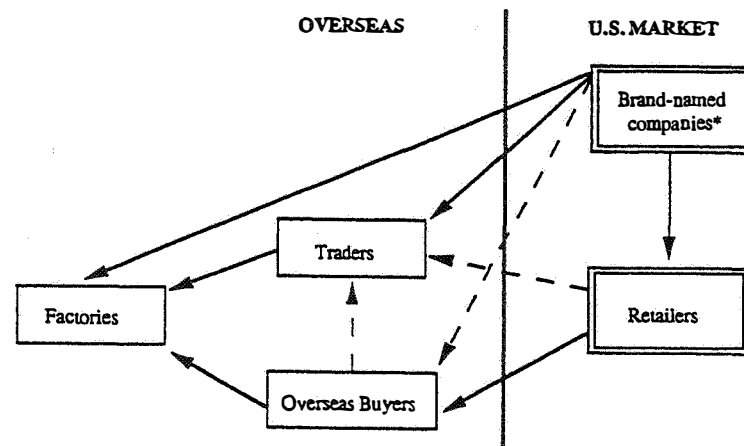
Buyer-driven commodity chains refer to those industries in which large retailers, brand-named merchandisers, and trading companies play the pivotal role in setting up decentralized production networks in a variety of exporting countries, typically located in the Third World. This pattern of trade-led industrialization has become common in labor-intensive, consumer-goods industries such as garments, footwear, toys, consumer electronics, housewares, and a wide range of hand-crafted items (e.g., furniture, ornaments). International contract manufacturing again is prevalent, but production is generally carried out by independent Third World factories that make finished goods (rather than components or parts) under original equipment manufacturer (OEM) arrangements. The specifications are supplied by the buyers and branded companies that design the goods.

Figure 5.1
The Organization of Producer-Driven and Buyer-Driven Global Commodity Chains

1) Producer-driven Commodity Chains
 (Industries such as automobiles, computers, aircraft, and electrical machinery)



2) Buyer-driven Commodity Chains
 (Industries such as garments, footwear, toys, and housewares)



*These design-oriented, national brand companies, such as Nike, Reebok, Liz Claiborne, and Mattel Toys, typically own no factories. Some, like The Gap and The Limited, have their own retail outlets that only sell private label products.

Note: Solid arrows are primary relationships; dashed arrows are secondary relationships.

One of the main characteristics of firms that fit the buyer-driven model, including athletic footwear companies like Nike, Reebok, and L.A. Gear (Donaghu and Barff, 1990) and fashion-oriented clothing companies like The Limited, The Gap, and Liz Claiborne (Lardner, 1988), is that frequently these businesses do not own any production facilities. They are not “manufacturers” because they have no factories.² Rather, these companies are “merchandisers” that design and/or market, but do not make, the branded products they sell. These firms rely on complex tiered networks of contractors that perform almost all their specialized tasks. Branded merchandisers may farm out part or all of their product development activities, manufacturing, packaging, shipping, and even accounts receivables to different agents around the world.

The main job of the core company in buyer-driven commodity chains is to manage these production and trade networks and make sure all the pieces of the business come together as an integrated whole. Profits in buyer-driven chains thus derive not from scale economies and technological advances as in producer-driven chains, but rather from unique combinations of high-value research, design, sales, marketing, and financial services that allow the buyers and branded merchandisers to act as strategic brokers in linking overseas factories and traders with evolving product niches in their main consumer markets (see Rabach and Kim, chapter 6 in this volume; also Reich, 1991).

The distinction between producer-driven and buyer-driven commodity chains bears on the debate concerning mass production and flexible specialization systems of industrial organization (Piore and Sabel, 1984). Mass production is clearly a producer-driven model (in our terms), while flexible specialization has been spawned, in part, by the growing importance of segmented demand and more discriminating buyers in developed country markets. One of the main differences between the GCC and flexible specialization perspectives is that Piore and Sabel deal primarily with the organization of production in *domestic* economies and local industrial districts, while the notion of producer-driven and buyer-driven commodity chains focuses on the organizational properties of *global* industries. Furthermore, a buyer-driven commodity chain approach would explain the emergence of flexibly specialized forms of production in terms of changes in the structure of retailing, which in turn reflect demographic shifts and new organizational imperatives. Finally, while some of the early discussions of flexible specialization implied that it is a “superior” manufacturing system that might eventually displace or subordinate mass production, buyer-driven and supplier-driven commodity chains are viewed as contrasting (but not mutually exclusive) poles in a spectrum of industrial organization possibilities.

Our analysis of buyer-driven commodity chains will focus on the main companies that coordinate these economic networks: large U.S. retailers. Whereas in producer-driven forms of capitalist industrialization, production patterns shape the character of demand, in buyer-driven commodity chains the organization of consumption is a major determinant of where and how global manufacturing takes place. The economic agents of supply and demand do not operate in a

political vacuum, however. They, in turn, respond to political pressures from the state.

THE ROLE OF STATE POLICIES IN GLOBAL COMMODITY CHAINS

National development strategies play an important role in forging new production relationships in the global manufacturing system (Gereffi and Wyman, 1990). Conventional economic wisdom claims that Third World nations have followed one of two alternative development strategies: (1) the relatively large, resource-rich economies in Latin America (e.g., Brazil, Mexico, and Argentina), South Asia (e.g., India and Bangladesh), and Eastern Europe have pursued import-substituting industrialization (ISI) in which industrial production was geared to the needs of sizable domestic markets; and (2) the smaller, resource-poor nations like the East Asian NICs adopted the export-oriented industrialization (EOI) approach that depends on global markets to stimulate the rapid growth of manufactured exports. Although the historical analysis of these transitions tends to have been oversimplified, today it is abundantly clear that most economies have opted for an expansion of manufactured or nontraditional exports to earn needed foreign exchange and raise local standards of living. The East Asian NICs best exemplify the gains from this path of development.

An important affinity exists between the ISI and EOI strategies of national development and the structure of commodity chains. Import substitution occurs in the same kinds of capital- and technology-intensive industries represented by producer-driven commodity chains (e.g., steel, aluminum, petrochemicals, machinery, automobiles, and computers). In addition, the main economic agents in both cases are TNCs and state-owned enterprises. Export-oriented industrialization, on the other hand, is channeled through buyer-driven commodity chains where production in labor-intensive industries is concentrated in small to medium-sized, private domestic firms located mainly in the Third World. Historically, the export-oriented development strategy of the East Asian NICs and buyer-driven commodity chains emerged together in the early 1970s, suggesting a close connection between the success of EOI and the development of new forms of organizational integration in buyer-driven industrial networks.

State policy plays a major role in GCCs. In EOI, governments are primarily facilitators; they are condition-creating and tend not to become directly involved in production. Governments try to generate the infrastructural support needed to make export-oriented industries work: modern transportation facilities and communications networks; bonded areas, like export-processing zones (including China's Special Economic Zones); subsidies for raw materials; customs drawbacks for imported inputs that are used in export production; adaptive financial institutions and easy credit (e.g., to facilitate the obtaining of letters of credit by small firms); etc. In ISI, on the other hand, governments play a much more interventionist role. They use the full array of industrial policy instruments (such

as local content requirements, joint ventures with domestic partners, and export-promotion schemes), while the state often gets involved in production activities, especially in upstream industries.

