Inter-firm relationships and governance structures: A study of the Ethiopian leather and leather products industry value chain

Synopsis of a PhD Dissertation[1]

Tebarek Lika[2]

Background

Over the last two decades, the questions, who are the key actors in value chains? What types of relationships exist between the different actors in value chains? Who makes strategic decisions in the chains? What are the reasons for domestic firms not to enter the global value chain? and, what opportunities and constraints do domestic value chains experience in the manufacturing process? have been high on the agenda of value chain researchers. The current study has contributed to these debates by probing two important domains of chain research: governance structures and inter-firm relationships in the context of a domestic value chain. The study has drawn on several bodies of literature. In particular, it utilized mainstream global value chain research, the analytical framework of institutional economics, paying special attention to transaction cost theory, the network approach to inter-firm dynamics and the literature on social capital and power influences. The inspiration for this study came from the observation that how social networks function within local but also global value chains is still inadequately understood. Up until now, global value chain research has been used to analyze the, often, international distribution of activities and value added in the production of a final good, and, thus, it lacks firm level data at the domestic level. Moreover, relatively little is known about the governance of inter-firm linkages in an African context

---

[1] Defended, November 2010, Bayreuth International Graduate School of African Studies (BIGSAS), University of Bayreuth, Germany.

[2] Assistant Professor, Department of Geography & Environmental Studies, Addis Ababa University.

and the ability of one firm in a chain to influence or determine the activities of other firms. Furthermore, most existing studies on value chain network structures overlook the evolution of inter-firm relationships and their possible impacts on present relations.

Against the backdrop of insufficient knowledge regarding how networks within value chains are horizontally and vertically created and maintained, as well as a lack of research concerning the dimensions and role of social capital in value chains, in particular the relational dimensions of trust, norms, expectations, obligations and identity, their effects and the conditions under which they occur, and how people become close to one another and cooperate, a framework was developed by combining global value chain and network theoretical approaches. Within this framework, the results of this study can be grouped into three main categories.

i) Findings dealing with the institutional and policy environment of the value chain;

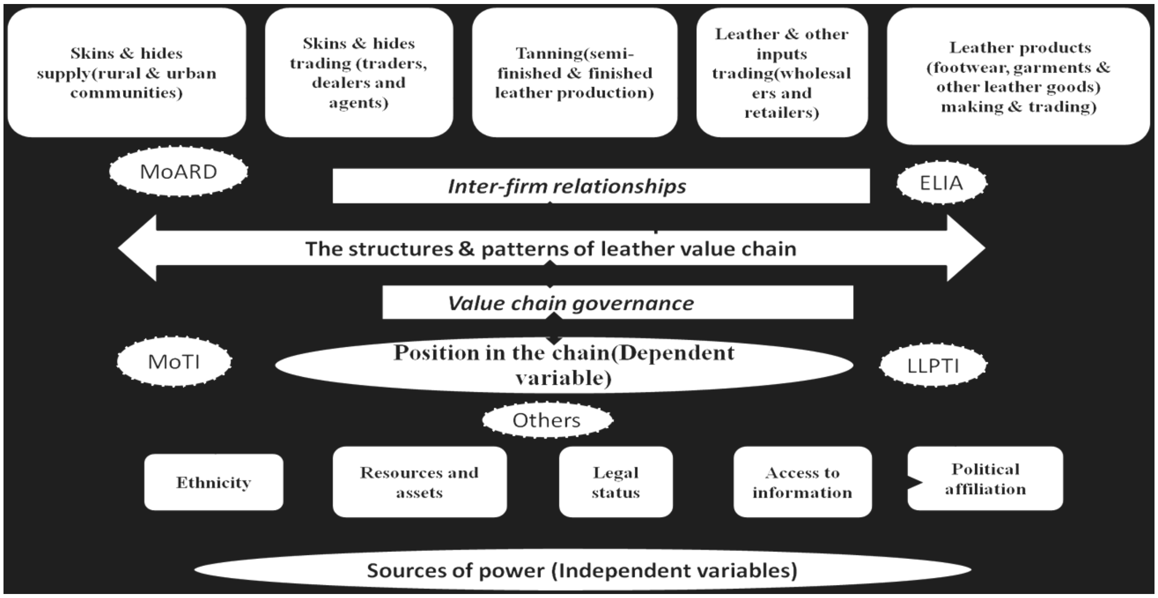
ii) Findings dealing with interaction and cooperation in the value chain; and

iii) Findings dealing with the distribution of power along the value chain.

