When Value Chains Go South:

Governance and Upgrading of the Kenyan Leather Sector

Thesis submitted in partial fulfilment of the requirements for the Degree of Doctor of Philosophy

by

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Thesis Abstract

In the last three decades, the global economy has witnessed an ambivalent phenomenon of integration through disintegration. Whilst the amount of regional and global trade dramatically increased, vertical specialisation prompted the outsourcing of manufacturing, assembling, and other business functions regionally and globally. The slicing up of value chains and the consequent surge in trade of intermediate goods drew the attention of scholars interested in the economic, social, and environmental consequences of this phenomenon. Yet, most of the literature on value chains has concentrated on the institutional and market linkages between firms in developed economies and delocalised suppliers in the global South. Conversely, less attention has been paid to the rise in South-South trade that accompanied the development of South-South and regional value chains.

The following chapters provide new evidence on the opportunities and constraints that participation in value chains across North-South, South-South, and regional trajectories entails for local suppliers in developing countries. This is achieved by means of a mixed-methods approach that combines firm-level export data with over 100 semi-structured interviews across the Kenyan leather sector.

On the one hand, results show how North-South value chains are characterised by more profitable and stable relationships between buyers and local suppliers. Nonetheless, whilst defined by higher product and process standards, linkages with developed economies appear to prevent rather than encourage local value addition. On the other hand, South-South value chains are governed by instability and distrust underpinned by pressures to reduce prices and lack of upgrading opportunities.

Like the global South, regional value chains are characterised by fierce competition and low profitability. Even so, they often constitute an alternative for small suppliers willing to venture into new products and functions. Particularly, the local and regional markets represent an upgrading platform for innovative firms whose low capital endowments prevent them from accessing premium North-South value chains. In this case, industrial policy and entrepreneurship play a crucial role in enabling smallholders to upgrade in a competitive environment.

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It is a rare privilege to spend four years of your life on a research project you are passionate about. What is even rarer is to find an academic mentor and supervisor to guide you through this project, providing prompt and continuous feedback while being a source of inspiration for your future career. I found two. From the moment I discussed my research proposal with them, Professors Xiaolan Fu and Diego Sanchez-Ancochea advised me regularly on how to frame my research, design and carry out fieldwork, and interpret final results while thinking rigorously about my epistemic and methodological framework. I am grateful to them for taking the time and passion to build my research skills and make me grow as a critical thinker.

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Abbreviations

AGOA	African Growth and Opportunity Act
AHITI	Animal Health and Training Institute
BRICS	Brazil, Russia, India, China, and South Africa
CAD	Cash against documents
CAK	Cobblers Association of Kenya
CMT	Cut, make and trim
COMESA	Common Market for Eastern and Southern Africa
COMESA-LLIP	COMESA-Leather and Leather Products Institute
CSR	Corporate Social Responsibility
EAC	East African Community
EOI	Export oriented industrialisation
FAO	Food and Agriculture Organization of the United Nations
FD	First-differenced
FE	Fixed-effect
Ftw-	Footwear manufacturer (followed by a unique code for each firm)
GI	Governance Index
GPNs	Global production networks
GVCs	Global value chains
Hnb-	Handbag manufacturer (followed by a unique code for each firm)
HS	Harmonized Commodity Description and Coding Systems
ICT	Information and communications technology
ILO	International Labour Organization
int.	Interview (used in brackets to indicate a quote from an interview, whenever the interviewee is not previously mentioned in the text)

IS	Import substitution
ITC	International Trade Centre
JKUAT	Jomo Kenyatta University of Agriculture and Technology
KAM	Kenya Association of Manufacturers
KEBS	Kenya Bureau of Standards
KFMA	Kenya Footwear Manufacturer Association
KhS	Kenyan Shilling
KIE	Kenya Industrial Estate Programme
KIRDI	Kenya Industrial Research and Development Institute
KITI	Kenya Industrial Training Institute
KLDC	Kenya Leather Development Council
KNBS	Kenya National Bureau of Statistics
KRA	Kenya Revenue Authority
KSLWU	Kenya Shoe and Leather Workers Union
KTA	Kariokor Traders Association
LAEA	Leather Articles Entrepreneurs Association
LC	Letter of Credit
LDCs	Least developed countries
LPM	Linear probability model
NEMA	National Environment Management Authority
OBM	Original brand manufacturer
ODM	Original design manufacturer
OECD	Organization for Economic Co-operation and Development
OEM	Original equipment manufacturer
OLS	Ordinary least squares
PCS	Pooled cross-sections
RBV	Resource-based view

RVCs	Regional value chains
SEs	Standard errors
SI	Size Index
SMEs	Small and medium-sized enterprises
Tan-	Tannery (followed by a unique code for each tannery)
TPCSI	Training and Production Centre for the Shoe Industry
ULAIA	Uganda Leather and Allied Industries Association
UNCTAD	United Nations Conference on Trade and Development
UNECA	United Nations Economic Commission for Africa
UNIDO	United Nations Industrial Development Organization
USD	US Dollars
WTO	World Trade Organization

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1.

A new geography of trade

1.1 Introduction

The rise of new global players such as Brazil, Russia, India, China, and South Africa (BRICS) has prompted the formation of a new geography of trade. Driven by these emerging economies, the share of South-South exports grew from 13% to nearly 25% between 2001 and 2011, with developing countries now exporting more to other developing economies than to the developed North.[1] This process has been accompanied by the formation of South-South and regional value chains, where the production and distribution of goods and services is coordinated among buyers and suppliers located in developing economies.

Whilst the linkage between multinational firms in the North and suppliers in the global South has been long debated in the literature, the impact that these new actors have on the governance of South-South market relationships is still in need of further research. With few notable exceptions (Kaplinsky & Farooki 2010; Kaplinsky et al. 2011; Nadvi 2014; Nadvi & Halder 2005; Navas-Alemán 2011; Horner 2016), the research agenda has ignored the significance that this new geography of trade has in

[1] According to Shirotori (2013), as of 2011, 56% of total exports from the South were directed to other developing countries (compared to about 41% in 2000). The same estimate from UNCTAD (2015), which excludes fuels, points to about 50% of the total exported value.

shaping buyer-supplier relationships. Moreover, studies comparing South-South and North-South value chains have often lacked methodological consistency.

This dissertation analyses whether and how North-South, South-South, and regional value chains differ in terms of their implications for local suppliers in developing countries. This is achieved through a mixed-method approach combining quantitative data analysis of firm-level export transactions with over 100 semi-structured interviews at different stages of the Kenyan leather value chain. As explained in chapter two, the case study was selected by virtue of its potential for value creation and because it spans North-South, South-South, and regional value chains.

The outcome of the study shows how North-South value chains are characterised by more profitable and stable relationships between global buyers and local suppliers. Nonetheless, whilst defined by higher product and process standards, linkages with developed economies appear to prevent rather than encourage local value addition. Conversely, South-South value chains are governed by instability and distrust underpinned by pressures to reduce prices and a lack of upgrading opportunities.[2]

Like the global South, regional value chains are characterised by fierce competition and low profitability. Nevertheless, they represent a unique source of opportunities for small suppliers willing to venture into new products and functions. Particularly, the region constitutes an upgrading platform for innovative firms whose low capital endowments prevent them from accessing premium northern markets. Here, elements of industrial policy and entrepreneurial strategy play a fundamental role in favouring smallholders' successful social and economic upgrading. The recent

[2] However, this result is not consistent across the global South, with China representing a less stable yet more profitable market compared to other southern buyers such as India and Pakistan.

emergence of the Kenyan leather handbag industry described in chapter seven is indicative in this respect.

The findings of this study have broader analytical implications for how participation in agro-based value chains affects producers in other parts of the world. Moreover, the methodological framework is constructed to allow for further testing by means of a comparative approach between, rather than just within value chains.

Overall, this study addresses a theoretical and analytical gap while speaking to a concrete socio-economic problem (King et al. 1994, p.15). Concerning the first, the research adopts an interdisciplinary approach that bridges the literature on global value chains (GVCs) and global production networks (GPNs) with the scholarship on innovation and technology, incorporating the latter's hypotheses on the effect of South-South trade. Furthermore, by adopting a mixed-methods approach, this study increases the descriptive and causal inference of a literature mostly dominated by qualitative case studies.

Concerning its relevance to a socio-economic problem, this thesis constitutes a unique attempt at analysing the obstacles and opportunities affecting practitioners across the Kenyan leather value chain. Moreover, to the extent that some analytical findings can be extended and tested across countries and sectors, the following chapters represent a useful evaluation of how economic and social gains are captured and distributed within global, regional, and local value chains. In this sense, the study speaks to national and international actors interested in favouring the growth of agro-based sectors while nurturing the wellbeing of their players.

The rest of this chapter is organised as follows. Section 1.2 discusses the dynamics linked to countries' participation in GVCs, while section 1.3 examines some

implications of South-South trade and introduces the thesis' research question. Finally, section 1.4 summarises the structure of the dissertation by chapter.

1.2 Participation in value chains: the smile curve

Globalisation has been characterised by an ambivalent phenomenon of integration through disintegration. On the one hand, under the influence of neo-liberal policies in the 80's and 90's, regional markets have undergone an unprecedented process of unification bringing about a dramatic increase in trans-border capital flows through portfolio financial operations and foreign direct investments (Bordo 2003; Obstfeld and Taylor 2003). On the other hand, this process has been accompanied by what Robert Feenstra (1998) has defined as the "disintegration of production" whereby different stages of production have been outsourced nationally and internationally as companies found it more convenient to do so (Milberg 2004, 54; Arndt and Kierzkowski 2001; Gereffi et al. 2013, 79).

In this context, the value chain as "a network of labour and production processes whose end result is a finished commodity [or service]" (Wallerstein & Hopkins 1986, p.17) has witnessed a pattern of global dispersion. Lead-firms in developed countries have increasingly focused on high-returns competences, *externalising* less profitable up- and downstream activities to benefit from enhanced competitiveness and lower labour costs (Baldwin 2013, pp.31–32; Milberg 2004, pp.60–61; Palpacuer et al. 2005).[3]

For their part, several developing countries embraced participation in GVCs as a unique opportunity to re-locate productive activities inside their borders, supporting not only economic growth but also better working conditions and improving social standards (Gereffi 1994; Flanagan 2005, p.84). The rationale was that if developing

[3] For a detailed explanation of dispersion and agglomeration forces within GVCs, see Baldwin (2013, pp.31–34) and Cattaneo et al. (2013, p.3).

economies cannot supply a whole product or service competitively, they can at least capture part of the gains by specialising in particular segments of the value chain (Jones et al. 2005; UNECA 2015, pp.98–99). In this way, integration into GVCs has been seen as a way of "putting firms on potentially dynamics learning curves" facilitating innovation transfer and human resources development (Gereffi 1999, p.39; Gereffi 2014, p.18; AfDB et al. 2014, p.15; Altenburg 2000).