In short, the role of the state at the point of production tends to be facilitative in buyer-driven commodity chains and more interventionist in producer-driven chains. However, there is an important caveat for buyer-driven chains. Since these are export-oriented industries, state policies in the consuming or importing countries (like the United States) also are highly significant. This is where the impact of protectionist measures such as quotas, tariffs, and voluntary export restraints comes in to shape the location of production in buyer-driven chains. If one compares the global sourcing of apparel (where quotas are prevalent) and footwear (no quotas),³ one sees that far more countries are involved in the production and export networks for clothes than for shoes. This is basically a quota effect, whereby the array of Third World apparel export bases continually is being expanded to bypass the import ceilings mandated by quotas against previously successful apparel exporters. Therefore the globalization of export production has been fostered by two distinct sets of state policies: Third World efforts to promote EOI, coupled with protectionism in developed country markets.

THE APPAREL COMMODITY CHAIN

The textile and apparel industries are the first stage in the industrialization process of most countries. This fact, coupled with the prevalence of developed country protectionist policies in this sector, has led to the unparalleled diversity of garment exporters in the Third World. The apparel industry thus is an ideal case for exploring the organization and dynamics of buyer-driven commodity chains. The apparel commodity chain is bifurcated along two main dimensions: (1) textile versus garment manufacturers; and (2) standardized versus fashion-oriented segments in the industry (see Taplin, chapter 10 in this volume, for a diagram incorporating both of these dimensions). A complete analysis also must take account of how backward and forward linkages are utilized in the apparel commodity chain to protect the profitability of leading firms.

Textile Versus Garment Producers

Textile manufacturers and garment producers inhabit different economic worlds. Textile companies are frequently large, capital-intensive firms with integrated spinning and weaving facilities. The major textile manufacturers "finish" woven fabrics into a variety of end products, including sheets, towels, and pillowcases. While the U.S. fiber industry is composed of TNCs that make synthetic as well as natural fibers, fabric producers are more diverse in size, including numerous small businesses along with industrial giants like Burlington Mills.

The apparel industry, on the other hand, is the most fragmented part of the textile complex, characterized by many small, labor-intensive factories. Two primary determinants explain shifts in the geographical location and organization of manufacturing in the apparel sector: the search for low-wage labor and the pursuit of organizational flexibility. Although apparel manufacturing depends on low wages to remain competitive, this fact alone cannot account for dynamic trends in international competitiveness. Cheap labor is what Michael Porter calls a "lower-order" competitive advantage, since it is an inherently unstable basis on which to build a global strategy. More significant factors for the international competitiveness of firms are the "higher-order" advantages such as proprietary technology, product differentiation, brand reputation, customer relationships, and constant industrial upgrading (Porter, 1990: 49-51). These assets allow enterprises to exercise a greater degree of organizational flexibility and thus to create as well as respond to new opportunities in the global economy.

Standardized Versus Fashion Segments

A second major divide in the apparel commodity chain is between the producers of standardized and fashion-oriented garments. In the United States, the majority of the 35,000 firms in the textile/apparel complex are small clothing manufacturers (Mody and Wheeler, 1987). For standardized apparel (such as jeans, men's underwear, brassieres, and fleece outerwear), large firms using dedicated or single-purpose machines have emerged. Companies that make standardized clothing include the giants of the American apparel industry, like Levi Strauss and Sara Lee (both \$4 billion companies), VF Corporation (a \$2.6 billion company with popular brands such as Lee and Wrangler jeans and Jantzen sportswear), and Fruit of the Loom (a \$1.6 billion firm that is the largest domestic producer of underwear for the U.S. market). These big firms tend to be closely linked with U.S. textile suppliers, and they manufacture many of their clothes within the United States or they ship U.S.-made parts offshore for sewing.⁴

The fashion-oriented segment of the garment industry encompasses those products that change according to retail buying seasons. Many of today's leading apparel firms like Liz Claiborne have six or more different buying seasons every year (Lardner, 1988). These companies confront far greater demands for variation in styling and materials, and they tend to utilize numerous overseas factories because of their need for low wages and organizational flexibility in this labor-intensive and volatile segment of the apparel industry.

It is the fashion-oriented segment of the apparel commodity chain that is most actively involved in global sourcing. In 1990, imports accounted for 51 percent of U.S. consumer expenditures on apparel. Of the \$75 billion spent on U.S. apparel imports (in a total U.S. market of \$148 billion), \$25 billion corresponded to the foreign-port value of imported clothing, \$14 billion to landing, distribution, and other costs, and \$36 billion to the retailers' average markup of 48 percent on imported goods (AAMA, 1991: 3). The consumer's retail price thus amounts

to three times the overseas factory cost for imported clothing. Meanwhile, the wholesale value of domestic apparel production totaling \$73 billion in 1990 was \$39 billion, with another \$34 billion going to the retailers' net markup of 46 percent. In other words, the global sourcing of apparel by major retailers and brand-named companies is big business in the United States and it is growing bigger every year. This is why the organization of global sourcing merits close attention.

The Impact of Backward and Forward Linkages

The severe cost pressures endemic in the labor-intensive segments of the garment industry highlight the interdependence between different economic agents in buyer-driven commodity chains. Throughout the 1980s, U.S. garment companies were demanding lower prices and faster delivery from their overseas (principally Asian) suppliers, as well as their largely immigrant core and secondary contractors in New York City and Los Angeles, who in turn squeezed their workers for longer hours and lower wages (Rothstein, 1989). But the intensity of these pressures has varied over time. Why do the garment manufacturers pressure their contractors more at some times than at others? In a related vein, how can we explain differences in the level and location of profits in this industry over time?

The answers to these questions lie in an analysis of the apparel industry's backward and forward linkages. Garment manufacturers are being squeezed from both ends of the apparel commodity chain. Textile firms in the United States have become larger and more concentrated as they turned to highly automated production processes. This allowed them to place greater demands on the domestic garment manufacturers for large orders, high prices for inputs, and favorable payment schedules (Waldinger, 1986). One response has been for U.S. garment companies to find more competitive overseas suppliers of textiles and fabrics. Since this option is constrained by quotas that limit the extent of U.S. textile imports, many apparel makers had little choice but to accede to the demands of their main domestic textile suppliers.

At the other end of the apparel commodity chain, U.S. retailers went through a merger movement of their own (Bluestone et al., 1981). A number of prominent retail companies have gone into bankruptcy, been bought out, or face serious economic difficulties.⁵ Those "big buyers" that remain are becoming larger, more tightly integrated organizationally and technologically, and frequently more specialized. This has put increasing pressure on merchandise manufacturers to lower their prices and improve their performance.⁶ The result is that garment firms again are squeezed, with negative consequences (e.g., lower purchase prices, increased uncertainty) for their domestic and overseas contractors and the affiliated workers who actually make the clothes.