These findings are discussed in more detail below.

Conceptual Framework of the Study[3]

[3] Note: MoARD=Ministry of Agriculture & Rural Development; MoTI=Ministry of Trade & Industry; LLPTI=Leather & Leather Products Technology Institute; ELIA=Ethiopian Leather Industry Association; Others=NGOs, associations, etc



Source: Own illustration based on the literature & empirical data

Institutional and Policy Environment of the Value Chain

Since it came into power in May 1991, the current Government of Ethiopia has embarked on several reforms, such as the privatization of public enterprises, the liberalization of foreign trade, the deregulation of domestic prices, the devaluation of the exchange rate, the reduction of tariffs and the establishment of private banks and insurance. These reforms, however, have not seen substantial improvements in the country's economy. Productivity remains very low and the country still suffers from poor international competitiveness. The leather and leather products industry is no exception. Although the leather and leather products industry has been regarded as a promising and reliable industry with the capacity to spearhead the entire manufacturing sector, so far this promise has not been fulfilled. The Ethiopian leather and leather products industry is constrained by several bottlenecks related to capacity, information and inputs, as well as the institutional and policy environment. The industry has not been able to penetrate the international market for meat, leather and leather products, even though the country is thought to have a comparative advantage. Although the tanning sector has long been engaged in the export market, its products (mainly in low value added form) remain uncompetitive in international markets. This also applies to the shoe industry. The leather garment and leather goods industry, on the other hand, has been trapped by a multitude of problems mainly rooted in the poor performance of the value chain. To date, the industry has made very little or no contribution to exports. Some of these failures can be related to inefficiencies at the firm level, but most of them are due to institutional and policy factors, such as ambitious reforms, which come only when governments are confronted with losses. Hence most reforms were regime specific and a onetime event. There is a contentious relationship between the state and private sector firms. In general, micro, small and medium enterprises expressed frustration with the government's anti-competitive practices of tax administration, customs and trade regulations, access to land, and preferential treatment with regard to licenses, land leases, accessing some resources and opportunities such as public markets, credit, allocation of foreign exchange and contracts. Although Ethiopia has made great strides in drafting reforms and policy strategies, since the current government took power in 1991, small enterprises find little incentive and support to invest in innovation. In addition, stringent and punitive measures, such as high tax rates, legal action taken against defaulting units and a lack of dialogue between the state and micro, small and medium-scale enterprises, are promoting suspicion, mistrust, individualistic behavior and informality.

Interaction and Cooperation in the Value Chain

The major findings of this study concerning interaction and cooperation in the value chain are:

i) There is limited interaction and cooperation between firms;
ii) The existing inter-firm linkages are predominantly market-based (arm’s length relationship);
iii) Networking based on ethnicity and religion plays an important role in inter-firm linkages; and
iv) Buyers often have advantages while small-scale suppliers face fierce competition with other producers.

With respect to interaction and cooperation between firms, this study has identified three different forms of interactions/linkages: 1) marketing; 2) linkages in the form of 'labor-job' arrangements; and 3) interactions that take the form of associations and welfare groups. The main form of interaction is transaction/market-based. But a form of non-market relations was also observed in memberships to business groupings or associations, where members make regular contributions to a common fund, and when buyers, input suppliers, large or small firms provide financial or material support or information to a community member to set up a business, or provide financial backing to a member so they can obtain a loan from a micro finance institution or from a rotating fund (*equb*). The *Gurage* ethnic group, who has a predominant place in the leather and leather products industry, has a reputation for supporting each other on social issues that may affect their business performance. Another form of linkage, though reported by only a few cases, is in the form of 'labor-job' arrangements, where micro or informal firms are supplied with raw-material or semi-processed finished goods for further processing (e.g. skiving service).