Different studies have shown how participation in GVCs correlates with increased employment rates and wages (Maertens & Swinnen 2009; Flanagan 2005, p.129), higher demand for skilled-labour force, and higher proportions of female labourers (Shepherd & Stone 2012). Furthermore, vertical integration into GVCs has been associated with capacity building of peripheral suppliers through knowledge-transfer from more experienced lead-firm (Gereffi 1994; Humphrey 2004, pp.10–11; Schmitz 2006, pp.555–557). In a nutshell, by entering GVCs, developing countries seize a chance to defy their traditional comparative advantages, profiting from specialisation in more rewarding activities, and participation in premium markets (Hobday 1995, p.40; Cattaneo et al. 2013, pp.5–7).

Nevertheless, many other studies in the GVCs literature question such an optimistic interpretation, noticing how, in several instances, dependence on external buyers leads to a *lock-in effect* that prevents developing countries from capturing increasing shares of value addition (Humphrey 2004, p.12; Barrientos et al. 2011; Humphrey & Schmitz 2002; Humphrey 2003b; Chiu & Wong 2004; Chang et al. 2016, p.165). The logic behind this reasoning is grounded in the idea that lead-firms in developed economies maintain control over the most profitable activities. In turn, developing countries engage in a *race to the bottom* to attract investments by means of low production costs and favourable financial conditions. In these circumstances, lead-

firms in the North acquire most of the value, whilst suppliers in the South face less favourable terms of trade (Kaplinsky 2000; De Boer et al. 2012; Goger et al. 2014, pp.3–4). For instance, despite the growth in South-South trade described in the next section, the share of OECD countries in terms of value addition was 61.6% in 2011, while that of BRIC countries together accounted for only 16.6%.[4] (UNCTAD 2015, p.28)

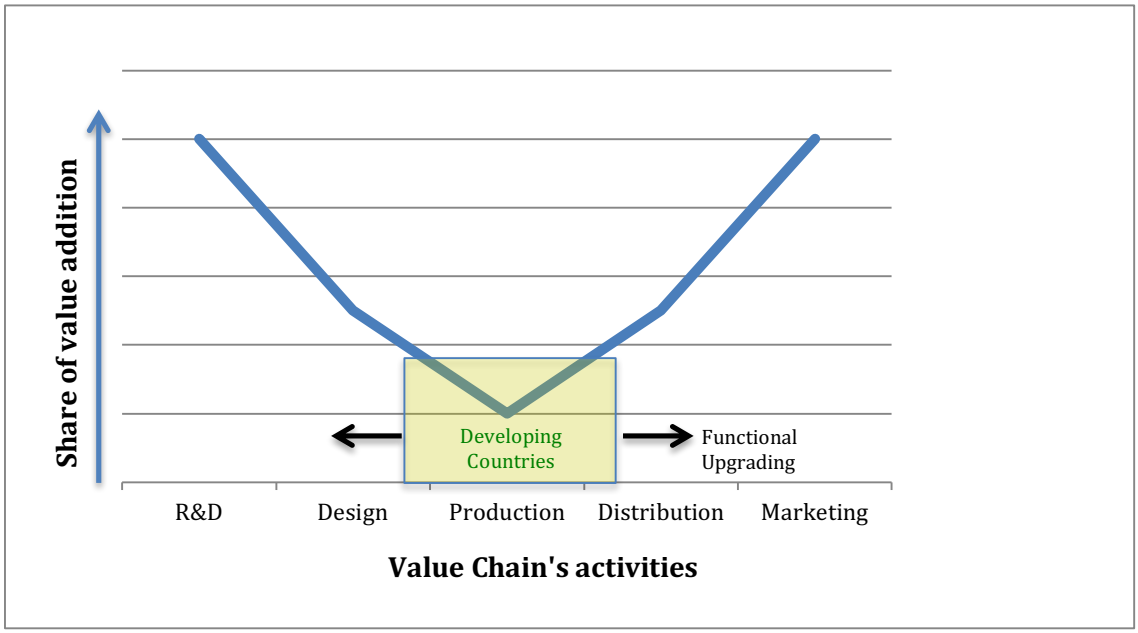
This disparity is captured by the *smile curve*. Different commodities and services present very different structures of value addition and distribution. Yet, most consumption goods tend to follow the model described in figure 1.1. The curve shows how knowledge-intensive tasks associated with higher value addition remain under the control of lead-firms in developed economies, while developing economies mostly enter the value chain at the bottom stages (Baldwin 2013; UNCTAD 2015).

The capacity of a country and a firm to climb the *smile curve* and access more profitable activities has been termed *functional upgrading* (Schmitz 2006, 554; Trienekens 2011, 70). Although value can be captured thorough a better organisation of production and/or the introduction of new and better products, the acquisition of new functions across the value chain is considered to have the most significant impact in terms of profitability and sustainable market development (Ciravegna & Giuliani 2008, p.251; Sonh Hanh 2008, pp.134–136; Schmitz 2006, p.567). In this respect, one of the main challenges among scholars researching value chains has been to understand the dynamics that enable developing countries to climb value chains in a way that fosters economic growth and sustainable development (Barrientos et al. 2011; Bernhardt & Milberg 2011; Goger et al. 2014).[5] This study is conceived within this research agenda. Taking the Kenyan leather value chain as a case study, it explores how local suppliers

[4] Of which China constituted 10.1%. This percentages are calculated from the total value of backward and forward linkages of all countries.
[5] This has been approached both from a macro perspective (internationalist GVCs scholars) and from a micro sectoral perspective (industrialist GVCs scholars) (Rabellotti et al. 2007, 9).

interact with global buyers and how such interaction affects the former's capacity to capture value across the chain.

Figure 1.1: Smile curve of value creation



Source: Adapted from Mudambi (2008, p.707); Oetero-Humphrey(2000, p.14); Baldwin (2013, p.37).

1.3 South-South Value Chains: Research Question

Understanding how local suppliers in developing countries access and participate in GVCs requires an understanding of the markets they relate to. Regulations, standards, consumer tastes, and labour costs differ across countries. This is notably the case between developed and developing economies – what this study refers to as the North and the South.

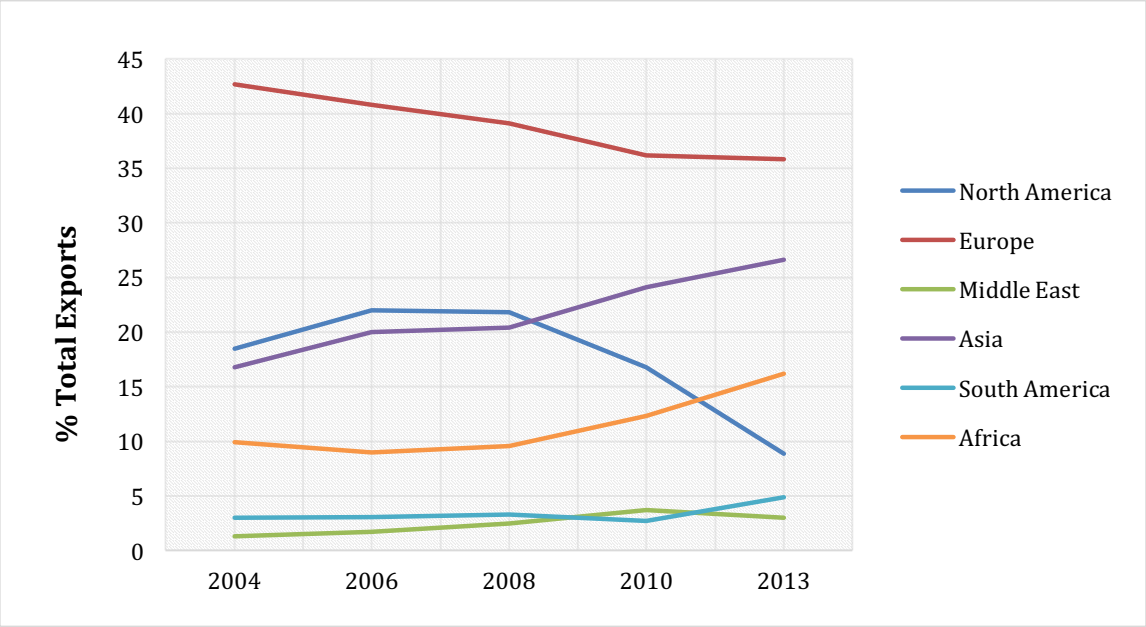
Since 2009, the South has been exporting more to other countries in the South than to the developed North, with South-South trade reaching a quarter of the world export in 2011 (UNCTAD 2013). This trend has been particularly strong in intermediate goods, which are considered the main proxy of trade modelled by and within GVCs

(OECD & WTO 2012; Milberg & Winkler 2011, pp.60–61).[6] According to the WTO (2014, p.13), in 2013 developing economies sent 35% of their exports to Asia, 6% to Latin and Central America, 6% to the Middle East and 4% to Africa. As part of this framework, developing nations have been increasingly trading with least developed countries (LDCs) with the latter exporting over 60% of their production to the South and acquiring an increasing amount of the former's exports.

As reported in figure 1.2, in the aftermath of the 2008 global crisis, the African continent has gradually switched its export trajectory from the US and Europe to Asia, the Middle East, and Africa. Whereas the bulk of African exports is dominated by mining products and resource-based manufacturing, regional intra-trade is more diversified and represents a promising venue to support industrialisation and the emergence of interconnected regional value chains (UNECA 2015, chap.4). It is estimated that about 50% of the total South-South trade in Africa is constituted by regional trade (UNCTAD 2015). As reported by Ogunleye (2012, p.55): "[t]he long-range future of South-South regional trade and economic integration, both among African countries and with other southern partners, holds very high promise."

[6] The South-South share of trade in intermediate inputs grew even faster than the overall trade, from 30% to about 57% of the total between 1996 and 2010 (UNCTAD 2015).

Figure 1.2: Share of regional trade flows in Africa's total merchandise exports



Source: Author's elaboration based on WTO International Trade Statistics (multiple years).