These illustrations show the importance of considering the full array of backward and forward linkages in the production process, as the GCC framework

does, rather than limiting our notion of transnational production systems to manufacturing alone. Industrial organization economics tells us that profitability is greatest in the more concentrated segments of an industry characterized by high barriers to the entry of new firms. Producer-driven commodity chains are capital- and technology-intensive. Thus manufacturers making advanced products like aircraft, automobiles, and computer systems are the key economic agents in these chains not only in terms of their earnings, but also in their ability to exert control over backward linkages with raw material and component suppliers, as well as forward linkages into retailing.

Buyer-driven commodity chains, on the other hand, which characterize many of today's light consumer goods industries like garments, footwear, and toys, tend to be labor-intensive at the manufacturing stage. This leads to very competitive and globally decentralized factory systems. However, these same industries are also design- and marketing-intensive, which means that there are high barriers to entry at the level of brand-named companies and retailers that invest considerable sums in product development, advertising, and computerized store networks to create and sell these products. Therefore, whereas producer-driven commodity chains are controlled by core firms at the point of production, control over buyer-driven commodity chains is exercised at the point of consumption.

In summary, our GCC approach is *historical* since the relative strength of different economic agents in the commodity chain (raw material and component suppliers, manufacturers, traders, and retailers) changes over time; it also is *comparative* because the structural arrangements of commodity chains vary across industrial sectors as well as geographical areas. Finally, contemporary GCCs have two very different kinds of governance structures: one imposed by core manufacturers in producer-driven commodity chains, and the other provided by major retailers and brand-named companies in the buyer-driven production networks. These have distinct implications for national development strategies and the consequences of different modes of incorporation into the world-economy.

THE RETAIL REVOLUTION IN THE UNITED STATES

In order to gain a better understanding of the dynamics of the governance structure in buyer-driven commodity chains, we need to take a closer look at the U.S. retail sector, whose big buyers have fueled much of the growth in consumer goods exports in the world economy. Changes in America's consumption patterns are one of the main factors that have given rise to flexible specialization in global manufacturing.

For the past two decades, a "retail revolution" has been under way in the United States that is changing the face of the American marketplace. A comprehensive study of U.S. department stores showed that the structure of the industry became more oligopolistic during the 1960s and 1970s as giant de-

partment stores swallowed up many once-prominent independent retailers (Blue-stone et al., 1981). The growth of large firms at the expense of small retail outlets was encouraged by several forces, including economies of scale, the advanced technology⁷ and mass advertising available to retail giants, government regulation, and the financial backing of large corporate parent firms. Ironically, despite the department store industry's transformation into an oligopoly, the price competition between giant retailers became more intense, not less (Blue-stone et al., 1981: 2).⁸

In the 1980s, the department store in turn came under siege. In their heyday, department stores were quintessential middle-class American institutions.⁹ These retailers offered a broad selection of general merchandise for "family shopping," with "the mother as 'generalist' buying for other family members" (Legomsky, 1986: R62).¹⁰ While this format typically met the needs of the suburban married couple with two children and one income, by 1990 less than 10 percent of American households fit that description. Today the generalist strategy no longer works. The one shopper of yesterday has become many different shoppers, with each member of the family constituting a separate buying unit (Sack, 1989).

The breakup of the American mass market into distinct, if overlapping, retail constituencies has created a competitive squeeze on the traditional department stores and mass merchandisers,¹¹ who are caught between a wide variety of specialty stores, on the one hand, and large-volume discount chains, on the other.¹² The former, who tailor themselves to the upscale shopper, offer customers an engaging ambience, strong fashion statements, and good service;¹³ the latter, who aim for the lower income buyer, emphasize low prices, convenience, and no-frills merchandising.

Tables 5.1 and 5.2 show the varied performance levels of some of the major U.S. retail chains in the 1980s and 1990s. In 1990, both Wal-Mart and Kmart surpassed Sears as the largest U.S. retailers in terms of sales (see Table 5.1). Wal-Mart, Kmart, and Target (a division of Dayton Hudson) now control over 70 percent of the booming discount store business in the United States. Wal-Mart and the leading specialty stores also have far better earnings than the department stores and mass merchandise chains. The 10-year compounded growth rates in net income for Wal-Mart (34.5 percent) and the two leading specialty retailers in apparel, The Gap (34.6 percent) and The Limited (33.5 percent),¹⁴ are the highest of any of the stores listed. In addition, the specialty stores tend to have the top rate of return on revenues of any U.S. retailers between 1987 and 1991 (see Table 5.2).

Wal-Mart appears to be in a much stronger position for future growth than its leading challenger, Kmart. In 1990 Wal-Mart cleared \$2 billion before taxes compared to Kmart's \$1 billion on basically the same volume of sales (Saporito, 1991: 54). The performance of companies like Kmart,¹⁵ J.C. Penney, and Woolworth have been hindered by their major corporate restructurings over the past several years. Although the specialty stores are considerably smaller than other

Table 5.1

Sales of Leading U.S. Retailers, 1987–1992 (Billions of Dollars)

	1987	1988	1989	1990	1991	1992
Discounters						
Wal-Mart	16.0	20.6	25.8	32.6	43.9	55.5
Kmart	25.6	27.3	29.5	32.1	34.6	37.7
Mass Merchandisers						
Sears	28.1	30.3	31.6	32.0	31.4	32.0
Dayton Hudson	10.7	12.2	13.6	14.7	16.1	17.9
Woolworth	7.1	8.1	8.8	9.8	9.9	10.0
Department Stores						
J.C. Penney	16.4	15.9	17.1	17.4	17.3	19.1
May Department Stores	10.3	8.4	9.4	10.1	10.6	11.2
Specialty Stores						
Melville	5.9	6.8	7.6	8.7	9.9	10.4
The Limited	3.5	4.1	4.6	5.3	6.1	6.9
The Gap	1.1	1.3	1.6	1.9	2.5	3.0
Toys "R" Us	3.3	4.0	4.8	5.5	6.1	7.2

Source: *Standard and Poor's Industry Surveys*, "Retailing: Current Analysis," April 20, 1989, p. R79; May 2, 1991, p. R80; May 13, 1993, p. R80; and company annual reports.

types of U.S. retailers, the former have the highest ratio of sales per retail square footage of any U.S. retail establishments and they have a reputation for more fashionable and higher quality merchandise.

Unlike the earlier "retail revolution" when department stores became oligopolies, the current surge of specialty and discount formats is less a function of the evolution of retail institutions than of overriding demographic and life style changes in American society. "The fragmentation of the American marketplace . . . reflects the expanding ranks of single-person households, the greater proportion of two-income families, and the sharp rise in the number of working women" (Legomsky, 1986: R62).¹⁶ Furthermore, there has been a widening of the gap between the rich and the poor in the United States.¹⁷ The retail sector has mirrored this dichotomy—stores have either gone upscale or low-price, with middle-income consumers pulled in both directions.

This segmentation of the American market creates numerous opportunities for specialized retail formats. Just as the era of mass production is giving way to flexible manufacturing in the productive sphere, the renowned American mass market is becoming more customized and personalized. This has paved the way for increased trans-Atlantic competition by European and other foreign-based retailers, such as Benetton in Italy and Laura Ashley in the United Kingdom. According to Lester Thurow, professor of economics and management at the Massachusetts Institute of Technology, "The American economy died about 10 years ago, and has been replaced by a world economy. . . . [American retailers] are going to face an international challenge" (Legomsky, 1986: R61).