Distribution of Power along the Value Chain

The study has identified that tanneries hold an overwhelming dominance in the Ethiopian leather and leather products industry value chain. Tanneries often have advantages over the supply of finished leather. This has created fierce competition between leather products manufacturers, who often scramble for finished leather supplied by tanneries. The results also highlight that power is concentrated in the hands of a small number of key producers of leather shoe and leather garments. This concentration of power resulted from the streamlining of lead firms, who have rationalized their operations as traders and processors, as well as manufacturers and retailers. Using different sources of power, these firms have gradually increased the scale of their operations and, in the process, have gained considerable economic and even political power. The framework used to analyze the power relationships and governance structures in the Ethiopian Leather and Leather Products Industry Value Chain (LLPIVC) takes into account the role of personal attributes, such as ethnic background and political interest, as sources of power, as well as structural sources of power, such as access to resources, information, position in the division of labor and legal status. However, whether benefits are reaped or not depends on firms’ responses to government policy, which determines the final outcome of the governance structure of the value chain. An interesting finding in the analysis of power distribution along the Ethiopian LLPIVC is that ethnicity and politics can exert considerable influence, effectively locking out less powerful firms from more profitable channels in the chain.

Theoretical Implications

This study’s findings extend previous research on governance and inter-firm relationships in three important ways. First, it demonstrates that studying governance patterns usefully adds to the vast amount of research on governance dynamics across value chains. The findings showed that the majority of Global Value Chain (GVC) research has treated the issue of governance in a functionalist way (simple lead firm-supplier relations) instead of taking a wider perspective of lead firm-supplier relations. While these studies have highlighted the centrality of governance to analyses of global value chains (e.g. Gereffi, 1994; Gereffi and Kaplinsky, 2001; Humphrey and Schmitz, 2001), they have given little insight into the power relations and asymmetries along value chains. By examining factual governance mechanisms and power relations both across value chains and within a single value chain at the level of segments, as well supported by Dolan and Humphrey (2004), Henderson et al. (2002), and Raikes et al. (2000), this study clarifies how power relations originate from, and are transformed by, strategies and practices inside firms as well as beyond.

Second, as well argued by some studies (e.g. Nadvi, 1999; Nadvi, 2008; Murphy, 2002/2003/2006; Sverrisson, 2000; Allen, 2003; Hess, 2004; Hess and Coe, 2006), it is certainly an oversight not to address the functioning of social networks within local but also global value chains, as social relations might play an important and so far neglected role in the struggle to participate in the rapidly changing world economy. Instead of viewing governance as a black box of simple lead firm-supplier(s) relations, which assumes that individuals and institutions exercise control over others, this study showed that by unpacking the enormous wealth of social networks it is possible to see the investment people make, the material and social resources they mobilize in order to make certain network connections work for them, and, how governance is being constituted by the practices of actors. Thus, a network conception of governance proves to be very important. Third, this study adds to research on ethnic entrepreneurship by showing that successful ethnic minorities are not only from urban Europe and/or North America (see among others: Nee and Sanders 1985; Sanders and Nee 1996) or against the misconception by some researchers in successful cases of industrial development in sub-Saharan Africa (e.g. McCormick, 1999), as there are some, though few, successful cases in Africa such as the shoe industry in Addis Ababa, Ethiopia (Bigsten and Söderbom,2006;Gunning and Mengistae, 2001; Sonobe et al., 2009). This study demonstrated that networking along ethnic lines can be a useful mechanism to mitigate economic and social problems, thereby leading to entrepreneurial success. However, although ethnic networks provide effective channels through which inter-firm linkages and value chains can be promoted or strengthened, they also create barriers that can block exchanges between actors in the chain, or they may lead to the exclusion of non-ethnic members.