South-South economic relations extend beyond simple trade to involve investment and finance, labour and workforce movement, as well as cooperation in global economic governance (Thrasher & Najam 2012). Although the evidence remains controversial, trade economists have long debated whether South-South trade among countries with similar factor endowments can favour the emergence of more sophisticated and growth-enhancing sectors (Amsden 1986; Klinger 2009). Yet, to what extent participation in South-South trade is structured within value chains and how this affects suppliers' economic and social gains has only just entered the development studies' agenda (UNCTAD 2015).

Gereffi (2014, p.15) recently acknowledged that firms in developing countries increasingly enter pre- and post-production activities along the *smile curve*, becoming themselves lead-firms within regional and GVCs. Most importantly, the rise of global trade players such as China and India, along with the recent contraction in demand from high-income economies, has witnessed a surge of South-South trade in GVCs where both lead-firms and suppliers are located in the developing world (Cattaneo et al. 2011).

As stressed by Nadvi (2014, p.142): "[w]hat is particularly interesting at this moment is the growing significance of Rising Power firms within value chains—not only as suppliers to leading Western firms but increasingly as organizers and value chain lead-firms in their own right."

Nevertheless, as stressed by Bamber et al. (2013, p.39), there still is a consistent lack of research on the implication that the emergence of South-South trade has on developing countries' participation in GVCs. Whereas some initial attention has been paid to how lead-firms in the South apply different market strategies from their northern counterparts (Kaplinsky & Farooki 2010; Bair & Gereffi 2013; Staritz & Morris 2013; Aykut & Goldstein 2006)(Staritz & Morris 2013; Aykut & Goldstein 2006), little systematic research has been carried out on how firms from the South influence upgrading opportunities of their respective suppliers.

As acknowledged by Horner (2016, p.3), despite its bias towards North-South GVCs, the analytical frameworks developed by the literature "can also provide crucial insights into the development implications of the emerging geography of trade […] in aspects of engagement between countries in the global South." Accordingly, drawing on the GVCs and GPNs literature, this thesis relies on an innovative mixed-methods approach to compare South-South and North-South value chains. Combining firm-level export data over a 10-year period with more than 100 semi-structured interviews, the aim of the next chapters is to explore how firms in developing countries interact with markets characterised by different standards and governance structures.

Through a focus on North-South, South-South, and regional links across the Kenyan leather value chain, this research discusses the upgrading dynamics experienced by local suppliers in their interaction with global and regional buyers. Moreover, the study provides an analysis of the institutional framework that enabled some actors (and

not others) to acquire and exploit increasing economic as well as social gains.

For this purpose, the scope of the thesis is to address the following research question: how does participation in value chains with different market trajectories relate to the upgrading of suppliers in developing countries?

The findings show that market trajectories influence suppliers' upgrading as they play a role in shaping value chains governance as well as local firms' market strategy. Yet, as chapters four and seven further argue, market trajectories answer only part of the question. Elements of industrial policy and entrepreneurship take on a pivotal function in explaining suppliers' upgrading in the value chain.

1.4 Structure of the thesis

The thesis unfolds in six chapters:

Chapter two – Literature review and case selection

The chapter defines the concepts of upgrading, governance, and market trajectories. It further reviews the main literature on the topic and clarifies the logic underpinning the process of case selection. An overview of the study's methodology for data collection and analysis is further provided.

Chapter three – The Kenyan leather value chain: a descriptive approach

The scope of this chapter is essentially descriptive. It defines the structure and history of the Kenyan leather value chain, its main actors, roles and respective *internal* and *external governance* linkages, as well as the dynamics underpinning social and economic upgrading across the chain. By pointing to the positive relation between functional and economic upgrading, this chapter provides a solid foundation for the

analysis in chapters four to seven – i.e. achieving functional upgrading within the Kenyan leather value chain entails the potential for both economic and social gains.

Chapter four – Governance and upgrading: evidence from export data

This chapter draws on firm-level transaction data of Kenyan leather exports between 2006 and 2015. The data analysis presents a first attempt to systematically quantify aspects of governance within GVCs. This is achieved through an index of dyadic stability in buyer-supplier relations. Moreover, using unit values and HS-codes as indicators of product and functional upgrading respectively, the correlation between market trajectories and upgrading is further assessed. Results show how participation in North-South, South-South, and regional value chains display different dynamics both in terms of governance and upgrading.

Chapter five – Governance and market trajectories: a matter of trust

The main goal of this chapter is to shed light on the link between market trajectories and governance emerging from chapter four. Through a set of interviews with tanners across Kenya and Uganda, the chapter explains how markets are associated with different characteristics defining the governance of buyer-supplier relationships. Tanners identify four main markets that differ in their product and process standards, sourcing strategy, trust, and stability – these are Europe, China, India and Pakistan, and the Region. Results further show how value chain governance is driven by higher environmental and quality standards as well as increasing labour costs in North-South linkages. Conversely, South-South relationships are characterised by lower standards and sub-optimal price-driven markets. In these circumstances, relational ties between buyers and suppliers are fostered to limit transaction costs and uncertainty about quality and costs.

Chapter six – When upgrading goes South: the case of Kenyan and Ugandan tanners

Drawing on the same data as chapter five, this chapter looks at the dynamics underpinning the relationship between upgrading, firm size, and market trajectories. The outcome reveals a scenario where decreasing quality, standardised production, and low profits trigger *exploration* into new functional stages. This is particularly the case among smaller firms engaging in South-South and regional value chains, while larger firms embedded in North-South value chains are less prone to upgrade their functions. In this context, it is the regional market that enables producers to capture value addition.

Chapter seven – Survivors vs. creators: a comparative analysis of Kenyan footwear and handbag manufacturers

By focusing on the most downstream linkage in the value chain, this chapter compares two groups of leather manufacturers: handbag and footwear producers. Whilst the former has recently experienced considerable social and economic upgrading, the latter has suffered a steady decline in the aftermath of the liberalisation process. This chapter builds on interviews with 65 manufacturers, using both descriptive statistics and qualitative data on the two subsectors. The outcome shows how local producers' capabilities to seize upgrading opportunities cannot be traced back to market trajectories and governance relationships only. Different business strategies are shown to originate within different historical periods characterised respectively by import substitution and export oriented industrialisation. The impact that industrial policy had on entrepreneurship, as well as the flexibility that characterises SMEs over large subsidised firms, are at the origins of the successful upgrading in the handbag subsector.

Chapter eight – Conclusion

2.

Literature review and case selection

2.1 Introduction

The objective of this chapter is to define the main concepts adopted across the study. Particularly, section 2.2 discusses the notions of governance, upgrading, and market trajectories. Section 2.3 further present a review of previous studies on governance and upgrading across North-South, South-South, and regional value chains. Researchers who are familiar with the literature on GVCs and GPNs may find this section redundant, yet they would still benefit from the multidisciplinary approach used to inform the research. Most of the literature presented spans across different scholarship traditions, including the research on GVCs and GPNs, but also the literature on trade, innovation, and technology transfer, which is often omitted from studies belonging to the first scholarly traditions.

Section 2.4 introduces the case study of the Kenyan leather value chain and further explains the rationale underpinning its selection on the base of three criteria: relevance to the country's economy, conformity with the research question, and significance for the current research agenda. Section 2.5 explains the validity and generalisability of the research findings to other countries and value chains. Finally, section 2.6 provides a methodological overview of the thesis, while more detailed aspects of analysis and methods are addressed in each chapter separately.

2.2 Conceptualisation

The study looks at the relationship between lead-firms in different markets and local suppliers in developing countries to understand whether and how this interaction relates to suppliers' upgrading. To guide the analysis in the following chapters, four concepts are in need of further clarification. These are: economic and social upgrading, governance, and market trajectory.

2.2.1 Economic upgrading

According to Gereffi (2014, p.12; Gereffi & Lee 2012, p.25), one of the main dimensions of GVCs analysis is *upgrading*.[7] This term is derived from the concept of innovation as a way to "ensure continuous improvement in product and process development" (Kaplinsky & Morris 2002, p.37). Whereas the wording *economic upgrading* was introduced only recently (Barrientos et al. 2011), the concept has been widely used across the literature as "industrial upgrading" or simply "upgrading" (Milberg & Winkler 2011, p.343). The latter has been associated with two broad meanings:

- The capacity of a firm/supplier to improve its competitiveness by increased productivity and value-added (Gereffi 2005, p.171; Kaplinsky & Readman 2005; Bernhardt & Milberg 2011).
- The process by which economic actors move from low- to relatively high-value activities in GVCs […] by making continuous improvements in processes, products, functions, and chain (McDermott 2007, p.104; Barrientos et al. 2011).

The GVCs literature has considered these definitions as complementary, with the four modes of upgrading illustrated in point two simply representing a more accurate

[7] The second dimension being governance, also defined as "top-down dimension" (Gereffi & Lee 2012, p.25).

redefinition of economic upgrading as defined in point one. Accordingly, it has been claimed, *economic upgrading* is the necessary consequence of new and more sophisticated products (*product upgrading*); new methods to transform inputs by superior technology and/or industrial organisation (*process upgrading*); new productive activities across the value chain (*functional upgrading*); and differentiation into completely new sectors and value chains (*chain upgrading*) (Humphrey & Schmitz 2002, p.1020; Trienekens & Van Dijk 2012, p.239; Gereffi 2005, pp.172–174). This pattern clearly emerges from Barrientos et al. (2011, p.323) according to whom: "[t]here are four types of economic upgrading: process-, product-, functional- and chain-upgrading". In a similar way, Gereffi (2014, pp.18–19), as well as Humphrey and Schmitz (2002, p.1020) define upgrading in terms of suppliers' capacity to increase incomes in the four forms defined above. The same concept is upheld by Kaplinsky and Morris (2001) and Humphrey (2004) and further applied in several case studies to analyse economic upgrading within different value chains (Ahmed & Nathan 2016; Butollo 2015b; Evers, Amoding, et al. 2014; Fromm 2007; Gibbon 2004a). Moreover, as depicted in figure 1.1, the crucial assumption put forth in the literature is that the "disembodied content of value added" increases progressively across each stage from process to product, functional and chain upgrading (Kaplinsky et al. 2002, p.10; Kaplinsky & Morris 2002, p.39; Humphrey 2004, p.8; Altenburg et al. 2008, p.330; Kaplinsky & Farooki 2010, p.4).