Table 5.2
Net Income and Return on Revenues of Leading U.S. Retailers, 1987–1991

Company	Net Income ^a (millions of dollars)					Compound Growth Rate (%)			Return on Revenues ^b (%)		
	1987	1988	1989	1990	1991	1-yr.	5-yr.	10-yr.	1987	1989	1991
Discounters											
Wal-Mart	628	837	1076	1291	1608	24.6	29.0	34.5	3.9	4.2	3.7
Kmart	692	803	323	756	859	13.6	8.5	14.6	2.7	1.1	2.5
Mass Merchandisers											
Sears	1649	1032	1446	829	1279	43.4	-1.1	7.0	3.4	2.7	2.2
Dayton Hudson ^c	228	287	410	410	301	-26.6	3.4	6.6	2.1	3.0	1.9
Woolworth	251	288	329	317	-53	NM	NM	NM	3.5	3.7	NM
Department Stores											
J.C. Penney	608	807	802	577	264	-54.2	-13.0	-3.8	3.8	4.7	1.5
May Department Stores ^d	444	503	515	500	515	3.0	6.2	15.1	4.2	5.4	4.9
Specialty Stores											
Melville ^e	285	354	398	385	347	-10.0	7.8	9.8	4.8	5.3	3.5
The Limited ^f	235	245	347	398	403	1.2	12.1	33.5	6.7	7.3	6.4
The Gap ^g	70	74	98	144	230	59.1	27.5	34.6	6.6	6.2	9.1
Toys "R" Us ^h	204	268	321	326	340	4.2	17.4	21.4	6.5	6.7	5.5

Source: *Standard and Poor's Industry Surveys*, "Retailing: Comparative Company Analysis," May 13, 1993, pp. R104-R107.

^a"Net income" refers to profits derived from all sources after deduction of expenses, taxes, and fixed charges, but before any discounted operations, extraordinary items, and dividend payments (preferred and common).

^bNet income divided by operating revenues.

^cDayton Hudson stores include: Target, Mervyn's, Marshall Field's, and Hudson.

^dMay Department Stores Company includes: Lord and Taylor, Filene's, Hecht's, Foley's, Kaufmann's, Robinson-May, Famous-Barr, and Meier & Frank, among others. May also owns the discount footwear chain of Payless ShoeSource stores.

^eShoes ^fGarments ^gToys ^hNM = not meaningful

Department stores and other mass merchandisers in the United States have tried to develop effective counterstrategies to these trends. Some retailers like J.C. Penney have sought to upgrade their status from mass merchandiser to department store by adding higher-priced apparel, and to increase profitability by emphasizing higher-margin merchandise that has a faster turn-around time (Sack, 1989: R80). Other firms have begun to diversify their appeal by establishing their own specialty retail outlets (like the Foot Locker stores, which are owned by Woolworth Corporation).¹⁸ On the international front, retailers and manufacturers alike are acquiring large importers to shore up their position in global sourcing networks,¹⁹ while unique organizational forms such as member-owned retail buying groups are being used in overseas procurement.²⁰

In summary, the transformation of the retail sector in the United States has remained fast-paced throughout the 1980s and 1990s. This reflects not only the changing demography and purchasing power of American society, but as we will see in the next sections, it also proves to be a significant determinant of production patterns within the global economy.

THE ECONOMIC AGENTS IN BUYER-DRIVEN COMMODITY CHAINS

Big buyers are embedded in GCCs through the export and distribution networks they establish with overseas factories and trading companies. In order to understand the structure and dynamics of this relationship, we must first identify the economic agents in buyer-driven commodity chains (retailers, traders, overseas buyers, and factories), and then look at the impact of the main coordinating group (large retailers) on global production patterns.

Retailers

The organization of consumption in the United States is stratified by retail chains that target distinct income groups in the population. There are several types of retailers: large-volume, low-priced discount stores; mass merchandisers; department stores; and "fashion" or upper-end specialized retailers that deal exclusively with national brand-named products. These stores vary in their mixes of nationally branded, store-branded, and unbranded products.²¹ The different categories of retailers also establish distinctive relationships with importers and overseas manufacturers. As one moves down this list of retailers, the quality and price of the goods sold increase, and the requirements for their international contractors become more stringent.

Traders

Trading companies have evolved from the global juggernauts that spanned the British, Dutch, and Japanese empires in centuries past to the highly specialized

organizations that exist today. As recently as twenty-five years ago, there were no direct buying offices set up by U.S. retailers in Asia.²² Originally, American retailers bought from importers on a "landed" basis—that is, the importer cleared the goods through U.S. customs.²³ In the late 1970s, importing began to be done on a "first-cost" basis. The buyer opened a letter of credit directly to the factory and paid the importer (or buying agent) a commission to get the goods to the export port. The buyer handled the shipping and distribution in the United States.

Before retailers established direct buying offices overseas, importers were the key intermediaries between retailers and their foreign contractors. There still is a broad array of specialized importers that deal in particular industries²⁴ or even in specific product niches within an industry.²⁵ While the importers handle production logistics and often help to develop new product lines, the leading apparel companies control the marketing end of the apparel commodity chain through their exclusive designs and brand-named products.²⁶

Overseas Buyers

There is a symbiotic relationship between the overseas buying offices of major retail chains and the role played by importers and exporters. The direct buying offices of major retailers purchase a wide assortment of products, typically grouped into "soft goods" (like garments and shoes) and "hard goods" (such as lighting fixtures, kitchenware, appliances, furniture, and toys). Obviously, it is difficult for these buyers to develop an intimate knowledge of the supplier networks and product characteristics of such a diverse array of items. As a result, retail chains depend heavily on the specialized importers and trading companies that continuously develop new product lines with the local manufacturers and that provide retailers with valuable information about the hot items and sales trends of their competitors.

In general, the U.S.-based buyers for American retailers tend to work with importers and trading companies in the fashion-oriented and new-product end of consumer-goods industries, while their overseas buying offices purchase the more standardized, popular, or large-volume items directly from the factories in order to eliminate the importer's commission. Large retailers usually have their own product development groups and buying offices in the United States for their most popular or distinctive items.

Factories

The factories that produce the consumer products that flow through buyer-driven commodity chains are involved in contract manufacturing relationships with the buyers who place the orders. Contract manufacturing (or specification contracting) refers to the production of finished consumer goods by local firms, where the output is distributed and marketed abroad by trading companies,

branded merchandisers, retail chains, or their agents.²⁷ This is the major export niche filled by the East Asian NICs in the world economy.