Methodological Implications

This study followed a mixed-method approach which combined qualitative and quantitative analysis. A mixed-method approach enables research triangulations (to cross check findings) (Voss et al., 2002). The decision to use mixed-methods was driven by the aim to examine the functioning of social networks and micro-level interactions by giving emphasis to socio-cultural, economic, spatio-temporal and political factors as the keys to building and shaping inter-firm relations and for revealing the dynamics of entrepreneurship. On the qualitative side, in depth-interviews and checklists were utilized to study the various processes in, and between, the firms involved at different levels of the value chain, whereas a quantitative analysis was used in the cross-sectional survey, which collected primary data on production and marketing issues. The study demonstrates that a mixed-method approach is an appropriate choice for capturing value chain dynamics at the cluster level and across the value chain. In general, the findings have three methodological implications.

First, it was found that getting reliable data from a business community which is filled with suspicions and secrets is a painstaking endeavor and may lead to unreliable results. However, the results indicate that more reliable data can be gathered through cross-checking perceptions of different actors (buyers-suppliers, producers-buyers, producers-producers, producers-business service providers, buyers-middlemen, producers-middlemen) rather than collecting dyadic data only from buyers and suppliers as most value chain studies do. For instance, this study largely benefited from information collected from indirect sources, such as retail and wholesale shops, input suppliers, middlemen, service providers (such as designers), associations and support institutions, about producers and vice versa for buyers. Second, the results indicate that perception differences among value chain actors towards certain issues can provide good evidence for evaluating loopholes in the value chain. The fact that the study focused on the various segments (i.e. footwear firms, garment firms and tanneries) of the value chain, unlike most previous studies which mainly studied one wing of the value chain, can be considered a strength. This substantiates the argument for a non-linear, flexible and holistic approach to value chain research. The study indicates that the lack of cooperation and transparency among value chain actors has paralyzed horizontal and vertical integration of value chain activities. Therefore, any intervention to promote the value chain should first begin with collecting relevant data from all stakeholders within and across the value chain, as was confirmed in the study. Third, it was observed that being an insider (i.e. being a member of a certain ethnic group) played a decisive role in getting in touch with "the untouchables”. The fact that the principal investigator shares the same ethnic background as most of the sample population allowed for more reliable data collection, as many of the things studied would not, in most cases, be released to an outsider. This is especially true when dealing with a minority group. This study has benefited from being able to attend social gatherings, association meetings and from going to coffee or lunch with some of the value chains' members.

Practical Implications

Implications for the Practice and Entrepreneurship

The study demonstrated a concentration of a certain ethnic group (the *Gurage*) in the leather and leather products industry of Ethiopia. This overrepresentation of *Gurage* entrepreneurs was particularly observed in shoe making. It was found that members of this ethnic group use ethnic networks to mobilize resources and opportunities, which in turn contribute to their success in business. Prior research that targeted this ethnic group corroborate these findings (Taye, 2001; Tegegne, 2009; Sonobe, 2009), as do similar studies in other countries (Portes and Bach, 1985; Light and Bonacich, 1988; Johnson, 2000; Wilson and Portes, 1980). As argued by Granovetter (1985), social networking based on ethnic lines may have positive and/or negative effects on economic development. On the positive side, the existence of ethnic based social networks plays a major role in mobilizing resources, opportunities, building trust and social capital that promote entrepreneurship (Basu, 1998; Rettab, 2001; Light and Bonacich 1988; Johnson, 2000; Wilson and Portes, 1980). This study's results further validate this perspective. In-group ties among the *Gurage* offer certain benefits to entrepreneurs such as rotating credits (*equb*), social security, labor and access to information. On the negative side, social ties in a closed network, such as the leather shoe clusters of Addis Ababa, may constrain entrepreneurs from accessing outside information (Burt, 1992). This study's results also reveal that many shoe making entrepreneurs have limited information about how to access and benefit from global trade. They also lack managerial and accounting skills; indeed, as one key informant from the tanning industry claimed, some of the entrepreneurs are not even aware that they can procure finished leather directly from tanneries. This might be one of the possible reasons that the Ethiopian leather and leather products industry has not been able to acquire adequate competitiveness to penetrate the export market and to benefit from opportunities in global markets for resource productivity and innovation.