Evidence suggests that upgrading in product, process, and functions may provide us with information about a firm's capacity to capture value through a more efficient process, newer and improved products, and higher value activities downstream the GVCs. However, this approach fails to account for the extent to which the four upgrading strategies may (or may not) result in increased profitability and

competitiveness for firms undertaking them.[8] In other words, to paraphrase Schmitz (2006, p.563), there is no evidence that upgrading as defined in point two automatically results in upgrading as defined in point one. In some cases, for instance, functional and product downgrading has been proved to be even more conducive to higher profits – as is the case in the wood industry in Gabon (Kaplinsky et al. 2011, p.27), the Mauritian apparel value chain (Gibbon 2004b), and the South African winemaking sector (Ponte & Ewert 2009). As presented by Rabellotti (2003), firms can undertake functional downgrading as a form of innovation to improve their competitiveness face to changes in global export markets.

For this reason, while some authors quantify *economic upgrading* as the consequence of increasing unit values and market shares (Kaplinsky & Readman 2005; Bernhardt & Milberg 2011), the current study defines this concept independent of its potential causes (i.e. product, process, functional and chain upgrading) as the more generic capacity of a firm to improve its competitiveness and profitability vis-á-vis other local and global actors. Chapters six points towards the lack of linearity linking the two definitions provided above, while chapter seven further unveils several qualitative aspects underpinning firms' upgrading in relation to both markets and policy dynamics.

2.2.2 Social upgrading

According to Barrientos et al. (2011, p.324), social upgrading reflects "the process of improvement in the rights and entitlements of workers as social actors, which enhances the quality of their employment". The notion is rooted in the ILO's Decent Work Agenda, which considers aspects of employment, rights at work, social protection,

[8] Subsequent chapters deal with the concepts of product, process, and functional upgrading, along with their impact on economic upgrading. "Chain upgrading" is not discussed in this thesis as it implies a move into a different value chain for which data are not available.

and social dialogue. Milberg and Bernhardt (2011, pp.6–7) quantify social upgrading in terms of an increase in overall employment rates accompanied by a rise in real wages. Whilst employment data is useful as workers' wellbeing is dependent on the number of jobs created (Bernhardt & Milberg 2011, p.7), its adoption hides aspects related to labour quality – such as causalisation and other forms of discrimination reflected on wages as an indicator workers' contracting power (Butollo 2015b; Selwyn 2013).

The relationship between economic and social upgrading has been the subject of a vast body of literature under the *Capturing the Gains* research programme (Goger et al. 2014). Scholars have herein acknowledged that, whilst economic upgrading is a necessary element to achieve social upgrading, the first does not necessarily lead to the second (Bernhardt 2013; Goto 2011, p.957).[9] It remains therefore unclear how and when increasing profits and better labour conditions are a function of each other (Milberg & Winkler 2010).[10]

In some instances, scholars have described how the adoption of unemployment and retirement benefits, increased labour rights, and better remuneration has proven efficient in retaining skilled workers and reducing replacement costs for firms (Hall & Soskice 2001, pp.50–51). However, as Mayer (2014) points out, in low-skilled labour sectors, workers are easily replaceable and loyalty is not a concern to the firm. Especially in developing countries, a fluid labour market allowing for low labour costs is usually preferable in the production of goods and services that require a less skilled workforce (Hall & Soskice 2001, p.44). In such context, whenever trade openness has

[9] Goto (2011) refers to economic upgrading as a necessary, though not sufficient cause for social upgrading. Barrientos et al. (2014, p.4) identify economic upgrading as pivotal to achieve sustainable social upgrading, but only in certain circumstances – which are linked to the labour skills and technology utilised by the specific value chains (Barrientos et al. 2011).

[10] The principle that social upgrading is a function of economic upgrading rests on the *marginal productivity theory of income distribution* according to which higher wages are a consequence of increasing marginal productivity (Varian 1992; Flanagan 2005).

increased economic gains, this has often resulted in higher profits rather than higher wages and improved labour conditions (Harriss 2002).[11]

This study posits economic and social upgrading as independent factors not related by any deterministic logic. Nevertheless, it is acknowledged that social upgrading shares with economic upgrading a set of sub-factors that can – but not necessarily are – conducive to its realisation: i.e. product-, process-, and functional upgrading. In fact, improved products, processes, and functions are not only expected to generate higher returns; they would also require an effort in acquiring, training, and retaining skilled labour forces (Fernandez-Stark et al. 2011, p.63; Staritz & Reis 2013, chap.2; Barrientos, Knorringa, Evers, Margareet Visser, et al. 2016). Moreover, as presented in chapter seven, social upgrading is further affected by the interaction of institutional factors exogenous to the production process and underpinned by the *internal* and *external governance* structure of the value chain.

Whereas economic upgrading reflects a firm's overall market competitiveness, the link between the former and social upgrading has proven less robust (Milberg & Winkler 2010; Goger et al. 2014). In general, firms are said to embrace a *high-road strategy* to upgrading whenever competitiveness and profitability are a consequence of increasing value addition, market share, as well as quality of employment – that is, when economic and social upgrading happen at the same time. Conversely, in a *low-road strategy* competitiveness is achieved by lowering labour costs in what is known as a *race to the bottom* (Milberg & Winkler 2010; Giuliani et al. 2005; AfDB et al. 2014, pp.68–69; Kaplinsky & Readman 2005). This last concept emerges clearly in the comparison between handbag and footwear producers in chapter seven.

[11] Quoted in Milberg and Winkler (2010, pp.15–16).

2.2.3 Governance

The concept of governance is used in the literature GPNs and GVCs to define the relationship between buyers and suppliers at different stages of the value chain (i.e. *internal governance*). Moreover, the same concept is also used to indicate linkages between actors in the value chain and external institutions such as governments, NGOs, working unions, and the civil society (i.e. *external governance*) (Keane 2008). Whilst the first definition extensively informed the GVCs literature, the scholarship on GPNs has concentrated on the second aspect, emphasising how institutions and regulations external to the production process shape actors' participation and upgrading dynamics (Coe et al. 2008; Vellema & Van Wijk 2014; Bair 2008). Most of this study, except for the institutional analysis provided in chapters four and seven, builds on the concept of *internal governance* and it is therefore to this definition that we now turn our attention.

The notion of *internal governance* focuses on the hierarchical relationship between buyers and suppliers to ensure certain product and process characteristics (Humphrey 2005). Value chains are organised networks that coordinate the flow of products, knowledge, and resources. Value chains often have a lead-firm that determines production parameters and exerts control over other actors in the chain (Navas-Alemán 2011). Such control is characterised by increasing monitoring and enforcement costs and depends on the complexity of knowledge to be transferred, the supplier's skills, as well as uncertainty about quality evaluation (Gereffi et al. 2005; Ponte & Sturgeon 2013).

Several theories of governance in GVCs have been put forth, however it is beyond the scope of this study to provide a comprehensive account in this sense (Pilbeam et al. 2012). Two major frameworks that further inform the research are the seminal work of Gereffi, Humphrey and Sturgeon (2005) and its subsequent review by Ponte and Sturgeon (2013). Both approaches have evolved from Williamson's (1971)

argument that value chain coordination is a consequence of market uncertainty and transaction costs.[12]

According to the first framework, the level of hierarchical coordination of each segment of the value chain is a consequence of the complexity of transactions, the actors' ability to codify and share information, and the capabilities of suppliers. Whenever transactions are easily codified, product specifications are rather simple, and suppliers have the capacity to realise the product with little or no input from the buyer, the relationship is market-based and there is no need for buyers to exert control by integrating upstream stages of production. Five degrees of governance are defined by the authors based on the level of information codifiability, product complexity, and supplier's capabilities (Gereffi et al. 2005). A very similar taxonomy is adopted by Humphrey and Schmitz (2000), who identify expected suppliers' characteristics in terms of their concentration, exit options, and dependence on buyers across four degrees of governance.[13]

The explanation provided by Ponte and Sturgeon (2013; Ponte & Gibbon 2005) of governance as *normalising* does not differ much. Accordingly, governance is dictated by uncertainty about quality; whenever the latter cannot be assessed upon price alone, more integrated forms of coordination are required to reduce risk for buyers (e.g. codified standards, provision of resources, trust bounds...) While this concept is further considered in the introduction of chapter four, table 2.1 below presents an analytical framework that encompasses and summarises both the Gereffi et al. (2005) and Humphrey and Schmitz (2004) taxonomy, as well as Ponte and Sturgeon's (2013) account on *quality conventions*. This framework is used in chapter three to define

[12] Integration occurs whenever transaction costs are lower if the activity is conducted within the boundaries of the firm.

[13] This latter framework has been operationalised within multiple case studies (Schmitz 2004; Navas-Alemán 2011).

governance interactions in the Kenyan leather value chain, while chapter four further develops the concept as part of an econometric model.

Table 2.1: Governance stages

Factors	Explanation	Variables
Market	Arm's length relations; No governance structure Coordination mechanism: Price	Dependence on intermediaries: No or little input from lead-firm on production Exit options: Many as cost of switching partner are low for both sides Information complexity: Low – standardised production Assistance: No technical assistance Buyers concentration: Low Producers concentration: Low Contracting: sporadic orders Quality convention: Market
Network	Coordination of activities between actors, but mutual interdependence Coordination mechanism: Codified standards and trust	Dependence on intermediaries: Low Exit options: Both producer and lead-firm have few exit options Information complexity: Simple codified information Assistance: Low and confined to codified information Buyers concentration: Medium Producers concentration: Medium/High Contracting: short-term contracts or sporadic orders Quality convention: Industrial
Quasi-hierarchy	Producer is subordinated to one or a few buyers; Strong power asymmetries and control exercised by lead-firm Coordination mechanism: Provision of resources and production management	Dependence on intermediaries: High Exit options for producers: Low (lock-in) Exit options for buyers: High Information complexity: High – Tacit knowledge and codified info (lead-firm set production parameters) Assistance: High - Producer's performance is monitored by buyer with frequent face-to-face interactions Buyers concentration: High Producers concentration: High Contracting: long-term Quality convention: Industrial / Domestic
Hierarchy	Vertical integration within a firm (direct ownership)	Managerial control flowing from managers to subordinates Products developed and produced in-house Quality convention: Domestic

Source: Author's elaboration based on Navas-Aleman (2011, p.1388) and Bazan and Navas-Aleman (2004) – amended based on Gereffi et al. (2005, p.86; 2014, p.13) and Ponte and Sturgeon (2013).