In 1980, for example, Hong Kong, Taiwan, and South Korea accounted for 72 percent of all finished consumer goods exported by the Third World to OECD countries, other Asian nations supplied another 19 percent, while just 7 percent came from Latin America and the Caribbean. The United States was the leading market for these consumer products with 46 percent of the total (Keesing, 1983: 338–39). East Asian factories, which have handled the bulk of the specification contracting orders from U.S. retailers, tend to be locally owned and vary greatly in size—from the giant plants in South Korea to the myriad small family firms that account for a large proportion of the exports from Taiwan and Hong Kong.²⁸

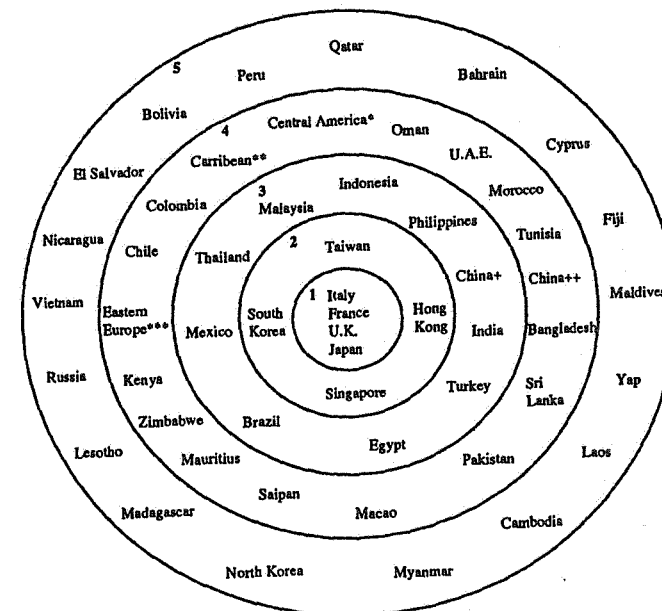
LOCATIONAL PATTERNS OF GLOBAL SOURCING

Big retailers and brand-named merchandisers have different strategies of global sourcing, which in large part are dictated by the client bases they serve (see Figure 5.2 and Table 5.3). Fashion-oriented retailers that cater to an exclusive clientele for “designer” products get their expensive, nationally branded goods from an inner ring of premium-quality, high-value-added exporting countries (e.g., Italy, France, Japan). Department stores and specialty chains that emphasize “private label” (or store brand) products as well as national brands source from the most established Third World exporters (such as the East Asian NICs, Brazil, Mexico, and India), while the mass merchandisers that sell lower-priced store brands buy from more remote tiers of medium- to low-cost, mid-quality exporters (low-end producers in the NICs, plus China and the Southeast Asian countries of Thailand, Malaysia, the Philippines, and Indonesia). Large-volume discount stores that sell the most inexpensive products import from the outer rings of low-cost suppliers of standardized goods (e.g., China, Indonesia, Bangladesh, Sri Lanka, Mauritius, the Dominican Republic, Guatemala). Finally, smaller importers serve as industry “scouts.” They operate on the fringes of the international production frontier and help develop potential new sources of supply for global commodity chains (e.g., Vietnam, Myanmar, Saipan).

Several qualifications need to be mentioned concerning the schematic, purposefully oversimplified locational patterns identified in Figure 5.2 and Table 5.3. These production frontiers represent general trends that can vary by industry, by specific products, and by time period. More detailed analyses that trace the global sourcing of particular products over time are required to explore the factors that lead to shifts in these linkages. Two examples will illustrate the complexity of these arrangements.

The first example focuses on large-volume discount stores such as Kmart and Wal-Mart. According to Table 5.3, they should source primarily from the three outer rings of the production frontiers, but our direct research indicates that these discounters also are prominent buyers in the second ring of East Asian NICs. Why? The reason is twofold. Apparel factories in relatively high-wage countries

Figure 5.2
Production Frontiers for Global Sourcing by U.S. Retailers: The Apparel Industry



- + Southern China
- ++ Interior provinces of China
- Guatemala, Honduras, Costa Rica
- ** Dominican Republic, Jamaica, Haiti
- *** Poland, Hungary, Czechoslovakia, Bulgaria

like Taiwan and South Korea work with anywhere from five to twenty clients (buyers) in a year. Although Kmart and Wal-Mart pay much less than department stores and specialty retailers like Macy's or Liz Claiborne, the factories use these discounters' large-volume orders to smooth out their production schedules so they don't have gaps or downtime. The other side of the equation is the discounter's vantage point. Kmart and Wal-Mart tend to source their most expensive, complicated items in the second-ring countries (e.g., infant's wear with a lot of embroidery). Thus they are using the more expensive and skilled workers in the NICs to produce relatively high-quality merchandise.

A second illustration deals with the upper-end retailers. Large apparel retailers like The Limited and The Gap, and brand-named companies like Phillips-Van Heusen and Levi Strauss, tend to source heavily in the second and third rings of Figure 5.2, but they also buy from countries located in the fourth and even the fifth rings. The reason they are positioned in the outer reaches of the production frontiers is that these companies engage in “price averaging” across their different manufacturing sites. A company like Phillips-Van Heusen, the

Table 5.3
Types of Retailers and Main Global Sourcing Areas

Type of Retailer	Representative Firms	Main Global Sourcing Areas ^a	Characteristics of Buyer's Orders
Fashion-oriented Companies	Armani, Donna Karan, Polo/Ralph Lauren, Hugo Boss, Gucci	First and second rings	Expensive "designer" products requiring high levels of craftsmanship; orders are in small lots
Department Stores, Specialty Stores, and Brand-named Companies	Bloomingdale's, Saks Fifth Avenue, Neiman-Marcus, Macy's, Nordstrom, The Gap, The Limited, Liz Claiborne, Calvin Klein	Second, third, and fourth rings	Top quality, high-priced goods sold under a variety of national brands and private labels (i.e., store brands); medium to large-sized orders, often coordinated by department store buying groups (such as May Department Stores Company and Federated Department Stores)
Mass Merchandisers	Sears Roebuck, Montgomery Ward, J.C. Penney, Woolworth	Second, third, and fourth rings	Good quality, medium-priced goods predominantly sold under private labels; large orders
Discount Chains	Wal-Mart, Kmart, Target	Third, fourth, and fifth rings	Low-priced, store-brand products; giant orders
Small Importers		Fourth and fifth rings	Pilot purchases and special items; sourcing done for retailers by small importers who act as "industry scouts" in searching out new sources of supply; orders are relatively small at first, but have the potential to grow rapidly if the suppliers are reliable

^aFor the countries in each of these rings, see Figure 5.2.

number-one seller of men's dress shirts in the United States, is confident that its quality control procedures will allow it to produce identical dress shirts in its factories in the United States, Taiwan, Sri Lanka, or El Salvador. This also permits these companies to keep some of their production in, or close to, the United States for quick response to unexpectedly high demand for popular items as well as to gain the goodwill of the American consuming public.

Figure 5.2 highlights some methodological difficulties raised by the commodity chains perspective. Nation-states are not the ideal unit of analysis for establishing global sourcing patterns, since individual countries are tied to the world-economy through a variety of export roles (Gereffi, 1989a, 1992). Production actually takes place in specific regions or industrial districts *within countries* that have very different social and economic characteristics (Porter, 1990). Where commodity chains "touch down" in a country is an important determinant of the kind of production relationships that are established with retailers. Thus there can be several forms of international sourcing within a single nation.²⁹

In the People's Republic of China, for example, Guangdong Province has very substantial investments from Hong Kong and Taiwan, while Fujian Province has a natural geographical and cultural affinity for Taiwanese investors. These two provinces in China are part of a Greater China Economic Region that includes Hong Kong and Taiwan (see Chen, chapter 8 in this volume). Thus China falls within both the third and the fourth rings of Figure 5.2: the quality and price of the products made in southern China (third ring) in affiliation with its East Asian NIC partners tend to be higher than for the goods produced in the interior provinces of China (fourth ring), where state enterprises are more prevalent.