Implications for Policy Makers

The findings indicate that micro, small and medium enterprises (MSMEs) play a significant role in employment creation and income generation in Ethiopia. However, government support for MSMEs is minimal. Many MSMEs operators expressed the view that current government policy and/or practice favors large enterprises. MSMEs generally expressed concern that the Ethiopian political and economic environment does not adequately promote and support the growth of MSMEs. Informants also reported differential treatment of certain ethnic and politically affiliated groups. Such tendencies encourage corruption and nepotism. As argued earlier, in the absence of fair treatment and efficiency in implementing laws, small enterprises are not likely to use mainstream business support agencies such as micro-finance institutions, often relying instead on self-help and informal sources of assistance. It is, therefore, essential that the government and support agencies address MSMEs' bottlenecks through concrete actions in the development of industry know-how, business management, credit schemes and public-private dialogues.

Conclusion

The idea for the current study first developed after observing a gap in the literature on value chain research. The studies carried out to date are either too general, thus missing the micro context, or are simply functionalistic and, therefore, fail to address the socio-cultural context. In contrast, the current study addresses both. Data was collected from all stakeholders within and across the value chain, allowing for a thorough view of the many and different features which constitute the chain. However, such an approach is time and energy consuming. This attempt to qualitatively examine the power distribution in the Ethiopian leather and leather products industry value chain may be taken as a good start to fill the literature gap. However, the fact that the investigation was limited to only a few select cases might be criticized as insufficient to capture the complexities of the entire value chain. Nevertheless, the framework employed in this study sought to provide a means of dealing with such complexity. Applying both qualitative and quantitative methodologies also allows for more detailed information. Future research should take into account some of the missed elements in this study, such as using advanced quantitative models to empirically test the bases of power and the extent to which governance or power is exercised in a value chain. In fact, very few studies of value chain governance use quantitative models. Similar research is needed in other sectors in order to gain deeper insight into the distinct features of ethnic entrepreneurship and how this operates within value chains. More importantly, future research should focus on exploring the evolution and dynamics of entrepreneurial talents and success by certain ethnic groups. In this regard a longitudinal study approach may work better.

Finally, the current study focused on the domestic level of the value chain since there are very few cases where domestic firms are linked with foreign firms in Ethiopia. In the next five or ten years, one should see an increase in Ethiopian leather exports as initial preparations are being worked out. This would create an opportunity to analyze the interface between domestic and global value chains. Therefore, future studies of this value chain should consider the link between domestic and global value chains.

References

Allen, J. 2003. *Lost Geographies of Power*. Oxford: Blackwell.

Basu, A. 1998. An exploration of entrepreneurial activity among Asian small business in Britain. *Small business economics*, 10(4): 313-326.

Bigsten, A. and Söderbom, M. 2006. What have we learned from a decade of manufacturing enterprise surveys in Africa? *World Bank Research Observer*, 21: 241-265.

Burt, R.S. 1992. *Structural Holes: The Social Structure of Competition*. Cambridge, MA: Harvard University Press.

Dolan, C. and Humphrey, J. 2000. Governance and trade in fresh vegetables: The impact of UK supermarkets on the African horticulture industry. *Journal of Development Studies*, 37(2): 147-176.

Gereffi, G. 1994. 'The organization of buyer-driven global commodity chains: How U.S. retailers shape overseas production networks', in G. Gereffi and M. Korzeniewicz .(eds.),*Commodity chains and global capitalism*, (pp. 95-122). Westport: Praeger.

Gereffi, G. and Kaplinsky, R. (eds.). 2001. The value of value chains. *IDS Bulletin*, 32(3), special issue.

Granovetter, M.S.1985. Economic action and social structure: The problem of embeddedness. *American Journal of Sociology*, (91): 481–510.

Gunning, J. W and Taye, M. 2001. Determinants of African manufacturing investment: The microeconomic evidence. *Journal of African Economies*, (10): 48-80.

Henderson, J., Dicken, P., Hess, M., Coe, N. and Yeung H.W.C. 2002. Global production networks and the analysis of economic development. *Review of International Political Economy,* 9(3): 436–464.