2.2.4 Market trajectory

The concept of market trajectory is used in this study to indicate the market of destination of a specific commodity or good. The research defines three main market trajectories: North-South whenever the buyer is located in a developed country;[14] South-South if buyer and supplier are both located in developing countries; and local/regional whenever the interaction between buyer and supplier occurs nationally or within a regional custom union.[15]

Due to the increasing segmentation of production, the market of reference for local suppliers does not necessarily correspond to the final market where a good is purchased and consumed. As discussed below in chapter four, this may raise some problems, particularly in respect to more upstream stages (e.g. raw and semi-processed materials). While the lack of information about final retailing remains a limitation throughout the study, the qualitative evidence presented in chapter five sheds light on how final markets directly impact on the relationship between buyers and supplier.

Table 2.2: Market trajectories

Market trajectory	Origin of buyer
North-South	Developed countries in the global North
South-South	Developing country in the global South
Local/Regional	Internal to the country or within regional blocks

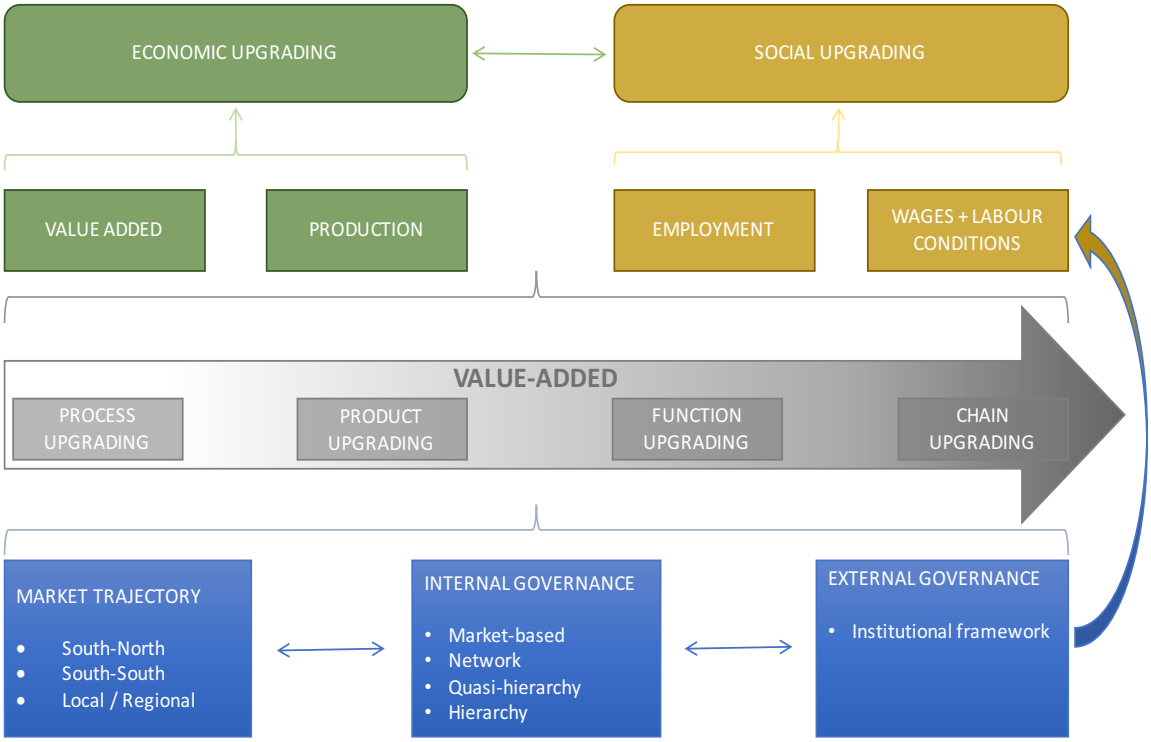
Source: Author's elaboration.

Figure 2.1 summarises the relationship between the concepts presented in this section. From the bottom to the top, it shows how market trajectories interact with aspects of governance to influence firms' upgrading strategies. Moreover, *internal governance* is expected to impact on firms' product, process, and functional upgrading

[14] For a better definition of South-South and the concept of "Triad" see Aykut and Goldstein (2006, p.85).
[15] As exported goods can be further processed and used as inputs for final goods in different markets, the concept of market trajectory is independent of the final consumer country.

and, potentially, on their economic and social upgrading. Yet, as observed above, the latter can be also influenced by elements of *external governance* such as industrial policies and other regulations. In order to inform the analytical work carried out in the following chapters, the next section looks at these conceptual linkages as they have been presented in the literature.

Figure 2.1: Upgrading and governance (summary)



Source: Author's elaboration.

2.3 Literature Review: Trade and GVCs

The relationship between South-South trade and economic development has been long researched by the scholarship on trade, innovation, and technology transfer. Only recently this argument has entered the realm of GVCs and GPNs studies.

The literature on trade and innovation takes its cue from the Heckscher-Ohlin model. Accordingly, countries export products that most intensively use their relatively abundant and cheapest factors of production. Based on this theory, the developing South

is expected to specialise in labour- and land-intensive unsophisticated goods, whereas the North increasingly focuses on innovative, capital intensive production. Development economists pinpointed how such trade-structure entails the risk for developing countries of being stuck in sectors with a comparative disadvantage in the production of innovative, higher-quality products (Stokey 1991; Flam & Helpman 1987; Sen 2009, pp.6–7). However, it has further been noticed that whereas innovation in North-South trade is a prerogative of the North,[16] South-South trade among countries with similar factor endowments can touch upon more sophisticated and growth-enhancing sectors, becoming in this way a "testing ground for structural innovation" (Klinger 2009, p.2). In this respect, whilst initial empirical research supported the conclusion that South-South trade generates greater technological spillover (Amsden 1986), more recent quantitative studies unveiled contrasting evidence.

For instance, according to Klinger (2009), North-South trade is the only trajectory that matters for structural transformation and economic growth in developing countries, with top-performing nations exhibiting a sophisticated commercial bound with the North. This approach is contended by recent studies on innovation transfer wherein developing countries' firms disclose a higher tendency to invest in neighbouring developing economies. Such dynamic would demonstrate a better appreciation of local conditions and an increased propensity to assume risks by southern lead-firms (Aykut & Goldstein 2006). Furthermore, due to their similar factor endowments, developing countries' lead-firms are said to transfer technologies that are more appropriate to the economy of other developing countries, allowing for an easier diffusion and a more efficient absorption by their southern suppliers (Acemoglu 2002;

[16] The South is often confined to a follow up role where innovation is dependent on reverse engineering (Helpman & Grossman 1991).

Weil & Basu 1998; Fu et al. 2014, p.13): "South–South trade and FDI will represent effective vehicles for the diffusion of these technologies, and policies should follow suit consistently" (Fu, et al. 2011, 1211).[17]

Both Klinger's perspective as well as the literature on technology transfer and innovation leave the door open for further inquiry. In his account on South-South trade and structural transformation, Klinger (2009, p.17) appreciates that developing countries exporting unsophisticated products may be able to "escape the trap [of the Hecksher-Ohlin model]" through growth in sophisticated South-South exports, though he maintains that this is arguably achievable in a North-South value chains as well (Hausmann et al. 2008).

Similarly, one of the main puzzles emerging from the literature on technology and innovation transfer is not just whether South-South trade is more (or less) conducive to economic growth, but how this phenomenon interacts with the consolidation of international trade in GVCs (Shirotori 2013). In their quantitative analysis of how innovation is transferred by trade relations in Ghanaian firms, Fu et al. (2014, p.29) acknowledge the pre-eminence of value chains, highlighting the persisting literature gap underpinning the interaction between innovation systems and GVCs (Fu et al. 2011, 1209). Moreover, Brach and Kappel (2009, 16–17; Rabellotti et al. 2007) point to a lack of research combining the value chain debate and the innovation discourse, along with the specific impact that the latter has on suppliers' long-term upgrading. In other words, as it is acknowledged that the participation in value chains is one of the main channels of innovation and technology transfer, what factors within GVCs favour innovation

[17] The rationale behind this approach is that foreign technology may be inappropriate with respect to the "psychosocial and biophysical context prevailing in a particular location" and less productive when making use of scares factor endowments – i.e. in low-tech sectors using unskilled labour intensively, capital-intensive innovation from northern countries will contribute to economic growth at a lower rate than in the North (Fu & Gong 2011; Acemoglu 2002).

capacities and upgrading remains unclear. For instance, how does this process depend on the nature of final markets where lead-firms are based? Does the market of reference play a role in defining the nature of the interaction between downstream buyers and upstream suppliers?

These questions have led to a second stream of literature analysing the impact of South-South trade on developing economies. Despite an initial focus on commercial dynamics of firms in different segments of the production chain, GVCs analysis has paid increasing attention to the role of value creation, differentiation, and appropriation in the relationship between firms in developed and developing countries. The surge of South-South trade within South-South GVCs further sparked the debate on the impact that a switch in market trajectory is going to have on upgrading dynamics of upstream suppliers in developing countries (Cattaneo et al. 2011; Kaplinsky & Farooki 2010; Keane 2012; Kaplinsky et al. 2011; Navas-Alemán 2011; Horner 2016; Nadvi 2014).[18] One of the main arguments put forth by GVCs scholars is that southern economies are different from the global North on the basis of three aspects (Cattaneo et al. 2011, p.4; Arora et al. 2014, p.47):

- Consumer preferences in southern markets are price-driven, whereas in northern markets they are characterised by considerations of quality and variety.
- Product and process standards are less stringent in developing countries for both final and intermediate goods (including social and environmental standards) (Essaji 2008; Sheldon 2012). Furthermore, southern firms tend to have lower corporate social responsibility (CSR) standards (Aykut & Goldstein 2006, p.100).

[18] Palpacuer (2005) and Gibbon (2008) already stressed the importance that markets' characteristics play in defining the structure of the value chain and suppliers' upgrading. However, most of their analysis is concerned with alternative markets within a North-South approach.

- Southern economies maintain a preference for relatively unprocessed products as their labour-intensive factor-endowment makes it more convenient for them to process raw material in-house.