Despite these qualifications, several generalizations can be made about the production frontiers identified in Figure 5.2. As one moves from the inner to the outer rings, the following changes are apparent: the cost of production decreases; manufacturing sophistication decreases; and the lead time needed for deliveries increases. Therefore there is a strong tendency for the high-quality, multiple-season "fashion" companies, as well as the more upscale department stores and specialty stores, to source their production from the three inner rings, while the price-conscious mass merchandisers and discount chains are willing to tolerate the lower quality and longer lead times that characterize production in the two outer rings. The "industry scout" role played by certain importers is particularly important for this latter set of buyers, since these importers are willing to take the time needed to bring the new, low-cost production sites located in the fourth and fifth rings into global sourcing networks.

TRIANGLE MANUFACTURING IN GLOBAL COMMODITY CHAINS

How do the countries in the inner rings of our global sourcing chart deal with the maturing of their export industries? What mechanisms are utilized to ensure a smooth transition to higher-value-added activities? One of the most important

adjustment mechanisms for maturing export industries in East Asia is the process of triangle manufacturing, which came into being in the 1970s and 1980s.

The essence of triangle manufacturing is that U.S. (or other overseas) buyers place their orders with the NIC manufacturers they have sourced from in the past (e.g., Hong Kong or Taiwanese apparel firms), who in turn shift some or all of the requested production to affiliated offshore factories in one or more low-wage countries (e.g., China, Indonesia, or Vietnam). These offshore factories may or may not have equity investments by the East Asian NIC manufacturers: they can be wholly owned subsidiaries, joint-venture partners, or simply independent overseas contractors. The triangle is completed when the finished goods are shipped directly to the overseas buyer, under the import quotas issued to the exporting nation. Payments to the non-NIC factory usually flow through the NIC intermediary firm.³⁰

Triangle manufacturing thus changes the status of the NIC manufacturer from a primary production contractor for the U.S. buyers to a "middleman" in the buyer-driven commodity chain. The key asset possessed by the East Asian NIC manufacturers is their longstanding link to the foreign buyers, which is based on the trust developed over the years in numerous successful export transactions. Since the buyer has no direct production experience, he prefers to rely on the East Asian NIC manufacturers he has done business with in the past to assure that the buyer's standards in terms of price, quality, and delivery schedules will be met by new contractors in other Third World locales. As the volume of orders in new production sites like China, Indonesia, or Sri Lanka increases, the pressure grows for the U.S. buyers to eventually bypass their East Asian NIC intermediaries and deal directly with the factories that fill their large orders.

The process of third-party production began in Japan in the late 1960s, which relocated numerous plants and foreign orders to the East Asian NICs (often through Japanese trading companies or *sogo shosha*).³¹ Today, the East Asian NICs, in turn, are transferring many of their factories and orders to China and a variety of Southeast Asian countries. Initially, triangle manufacturing was the result of U.S. import quotas that were imposed on Hong Kong, Taiwan, South Korea, and Singapore in the 1970s. These quotas led to the search for new quota-free production sites in the region. Then in the late 1980s the move to other Asian and eventually Caribbean factories occurred because of domestic changes—increased labor costs, labor scarcity, and currency appreciations—in the East Asian NICs. The shift toward triangle manufacturing has been responsible for bringing many new countries into these production and export networks, including Sri Lanka, Vietnam, Laos, Mauritius, small Pacific islands (like Saipan and Yap), Central America, and Caribbean nations.

The importance of triangle manufacturing from a commodity chains perspective is threefold. First, it indicates that there are repetitive cycles as the production base for an industry moves from one part of the world to another. An important hypothesis here is that the "window of opportunity" for each new production base (Japan—East Asian NICs—Southeast Asian countries—China—Vietnam—

the Caribbean) is growing progressively shorter as more new entrants are brought into these global sourcing networks. The reasons include the fact that quotas on new exporting countries in apparel are being applied more quickly by the United States,³² and technology transfer from the East Asian NICs is becoming more efficient.

The second implication of triangle manufacturing is for social embeddedness. Each of the East Asian NICs has a different set of preferred countries where they set up their new factories. Hong Kong and Taiwan have been the main investors in China (Hong Kong has taken a leading role in Chinese production of quota items like apparel made from cotton and synthetic fibers, while Taiwan is a leader for nonquota items like footwear,³³ as well as leather and silk apparel); South Korea has been especially prominent in Indonesia, Guatemala, the Dominican Republic, and now North Korea; and Singapore is a major investor in Southeast Asian sites like Malaysia and Indonesia. These production networks are explained in part by social and cultural networks (e.g., ethnic or familial ties, common language), as well as by unique features of a country's historical legacy (e.g., Hong Kong's British colonial ties gave it an inside track on investments in Jamaica).

A final implication of the GCC framework is that triangle manufacturing has allowed the East Asian NICs to move beyond OEM production. Most of the leading Hong Kong apparel manufacturers have embarked on an ambitious program of forward integration from apparel manufacturing into retailing. Almost all of the major Hong Kong apparel manufacturers now have their own brand names and retail chains for the clothing they make. These retail outlets began selling in the Hong Kong market, but now there are Hong Kong-owned stores throughout East Asia (including China), North America, and Europe.³⁴ These cycles of change for East Asian manufacturers suggest the need for more elaborated product life cycle theories of Third World industrial transformation.

CONCLUSIONS

The role of the main economic agents in buyer-driven commodity chains is far from static. The sources of change are rooted in economic and political factors, plus the shifting organizational patterns of the distinct segments of GCCs. Several trends are particularly noteworthy. First, there has been an increased concentration of buying power in the leading U.S. retail chains. This has been the result of spectacular growth strategies by a few companies (especially the large-volume discount stores like Wal-Mart in the 1980s and Kmart in the 1970s), slumping performance by several established retail leaders (such as Sears Roebuck and Montgomery Ward), and many bankruptcies in the small- and large-firm retail sector.

Second, at the same time as there has been a consolidation in the buying power of major retail chains, there has been a proliferation of overseas factories (especially in Asia) in most consumer-goods industries. In several notable cases,

like garments and shoes, there is currently a substantial excess production capacity worldwide that will lead to numerous plant closings or consolidations in major exporting countries, such as the People's Republic of China. This combination of concentrated buying power in the retail/wholesale sector and excess capacity in overseas factories has permitted the big buyers in GCCs to simultaneously lower the prices they are paying for goods and dictate more stringent performance standards for their vendors (e.g., more buying seasons, faster delivery times, and better quality) in order to increase their profits.