Hess, M. 2004. Spatial relationships? Towards a reconceptualization of embeddedness. *Progress in Human Geography,* 28(2): 165-186.

Hess, M. and Coe, N.M. 2006. Making connections: Global production networks, standards, and embeddedness in the mobile-telecommunications industry. *Environment and Planning A*, 38(7): 1205-1228.

Humphrey, J. and Schmitz, H.2001. Governance in global value chains. *IDS Bulletin*, 32(3): 19-29.

Johnson, S. 2000. Literature reviews on social entrepreneurship. Edmonton: Canadian Centre for Social Entrepreneurship.

Light, I. and Bonacich, E. 1988. Immigrant Entrepreneurs: Koreans in Los Angeles, 1965-1982. Berkeley: University of California Press.

McCormick, D. 1999. African enterprise clusters and industrialization: Theory and reality. *World Development*, (27): 1531–1551.

Murphy, J.T. 2002. Networks trust and innovation in Tanzania’s manufacturing sector. *World Development*, 30(4): 491-519.

______2003. Social space and industrial development in East Africa: Deconstructing the logics of industry networks in Mwanza, Tanzania. *Journal of Economic Geography*, 3(2): 173-198.

______2006. The socio-spatial dynamics of creativity and production in Tanzanian industry: Urban furniture manufacturers in a liberalizing economy. *Environment and Planning A*, 38(10): 1863-1882.

Nadvi, K. 1999. Shifting Ties: Social networks in the surgical instrument cluster of Sialkot, Pakistan. *Development and Change*, 30(1): 143-177.

______2008. Global standards, global governance and the organization of global value chains. *Journal of Economic Geography*, 8(3): 323-43.

Nee, V. and Sandres, J. 1985. The road to parity: Determinants of the Socio-economic Achievements of Asia-Americans. *Ethnic and Racial Studies*, (8): 75-93.

Portes, A. and Bach R. 1985. Latin journey: Cuban and Mexican immigrants in the United States. New York: University of California Press.

Raikes, P., Jensen, M.F, and Ponte, S. 2000. Global commodity chain analysis and the French Filiere approach: comparison and critique. *Economy and Society*, 29(30): 390-417.

Rettab, B. 2001. The emergence of ethnic entrepreneurship: A conceptual framework. Research Report H200103, Zoetermeer: EIM.

Sandres, J. M. and Nee, V. 1987. Limits of ethnic solidarity in the enclave economy. *American Sociological Review,* 52: 745-73.

Senobe, T. 2009. An exploration into the successful development of the leather shoe industry in Ethiopia. *Review of Development Economics*, 13(4): 719-736.

Sverrisson, A. 2000. Economic cultures and industrial development in the South. In Sverrisson, A. and Van Dijk, M.P. (eds.), *Local Economies in Turmoil: The Effects of Deregulation and Globalization.* New York: St. Martin's Press.

Taye, M. 2001. Indigenous ethnicity and entrepreneurial success in Africa: Some evidence from Ethiopia. Retrieved from HUhttp://econ.worldbank.org/files/1387_wps2534.pdf UH.

Tegegne,G. 2009. Small scale footwear production in Ethiopia: A value chain perspective, in Dorothy McCormick, Joseph A.Kuzilwa and Tegegne-Gebre-Egeziabher. (eds.), *Industrializing Africa in the era of globalization: Challenges to clothing and footwear*. Nairobi: University of Nairobi Press.

The development of the footwear industry in Ethiopia: How different is it from the East Asian experience. Miemo, Foundations for Advanced Studies on International Development. Sonobe, T., Akoten, J. and Otsuka, K.2009. An exploration into the successful development of the leather shoe industry in Ethiopia. *Review of Development Economics*, 13(4): 719-736.

Voss, C., Tsikritktsis, N. and Frohlich, M. 2002. Case research in operations management. *International Journal of Operations and Production Management* 22(2): 195-219.

Wilson, K.L. and Portes, A. 1980. Immigrant enclaves: An analysis of the labor market experiences of Cubans in Miami. *American Journal of Sociology,* 86(2): 295-319.