With reference to the first two aspects, there have been some attempts at showing how South-South trade within less integrated value chains represent a better platform to achieve economic upgrading for local suppliers (Berg & Markarian 2013, p.121; Evers, Opondo, et al. 2014; Navas-Alemán & Bazan 2001; Navas-Alemán 2011). However, these studies are often limited to qualitative accounts of single linkages of the value chain and lack a clear-cut comparative approach across value chains with different market trajectories. Furthermore, they run counter to point three, according to which southern markets would prevent rather than increase the potential for functional upgrading (Kaplinsky et al. 2010).

Particularly striking is how hypotheses on suppliers' participation in South-South GVCs do not distinguish between the global South's emerging markets (export to emerging market economies in the global South - e.g. India, China, and Brazil) and regional-local trade (production for the internal market and exports to neighbouring countries within regional trade unions). In this context, the tendency of emerging economies such as China and India to reassess North-South relationships on a South-South trajectory has been previously reported in the literature but is nevertheless in need of further research (Gereffi & Sturgeon 2013, p.339; Gourdon 2011; Thrasher & Najam 2012; Rangel 2012). As Ferandez-Stark and Bamber (2013, p.37) highlight, the empirical literature on the phenomenon remains scant and, whilst several studies put greater emphasis on price competitiveness and lower standard requirements characterising South-South and regional trade (Mainville et al. 2003; Henson & Humphrey 2010; Kaplinsky & Farooki 2010; Ouma 2010), little attention has been paid to the different levels of governance, as well as product-, process- and functional

upgrading that are connected to these alternative market trajectories. Furthermore, it remains unclear to what extent functional upgrading within regional value chains (RVCs) is a consequence of less captive governance relations (Bazan & Navas-Alemán 2004), *learning-by-exporting* to premium markets (Gereffi 1999; 2014; Yeung 2009; Melitz & Trefler 2012, p.92), institutional dynamics of regional markets (Butollo 2015a; Schmitz 2006, p.568), or other firm-specific capabilities influencing actors' business strategies (Lutz 2012).

In this respect, the current literature lacks a systematic comparison of the effect that factors internal and external to the value chain can have on suppliers' economic- and social upgrading. What mechanisms underpin the relationship between market trajectories and suppliers' upgrading? Are regional and local markets a downgraded platform for suppliers who cannot compete in global markets (Gereffi 1999; Goger et al. 2014; Barrientos 2012; Lin & Chang 2009), or are they instead more conducive to innovation and functional upgrading (Navas-Alemán 2011)?

The next two sub-sections provide a classification of the available literature on the relationship between upgrading and market trajectories along four major arguments.

2.3.1 Market trajectories and economic upgrading

The previous sub-section pointed to three aspects that differentiate southern and northern markets: (i) price-driven consumer preferences; (ii) lower product and process standards; (iii) a propensity towards unprocessed imports. Based on these specifications, scholars advanced two main arguments regarding how participation in South-South GVCs relates to suppliers' upgrading. Whereas South-South GVCs are considered to favour functional upgrading by a first group of researchers, critics see traditional North-South linkages as the main trigger of value addition. Both arguments take their cue from the notion that northern economies are likely to display more relational forms of

governance through higher standards and tighter regulations (Nadvi 2008, p.325; Ouma 2010, p.198; Lee et al. 2012, p.12327).

- First argument: Suppliers in North-South value chains are likely to experience limited access to functional upgrading with potentially negative consequences in terms of economic upgrading.

This argument draws both on the GVCs literature on governance, as well as research on trade and innovation mentioned in the previous section.

Firstly, according to Humphrey and Schmitz (2000; 2002), whereas product and process upgrading can be easily absorbed through codified information, functional upgrading requires a long-term accumulation process based on continuous experience and learning (Navas-Alemán 2011, p.1388; Schmitz 2006, p.562). In such a context, despite favouring process and product upgrading, more relational forms of governance prevent suppliers' functional upgrading to the extent that lead-firms have an interest in retaining high value-added activities along the chain: "[b]uyers and processors who consider sourcing their main competence will be increasingly reluctant to see producers' management power enhanced" (Humphrey & Schmitz 2002, p.1025; 2004b, pp.356–359).

Quality-driven markets with higher standards typical of northern economies are associated with more hierarchical modes of governance, requiring trust-based relationships between buyers and suppliers (Dallas 2015; Fessehaie 2012; Bair 2008). Conversely, price-driven southern markets result in lead-firms' disincentive to meet the cost of more relational forms of governance (Navas-Alemán & Bazan 2001; 2004, p.6; Fessehaie 2012). As a consequence, suppliers engaged in North-South value chains are more likely to experience a "lock-in" effect as their attempts to acquire the knowledge required to functionally upgrade is prevented by buyers striving to retain profitable

activities (Navas-Alemán 2011; Humphrey 2003a, pp.18–19; Dolan & Humphrey 2000; Gibbon 2001, p.352; Humphrey & Oetero 2000, p.24). This phenomenon has been accentuated in the aftermath of the 2008 global financial crisis as northern multinational companies have undergone increasing pressures to insource some of the previously-outsourced activities (Barrientos & Visser 2012, p.36).

The limited room for functional upgrading in North-South GVCs is therefore expected to narrow suppliers' access to value addition, with negative consequences in terms of economic upgrading. By contrast, South-South value chains with less tight forms of governance are expected to functionally upgrade through "prior apprenticeship" and independent investments in national markets (Bazan & Navas-Alemán 2004, pp.124–126). Moreover, once functional upgrading has been achieved, local and regional markets represent a more stable platform for local producers. By virtue of their extensive market knowledge and access to consumers' information, local upgraders are expected to enjoy a better bargaining position over their foreign competitors (Funcke et al. 2014, p.31; Goger et al. 2014, p.12; Evers, Opondo, et al. 2014, p.39; Sturgeon & Kawakami 2010; Pérez-Villar & Seric 2015).

Secondly, the literature on trade and innovation has looked at South-South trade as a potential testing ground for "structural innovation" and "greater political and economic equality" (Klinger 2009, p.2; Thrasher & Najam 2012, p.2). South-South market relations have been associated with an increase of trade in "sophisticated" goods as well as a better diffusion and absorption of innovation due to the similar factor endowments characterizing countries in the global South (Acemoglu 2002; Weil & Basu 1998; Fu et al. 2011; Pradhan 2007; Amsden 1986). This dynamic has been assessed within the South-South pharmaceutical value chain in Uganda (Haakonsson 2009).

However, as observed in the following paragraphs, this view is not unchallenged neither in the trade nor in the GVCs literature.

- Second argument: Suppliers in South-South value chains are likely to experience *lock-in* into low functional stages with a negative impact on economic upgrading.

This argument draws on two main concepts: (i) the propensity of southern economies for unprocessed imports; and (ii) the theory that functional upgrading occurs once firms have achieved high production competences.

According to the first concept, lower levels of per-capita income in southern economies drives the demand for affordable and undifferentiated production (Kaplinsky & Farooki 2010, p.21; Arora et al. 2014, p.47).[19] This is reflected in the low labour and environmental costs that disincentives outsourcing, limiting functional upgrading of upstream suppliers. To the extent that exporting unprocessed commodities requires less investment in processing skills and innovation, this is likely to draw increased upstream competitiveness in developing countries (Kaplinsky & Farooki 2010; Kaplinsky et al. 2011, p.24; Karuga 2010, p.147). For instance, scholars have studied how trade in GVCs between Africa and Asia is often asymmetric (with the former exporting primary commodities and importing manufacturing) and lacking the outsourcing phenomenon that characterises North-South GVCs (Alden 2005; McCann 2010; Horner 2016, p.5; Henderson & Nadvi 2011, pp.293–294). In this context, South-South trade becomes a source of economic development for booming developing economies and a threat of deindustrialisation and *resource course* for smaller countries who act as providers of raw inputs to the former (Gallagher 2012; Thrasher & Najam 2012; UNCTAD 2010; Rangel 2012).

[19] Developing markets are therefore described as *price-driven*, to the extent that buyers' decisions are determined by price rather than quality considerations.

In the North, the higher cost of processing associated with labour and environmental regulations, as well as process and product standards, ensures that buyers reduce costs and decrease risk by outsourcing non-core functions (Kaplinsky et al. 2011, pp.28–29; Shepherd & Stone 2012).[20] A typical example of this phenomenon is how *corporate financialisation* has fostered outsourcing practices to maximise shareholders' value by containing risk rather than maximising market share (Palpacuer et al. 2005; Ponte & Gibbon 2005, p.16).

In such a scenario, functional upgrading occurs once firms have consolidated their position in lower segments of the value chain, having mastered high production competences through process and product upgrading (Gereffi 1999; 2014; Kaplinsky et al. 2002; Fernandez-Stark et al. 2011, pp.23–24; Yeung 2009). In other words, the achievement of high levels of quality and technical capabilities facilitates and stimulates functional upgrading into increasing value addition (Jean 2014). This is in line with studies on *learning-by-exporting*, according to which firms' participation in global export markets is more conducive to market learning, increased productivity, and "trade-induced innovation" (Fafchamps et al. 2007; Mengistae & Patillo 2004; Birdsall et al. 1993; Lileeva & Trefler 2010; Melitz & Trefler 2012; Aw et al. 2008).[21]

Economic upgrading of local suppliers embedded in North-South GVCs is expected not only as a consequence of product, process, and functional upgrading, but also as a result of reduced competitiveness generated by high entry barriers in the form

[20] Except for capital-intensive, high value-added functions such as marketing and branding.

[21] Yet, since it focuses primarily on exporters in developed economies, this literature does not provide a comparison within developing markets. Quantitative studies establishing a link between exporting and innovation have focused exclusively on product and process upgrading in North-North trade, ignoring aspects of functional upgrading on a South-South trajectory. Moreover, this literature describes "trade-induced innovation" and export-led productivity growth through econometric models measuring marginal costs of production and the cost of trade and competition in the import and export of both final and intermediate inputs (Melitz & Trefler 2012; Bloom et al. 2016; Damijan & Kostevc 2010; Fernandez & Gavilanes 2016; Vogel & Wagner 2010). This study is limited to an analysis of export data within a logic of value chain governance and upgrading that ignores companies' marginal production costs and import data.

of high certification and monitoring costs for suppliers and buyers respectively (Trienekens 2011, p.54; Gereffi & Lee 2012, pp.3–4). In these circumstances, producers who manage to adapt to GVCs' requirements are rewarded through higher profits (Funcke et al. 2014; Jaffee & Masakure 2005, p.331), whereas increased competitiveness is likely to eat out profits among producers in sub-standard southern and regional markets.