Third, big buyers are acutely sensitive to political factors that can affect global supply networks and they currently are in a position to alter overseas production patterns accordingly. For example, during the recent debate in the United States about renewing the People's Republic of China's most-favored-nation (MFN) status, several large retailers and importers decided to diversify or curtail their purchases from China.³⁵ This led overseas suppliers to scramble to set up production facilities in nations perceived to be relatively "safe" in terms of domestic political stability (such as Indonesia, Thailand, and Malaysia). In quota-restricted industries like garments, retailers and importers also have taken the lead in encouraging production in countries that have favorable quota arrangements with their main export markets in North America and Europe. In other words, quotas drive overseas investment decisions and thus help shape global commodity chains.

Fourth, the recent recession in the world economy has placed a premium on low-priced goods in developed-country markets. This has strengthened the position of the large-volume discount chains in the retail sector and led retailers and manufacturers alike to look for new ways to cut costs. This further enhances the impact of retailers on overseas production networks.

One trend we might look for in the future is the establishment of consolidated factory groups (perhaps involving linkages between manufacturers and trading companies) to counter the increased leverage of the large buying groups. These could be coordinated by manufacturers in the East Asian NICs, who continue to be the nexus for many of the orders placed by U.S. big buyers. Exporters in the East Asian nations have accounted for much of the technology transfer to lower-cost production sites; they have access to export networks through their established contacts with the U.S. buyers, and they still handle much of the quality control, financing, and shipping needed to get goods to their destination markets in a timely fashion.

Finally, despite the fact that the East Asian NICs have managed to move beyond OEM production through forward as well as backward integration in the apparel commodity chain, the implications of triangle manufacturing for downstream exporters in Southeast Asia, Latin America, and Africa are not so promising. Genuine development in these countries is likely to be truncated by the vulnerabilities implied by their export-processing role in global sourcing networks. The main assets that Third World exporters possess in buyer-driven

commodity chains are low-cost labor and abundant quotas. These are notoriously unstable sources of competitive advantage, however.

Few countries in the world have been able to generate the backward and forward linkages, technological infrastructure, and high levels of local value-added of the East Asian NICs. Even the obvious job creation and foreign exchange benefits of export-oriented industrialization for Third World nations can become liabilities when foreign buyers or their East Asian intermediaries decide because of short-term economic or political considerations to move elsewhere. Triangle manufacturing is most advantageous to the overseas buyers and intermediaries in buyer-driven commodity chains. The long-run benefits for Third World countries occur only if exporting becomes the first step in a process of domestically integrated development.

NOTES

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1. The linkages between big buyers and their strategies of global sourcing were derived from numerous interviews carried out by the author in East Asia and the United States. A wide variety of trading companies, direct buying offices, and factories in Taiwan, Hong Kong, South Korea, and the People's Republic of China were visited in August–October 1991 and September–December 1992. Interviews also were conducted in the headquarters of major U.S. retailers and apparel firms in New York City and Los Angeles during the summers of 1991 and 1992.

2. The absence of factories also characterizes a growing number of U.S. semiconductor houses that order customized as well as standard chips from outside contractors (Weber, 1991).

3. Orderly marketing agreements were imposed by the United States on footwear exporters in Taiwan and South Korea in 1977, but these were rescinded in 1981.

4. This used to be known as 807-production in the Caribbean and the Far East, and *maquiladora* assembly in Mexico. Now there is a new U.S. tariff classification system called the Harmonized Tariff Schedule that replaces the 807 section with a 9802 tariff code. The basic idea in this system is to allow a garment that has been assembled offshore using U.S.-made and -cut parts to be assessed a tariff only on the value added by offshore labor.

5. The much publicized bankruptcy of R. H. Macy & Company in 1992 is a recent example of the competitive problems that have affected the traditional department store (Strom, 1992).

6. Garment manufacturers have been required to add more buying seasons, offer a greater variety of clothes, agree to mandatory buy-back arrangements for unsold merchandise, provide retailer advertising allowances, and so on.

7. These new technologies include: electronic data interchange (EDI), which is a system for communicating to the retailer what is selling well and what needs to be replenished; computerized point-of-service inventory control; merchandising processing systems that monitor cash flows from order placement to shipping to billing and payment; and electronic mail hook-ups for every online store in worldwide networks of retail outlets.

8. Enhanced price competition is compatible with oligopoly because the economies of scale and scope of large-volume discount chains lead to high concentration levels in the retail sector, at the same time as the discounters stimulate considerable price competition because of their low-income customer base.

9. Many department stores carry familiar household names: Macy's, Bloomingdale's, Jordan Marsh, Mervyn's, Nordstrom, Dillard, Filene's, Kaufmann's, Saks Fifth Avenue. Numerous American retail chains today are owned by holding companies, such as the May Department Stores Company, Federated Department Stores, and Dayton Hudson. In Europe, where consumers were more inclined to shuttle from store to store for their individual apparel and accessory needs, the department store never developed into the prominent retailing institution that it has in the mass market of the United States.

10. General merchandise retailers provide a broad selection of "soft goods" (including apparel and home furnishings) and "hard goods" (appliances, hardware, auto, and garden supplies, etc.).

11. The best-known mass merchandising chains are Sears Roebuck & Co., Montgomery Ward, and Woolworth Corporation. These stores are a notch below the department stores in the quality of their merchandise and their prices, but they offer more service and brand-name variety than the large-volume discount retailers. In terms of their overall position in American retailing, though, department stores and mass merchandisers face similar competitive environments.

12. The three most prominent discount chains today are Wal-Mart, Kmart, and Target. Discount chains may focus on a specific product, such as shoes (Payless ShoeSource, Pic 'n Pay, and the 550-store Fayva Shoes retail chain owned by Morse Shoe). Historically, discount retail chains differed from department stores because the former carried broader assortments of hard goods (e.g., auto accessories, gardening equipment, housewares) and they relied heavily on self-service.

13. Department stores have tried to simulate a specialty-store ambience through the creation of "store-within-a-store" boutiques, each accommodating a particular company (like Liz Claiborne or Calvin Klein) or a distinct set of fashion tastes. Similarly, Woolworth Corporation has shed its mass merchandising image by incorporating dozens of specialty formats in its portfolio of 6,500 U.S. stores, including Foot Locker, Champs Sports, Afterthoughts accessories, and The San Francisco Music Box Co. Specialty stores now account for about half of Woolworth's annual revenue, up from 29 percent in 1983 (Miller, 1993).

14. The Gap, one of the most popular and profitable specialty clothing chains in American retailing today, only sells clothes under its own private label. In 1991 The Gap surpassed Liz Claiborne Inc. to become the second-largest clothes brand in the United States after Levi Strauss (Mitchell, 1992). The Limited is another major force in specialty apparel. It is regarded as the world's largest retailer of women's clothing. The Limited is composed of 17 divisions (such as Victoria's Secret, Lerner, Lane Bryant, and Structure), more than 4,100 stores, 75,000 employees, and 1991 sales of \$6.3 billion.

15. Kmart's net income in 1990 recovered to \$756 million, after its nosedive to \$323 million in 1989. One of the areas where Kmart has been lagging, however, is its electronic

data interchange (EDI) systems. In 1990 it embarked on a six-year store modernization program. Kmart management hopes that point-of-sale systems, a satellite network, and automated replenishment combined with just-in-time merchandise delivery will improve the performance of its 2,400 general merchandise stores. Kmart also has 2,000 specialty retail stores, including Waldenbooks, Pay Less Drug Stores, and PACE Membership Warehouse.