2.3.2 Market trajectories and social upgrading

Concerning social upgrading, comparative studies across market trajectories are few. This notwithstanding, two opposing arguments can be drawn from the literature:

- First argument: Suppliers embedded in North-South value chains are more likely to experience social upgrading.

The increasingly preeminent role played by labour and environment regulations in developed economies is expected to increase the premium on final production through an improvement of labour conditions among local suppliers (Humphrey 2005, p.5; Lee et al. 2012; Maertens & Swinnen 2009; Humphrey et al. 2004). Moreover, North-South GVCs are usually associated with a tendency towards higher wages and increased employment rates (Shepherd & Stone 2012, p.19; Humphrey et al. 2004, pp.75–77). This is usually attributed to the crucial role played by CSR departments and private governance structures in lead-firms (Blowfield & Dolan 2008, p.4), along with an increasing need to retain a high-skilled labour force through permanent and improved contracting (Mayer 2014; Fernandez-Stark et al. 2011, p.63).

This situation contrasts with the lack of mandatory social and environmental standards that characterises developing countries (Kaplinsky & Farooki 2010, p.18;

Evers, Opondo, et al. 2014, p.37).[22] Moreover, CSR departments tend to play a limited role in South-based lead-firms and multinational companies (Tan-Mullins & Giles 2013, pp.22–23; Afsharipour & Rana 2014, pp.227–228).

- Second argument: Suppliers embedded in South-South value chains are more likely to experience social upgrading.

By decreasing costs and shifting responsibility upstream, lead-firms in developed economies favour a dislocation between the commercial dimension of labour as a factor of production and the "societal embeddedness of workers" (Nadvi 2004, p.25; Barrientos 2013). In such conditions, local and regional value chains in the South are more likely to implement regulations that do not follow the top-down logic of buyers' private standards (Otieno & Knorringa 2012; Hughes et al. 2013; Coe & Wrigley 2007). The beneficial effect that locally-defined standards may have on both social and economic upgrading of domestic producers has been documented in the literature (Vellema & Van Wijk 2014; Tallontire et al. 2011; Selwyn 2012; Thompson & Lockie 2013). For instance, less stringent market barriers in southern economies have been observed to allow for increasing participation of smallholders, who are often unable to comply with North-South costly regulations (Barrientos & Visser 2012, p.20; Goger et al. 2014, pp.10–11; Barrientos, Knorringa, Evers, Margareet Visser, et al. 2016).

In addition, scholars have also pointed to the beneficial effect generated by functional upgrading within regional value chains as firms develop marketing and distribution departments to cope with new functions. The need to retain scarce knowledge within these segments of the chain is expected to trigger better salaries and improved working conditions (Berg & Markarian 2013, pp.121–131). Conversely, the

[22] This tendency is however criticised, especially with regard to environmental standards increasingly being introduced in industrialising developing countries (Jotzo & Stern 2010).

functional immobility of North-South GVCs (described in section 2.3.1) and the higher compliance costs embedded in these economies are likely to have a negative impact on employment and wages as producers functionally downgrade or exit the market (Gibbon 2001, pp.349–350; Trienekens & Zuurbier 2008, p.119; Dolan & Humphrey 2000, p.157; Humphrey et al. 2004, p.75; Humphrey 2004, pp.26–27; 2005, p.26).

Table 2.3 summarises the relationship between market trajectories and social and economic.

Table 2.3: Economic and social upgrading by market trajectory

	Economic Upgrading	**Social Upgrading**
North-South	Higher costs of processing favour outsourcing of functions upstream; Value chain assistance through more relational governance favours product and process upgrading of local suppliers; Functional upgrading is achieved once suppliers master product and process standards; High entry barriers prevent cut-throat competition and a *race to the bottom* (as it would instead happen in South-South GVCs)	Higher labour and environmental standards; More consistent role of CSR activities among lead-firms in the North; Increasing need for labour force retaining and training into higher-skilled functions;
South-South	Higher potential for functional innovation into more value-added activities due to less relational governance; More effective vehicle for knowledge and innovation transferring between countries with similar factor endowments; More stability in terms of sales and revenues from domestic and regional markets.	Increased market participation for smallholders due to lower entry barriers; New and better paid jobs, as companies acquire new functions; Local standards empower producers and increase their bargaining position.

Source: Author's elaboration.

As it emerges from the literature, there is a lack of clarity in explaining the interaction between governance, upgrading, and market trajectories. Contradictions are in line with the complexity that is expected from case studies across different regions and value chains. However, both at the sector- and firm-level, the lack of comparative approaches across North-South, South-South, and regional value chains is striking. Furthermore, as stressed in section 2.7, the scarce use of quantitative data to inform the analysis further constrains the explanatory power of these argumentations.

2.4 Case Study: the Kenyan Leather Value Chain

This research focuses on the relationship between local suppliers in developing countries and buyers across different market trajectories. For this purpose, the study investigates the leather value chain in Kenya.

The case study has been selected a-priori based on the study's research question with no previous knowledge on the final outcome.[23] Drawing on Stake's (1995) classification, the case study has both a descriptive and explanatory nature. On the one hand, it investigates aspects specific to the Kenyan leather value chain that may interest local practitioners and policy makers; on the other, it exemplifies and explains value chain dynamics that extend beyond the case at hand to other countries and industries.

Drawing on the methodological literature, the selection has been carried out following three criteria: (i) relevance to the country's economy (King et al. 1994, p.15): great potential of the leather sector to favour sustainable economic development compared to other agro-based industries; (ii) relevance to the research question and purpose of the study (Seawright & Gerring 2008): the multiple market trajectories served by the Kenyan leather sector, wherein firms interact with northern, southern, and regional buyers at once; and (iii) the significance of the case study with respect to the current research on value chains.

Whilst the selection of the leather sector is based on the criteria listed above, the use of Kenya as a country of reference was convenient to the availability of and accessibility to the data. The risks associated with convenient sampling have been well documented in the literature (Patton 1990, pp.180–183; Shakir 2002). In this case, however, this is not a major concern insofar as Kenya has not been selected on the basis of any expected outcome on the dependent variable. As stressed in sections 2.5 and 2.6,

[23] Selection based on the dependent variable is avoided (Geddes 1990).

while the lack of comparative cases represents a limitation, the reliability of the epistemological and methodological approach should allow for the replication and further testing of the findings.

2.4.1 Relevance to the country's economy

Whilst it has been acknowledged that manufacturing activities are normally more conducive to economic and social upgrading than agriculture (Kaldor 1967; Szirmai 2012; Chang et al. 2016; Chege et al. 2015, p.22; Keane & Te Velde 2008), recent studies stressed how increasing value can be extracted from agriculture and that this sector, no less than manufacturing, displays wide potential for upgrading (Humphrey 2005, p.1; Vorley et al. 2009, p.186). Increasing efficiency and participation in agro-based GVCs has been identified by multiple donors as a key contributor to sustainable economic development, especially in Africa where 24% of the continent annual growth comes from this sector (Byerlee 2013; AfDB et al. 2014; FAO 2001, para.165; Kaplinsky 2006).

Spanning the agricultural and manufacturing domains, the leather value chain represents a renewable source of growth for countries endowed with vast quantities of livestock and a growing internal demand for footwear and other leather goods. For this purpose, building capacity within the leather value chain has been indicated as a crucial strategy to foster economic development in countries such as Kenya, where livestock contributes to a large share of the country's GDP (Mwinyihija & Quisenberry 2013a; Van der Loop 2004).

Furthermore, seminal studies in the GVCs tradition identified leather as a labour-intensive value chain in which developing countries have acquired increasing share of value addition (Gereffi 1999, pp.38–42; Schmitz & Knorringa 2000; Hausmann 2014). According to the FAO Statistical Compendium for Raw Hides and Skins (2014), leather

represents one of the most lucrative agro-based commodities whose multiple processing stages allow for increasing gains from trade. Table 2.4 shows the significance of the leather value chain for developing countries in comparison to other agro-based commodities traded in these economies. With 24.4% of the total share, leather represents the most lucrative sector whose room for growth is further enhanced by the fact that developed nations still retain a large slice of value addition.

Finally, to prevent a phenomenon of *immiserising growth*, upgrading into higher value addition should be sustained by a country's factor endowments (Lin & Chang 2009; Lall 2000; Kowalski et al. 2015; Hausmann et al. 2008).[24] In this respect, the livestock sector has traditionally played a key role in the economic and social development of local districts in East Africa, especially in Kenya where it contributes to over 6% of the GDP (KNBS 2014), making it the third country for livestock population in Africa (World Bank 2015, p.iii; Muchie 2000).

[24] In the 50's, Singer and Prebisch postulated that one of the major constraints to economic growth in developing countries was the latter's dependency on the export of primary commodities whose terms of trade were constantly deteriorating vis-à-vis manufacturing products coming from the developed North. Yet, as stressed by Milberg (2004, p.75), many developing countries that moved into the production of manufactures across the 70's and the 80's found themselves within a second wave of decreasing terms of trade – i.e. "a modern day Singer Prebisch trap" – a situation where increasing economic activity and employment is accompanied by falling economic returns – i.e. *immiserising growth* (Kaplinsky & Morris 2002; Goto & Endo 2014).

Table 2.4: Comparison of selected commodities between developed and developing economies

	Developing Countries USD (million)	Contribution to total exported value (developing countries)	Developed Countries USD (million)	Contribution to total exported value (developed countries)
Raw hides and skins	367	0.3%	4,709	6.9%
Leather	9,478	7.3%	8,478	12.4%
Footwear with leather upper	21,831	16.8%	23,647	34.6%
Total Leather	**31,676**	**24,4%**	**36,842**	**53.9%**
Sugar	22,035	17.0%	7,506	11.0%
Meat	9,511	7.3%	14,528	21.2%
Rubber	20,312	15.6%	1,186	1.7%
Coffee	17,437	13.4%	2,377	3.5%
Rice	16,548	12.7%	4,135	6.0%
Cotton	7,376	5.7%	7,33	1.1%
Tea	5,026	3.9%	1,121	1.6%

Notes: Data was averaged over three years 2012-2014.
Source: Author's elaboration based on ITC (2015), FAO (2014), and Mwinyihija (2014a, p.27).