16. At the end of 1985, nearly 60 percent of mothers with children under eighteen were working, according to Labor Department figures, up nearly 5 percent from one year earlier.

17. Between 1977 and 1989, the richest 1 percent of American families reaped 60 percent of the growth in after-tax income of all families and an even heftier three-fourths of the gain in pretax income, while the pretax income of the bottom 40 percent of American families declined (Nasar, 1992). Similarly, a detailed study on family income prepared by the House Ways and Means Committee of the U.S. Congress found that from 1979 to 1987 the standard of living for the poorest fifth of the American population fell by 9 percent, while the living standard of the top fifth rose by 19 percent (Harrison and Bluestone, 1990: xi).

18. The eighteen-year-old Foot Locker chain, with 1,500 U.S. stores and \$1.6 billion in annual sales, has generated an entire family of spin-offs, including Kids Foot Locker, Lady Foot Locker, and now World Foot Locker. Woolworth, which already garners 40 percent of its sales in foreign countries, plans to add 1,000 Foot Locker stores in Western Europe by the end of the decade (Miller, 1993).

19. For example, Payless ShoeSource International, the largest U.S. footwear importer, is owned by May Department Stores; and Meldisco, a division of Melville Corporation, handles the international purchasing of shoes for Kmart. Pagoda Trading Co., the second-biggest U.S. shoe importer, was acquired three years ago by Brown Shoe Co., the largest U.S. footwear manufacturer.

20. Associated Merchandising Corporation (AMC) is the world's largest retail buying group. It consolidates the overseas purchasing requirements of 40 member department stores, and it sources products from nearly 70 countries through its extensive network of buying offices in Asia, Europe, and Latin America.

21. Many brand-named companies like Liz Claiborne and Nike don't allow their products to be sold by discount stores or mass merchandisers, which has prompted the proliferation of "private label" merchandise (i.e., store brands).

22. Sears Roebuck, Montgomery Ward, and Macy's were the first U.S. companies to establish direct buying offices in Hong Kong in the 1960s. However, the really big direct orders came when Kmart and J.C. Penney set up their Hong Kong buying offices in 1970; within the next couple of years, these sprawling merchandisers had additional offices in Taiwan, South Korea, and Singapore. By the mid-1970s, many other retailers such as May Department Stores, Associated Merchandising Corporation, and Woolworth jumped on the direct buying bandwagon in the Far East.

23. The early importers with offices in the Far East were Japanese and American companies like Mitsubishi/CITC (a Japanese-U.S. joint venture), C. Itoh, Manow, and Mercury.

24. For example, Payless ShoeSource International, Pagoda, and E.S. Originals are large importers that deal exclusively in footwear.

25. There are different importers for women's shoes versus men's shoes, dress shoes

versus casual footwear, women's dresses versus men's suits, adult versus children's clothes, and so on.

26. Nike, Reebok, and L.A. Gear are the major brand-named companies in athletic footwear, while Armani, Polo/Ralph Lauren, and Donna Karan are premium labels in clothes. However, all of these companies have diversified their presence in the apparel market and put their labels on a wide range of clothes, shoes, and accessories (handbags, hats, scarves, belts, wallets, etc.).

27. "Contract manufacturing" is more accurate than the commonly used terms "international subcontracting" or "commercial subcontracting" (Holmes, 1986) to describe what the East Asian NICs have excelled at. Contract manufacturing refers to the production of finished goods according to full specifications issued by the buyer, while "subcontracting" actually means the production of components or the carrying out of specific labor processes (e.g., stitching) for a factory that makes the finished item. Asian contract manufacturers (also known as contractors or vendors) have extended their production networks to encompass domestic as well as international subcontractors.

28. Taiwan and Hong Kong have multilayered domestic subcontracting networks, including large firms that produce key intermediate inputs (like plastics and textiles), medium-sized factories that do final product assembly, and many small factories and household enterprises that make a wide variety of components.

29. In Mexico, for instance, there is a vast difference between the *maquiladora* export plants along the Mexico-U.S. border that are engaged in labor-intensive garment and electronics assembly, and the new capital- and technology-intensive firms in the automobile and computer industries that are located further inland in Mexico's northern states. These latter factories use relatively advanced technologies to produce high-quality exports, including components and subassemblies like automotive engines. They pay better wages, hire larger percentages of skilled male workers, and use more domestic inputs than the traditional *maquiladora* plants that combine minimum wages with piecework and hire mostly unskilled women (Gereffi, 1991).

30. Typically this entails back-to-back letters of credit: the overseas buyer issues a letter of credit to the NIC intermediary, who then addresses a second letter of credit to the exporting factory.

31. The industries that Japan transferred to the East Asian NICs are popularly known as the "three Ds": dirty, difficult, and dangerous.

32. This may change if a new General Agreement on Tariffs and Trade is signed.

33. After controls were relaxed on Taiwanese investments in the People's Republic of China in the late 1980s, around 500 footwear factories were moved from Taiwan to China in less than two years. Although China recently passed Taiwan as the leading footwear exporter to the United States (in terms of pairs of shoes), it is estimated that nearly one-half of China's shoe exports come from Taiwanese owned or managed firms recently transferred to the mainland (author interviews with footwear industry experts in Taiwan).

34. A good example of this is the Fang Brothers, one of the principal suppliers for Liz Claiborne, who now have several different private-label retail chains (Episode, Excursion, Jessica, and Jean Pierre) in a variety of countries including the United States.

35. During an October 1991 interview in the Hong Kong office of one of the largest U.S. footwear importers, I was told that the American headquarters of the company ordered 25 percent of the importer's purchases from the People's Republic of China to

be shifted to Indonesia within one year to avoid the supply disruptions that would occur if China's MFN status were denied.

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6

Where Is the Chain in Commodity Chains? The Service Sector Nexus

Eileen Rabach and Eun Mee Kim

A significant feature of the current restructuring of capitalism is the extensive atomization of production. This atomization, which is a basic property of capitalism, has accelerated because of tremendous advances made in telecommunications, transportation, and the development of Third World nations during the late twentieth century. Concomitant to the atomization of production has been the globalization of production. Both of these processes necessitate an increasingly important role for services to play in GCCs. Global commodity chain (GCC)¹ research has illustrated how production nodes and activities have multiplied and have spread throughout the world.

Services represent the missing link in global commodity chain research on the restructuring of capitalist production. Service activities not only provide linkages between the segments of production within a GCC and linkages between overlapping GCCs, but they also bind together the spheres of production and circulation. Services have come to play a critical role in GCCs because they not only provide geographical and transactional connections, but they *integrate* and *coordinate* the atomized and globalized production process. Without the integrating and coordinating function fulfilled by services, GCCs would not be viable in today's highly competitive economic environment.

In this chapter we focus on services as a point of entry for the analysis of GCCs. There are three purposes in this chapter. The first is to clearly define the concept "services" and to further distinguish categories of services that are critical for a better understanding of GCCs. The second is to discuss the function of services in GCCs and their significance in "core niches." And lastly, we