2.4.2 Relevance to the research question

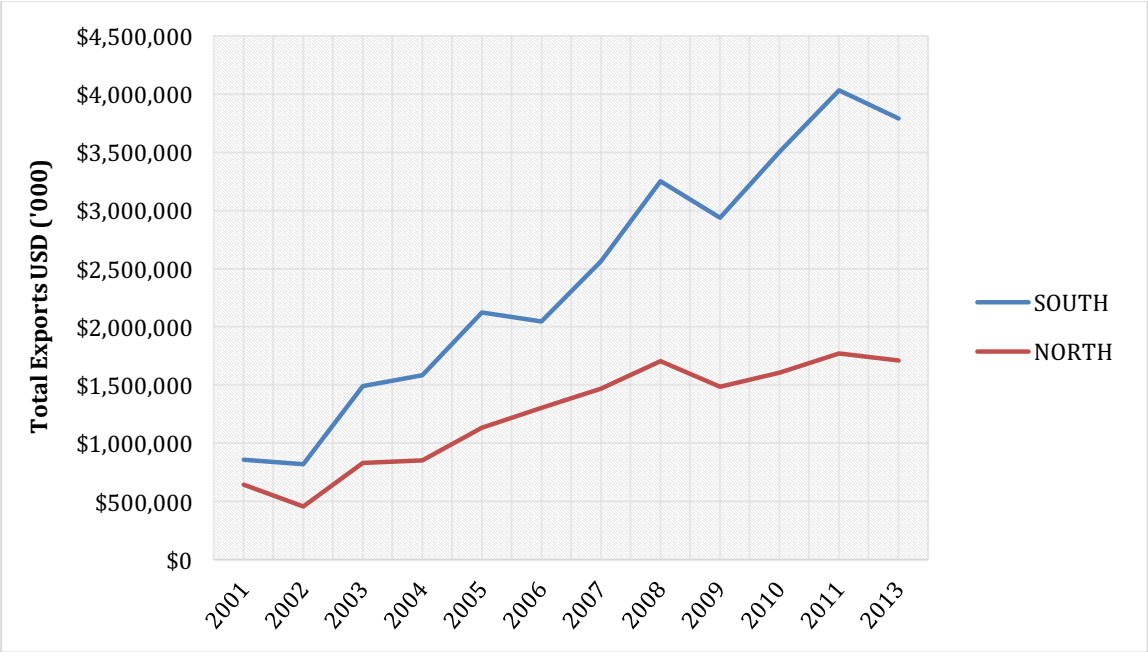
In conformity with the overall trend, Kenya too is witnessing a gradual move of its export base from the North to the global South – including East- and South-Asia, the Middle-East, and the African region. Figure 2.2 below shows how the country's exports to the South have been increasing much faster compared to those towards the North.

In this respect, the leather value chain presents all three alternative market trajectories put forth in the literature: North-South, South-South, and local/regional. As reported in chapter three, of the total exported value across the value chain between 2006 and 2015, the North acquired about 42%, the South 50%, and the Region 8%. The latter estimate does not include the local market and the informal economy, whose percentage would considerably increase the regional figure.

In light of the study's research question, an analysis of the Kenyan leather value chain allows for a *most-similar case comparison* wherein the chosen cases resemble on

all measured independent variables, except the independent variable of interest (Seawright & Gerring 2008, pp.304–305) – i.e. the market trajectory.

Figure 2.2: Kenya's exports to the North and the South over time



Source: Author's elaboration based on ITC (2015).

2.4.3 Theoretical and analytical relevance

The significance that the leather value chain as a case study holds for the theoretical and analytical literature on value chains can be assessed in relation to three major aspects.

Firstly, most of GVCs and GPNs studies on manufacturing production, and more precisely on labour-intensive, low-tech industries (OECD 2011), have concentrated on regions where these sectors have been highly integrated within global supply chains. The leather cluster in Kolkata and the footwear manufacturing clusters in Agra (India) (Roy 2013; Knorringa 1999; Schmitz & Knorringa 2000), the shoe-manufacturing units in Brazil Sinos Valley and across China and Vietnam (Bazan & Navas-Alemán 2004; Navas-Alemán 2011; Dallas 2015; Buchanan et al. 2012) are all globally established hubs for the production of footwear and leather goods. In Sub-Saharan Africa, with the

exception of some technical studies on leather in the COMESA region,[25] the focus has been mostly diverted to the apparel sector and its upgrading dynamics in relation to aspects of ownership and market governance. In these cases, attention has been paid to established global suppliers, mostly foreign owned, operating on large-scale export production zones (Staritz & Morris 2013; Godfrey 2015; Pickles 2012; Gibbon 2008). Limited focus has been placed on upstream linkages, characteristic of developing countries who lack the capacity to manufacture on a global scale. In this respect, as suggested by Bamber et al. (2013, pp.36–39), the GVCs literature is still in need of further research on factors favouring and preventing the upgrading of local SMEs in emerging market economies.

Secondly, the definition of *value chain* as the set of activities required to bring a product (or service) from its conception to its final delivery has been subjected to a fairly restrictive interpretation (Kaplinsky & Morris 2002, p.4). As stressed by Gibbon (2008, p.32), GVCs scholars have identified value chains with "[r]estricted sections of more extensive and geographically dispersed input-output structures", excluding in this way upstream procurement stages as well as alternative market trajectories. GVCs have been therefore likened to the relationship between supply and final consumption markets in specific markets and sectors. This approach is quite problematic, not only as the same firm may deal with buyers across different markets trajectories, but also because upstream procurement and processing stages have a profound impact on the way the chain is governed and upgrading occurs (Ponte & Sturgeon 2013). For instance, even though the GSP and EPA status[26] gives Kenya facilitated access to the European leather market, most local tanners cannot access this market due to a lack of control on

[25] See the work of COMESA-LLIP by Prof. Mwinyihija referred in this study.
[26] Generalised Scheme of Preferences.

upstream stages required to achieve the demanded standards. Furthermore, contrary to the finding of other studies in the apparel value chain (Gibbon 2008; Staritz & Morris 2013), in the Kenyan leather sector few enterprises appear to deal with one single market, let alone single buyers. For this purpose, this study looks at the leather value chain holistically in order to encompass both up- and downstream linkages while assessing their impact on suppliers' upgrading.

Thirdly, for the reasons spelled out in point one and two, GVCs and GPNs studies in Kenya have been mostly limited to agriculture and horticulture. The reasons behind this choice appear to be: (i) the larger share of the country GDP that these sectors entail (25-30%) against the 8-9% of manufacturing (KNBS 2014); (ii) the Kenyan development of a strong *non-traditional* export sector in the last two decades (i.e. horticulture and cut-flowers) along with a solid *traditional* production based principally on tea and coffee (Dolan and Humphrey 2000; Minot and Ngigi 2004; Dolan 2010; Blowfield and Dolan 2010);[27] (iii) the presence of an emerging local retailing system that absorbs increasing amounts of agricultural production from and for the internal market (Evers, Opondo, et al. 2014, pp.27–28; Dakora 2012, p.27); (iv) the recent adoption of local standards (e.g. KenyaGAP) with recognised equivalence to global standards such as GlobalGAP (Otieno & Knorringa 2012, p.131). Despite acknowledging the value of these studies in their respective value chains, this research moves the focus towards an emerging sector that has not yet reached the same level of wealth creation as horticulture, but whose potential has been growing disproportionally in the last two decades. The leather industry has been identified, along with textile-apparel and food-processing, as a priority sector under pillar one of the country Vision

[27] For a definition of traditional and non-traditional agriculture refer to (Hallam et al. 2004; Raikes & Gibbon 2000; Humphrey 2003a; Keane 2008; Weinberger & Lumpkin 2005).

2030 and Industrial Transformation Programme (Brendon 2015).

2.5 Validity and generalisability of the case study

Validity and generalisability refer to how well processes can be replicated and findings generalised beyond the specific circumstances of the case.

Concerning validity, a major goal of this study is to define a methodology that can be replicated across different value chains and countries. This is achieved by means of a mixed-methods approach that is illustrated in section 2.6 and further specified in each chapter.

Concerning the generalisability of the case study to other instances, as stressed by Baskarada (2014, p.8): "[c]ase studies, like experiments, are generalizable to theoretical propositions and not to populations or universes." In this respect, the theoretical propositions advanced here should be testable using the same methods within a comparative research framework. Yet, to the extent that this study is mostly concerned with aspects internal to the value chain (i.e. *internal governance*, upgrading, and market trajectories), comparative cases need to satisfy a set of external conditions characteristic of the Kenyan leather value chain and indicative of its upgrading potential.[28]

In his analysis of upgrading in developing economies, Talbot (2002) identified three main conditions that underpin cases of successful participation in GVCs.[29] According to the author, strategies aimed at increasing value addition can succeed

[28] As for the definition of governance, external refers the fact that such conditions are independent of the buyer-supplier linkage in the value chain.

[29] Originally, the criteria were four. On the top of the three conditions reported here, the moment in which the product becomes storable and transportable should not be at the chain's earliest stage and initial processing phases should entail high economies of scale. This is partially true for the leather value chain. While raw material is still traded, skins and hides can be transported and stored for over a month-period only once they have been processed into wet blue – a capital intensive activity that entails high economies of scale and large fixed investments (Mwinyihija 2014d; 2014a).

whenever: (i) the government intervenes in favouring value addition through midwifery and husbandry policies; (ii) there is an established class of local entrepreneurs able to seize the incentives provided by the government and invest accordingly; and (iii) a growing domestic market allows companies to functionally upgrade locally. Again, these conditions say nothing of firms' up- or downgrading dynamics and less so about the structure of value chains' interactions. Yet, their presence suggests an enabling and conducive environment for firms' upgrading within GVCs and RVCs. The leather value chain in Kenya appears to fulfil these criteria.

Firstly, concerning state intervention, the Kenyan government has assumed a strong husbandry position towards the leather sector to favour upgrading among existing actors. This has led to the creation in 2010 of a platform where public and private representatives of the sector meet to deliberate on relevant issues – i.e. the Kenya Leather Development Council (KLDC). This body has been accompanied by the constitution of the Leather Articles Entrepreneurs Association (LAEA), and the strengthening of the Kenya Footwear Manufacturer Association (KFMA). Though with differing agendas, these institutions have made constant pressures on the government to release a coherent policy plan coordinating leather-related operations in the country and promoting value addition. This effort has been substantiated through the insertion of leather as a flagship sector in the Vision 2030 and the Kenya Leather Industry Diagnosis, Strategy and Action Plan in 2015. Drawing on Talbot's threshold, section 3.4 in chapter three provides an assessment of the value chain policy with an historical categorisation of government interventions.[30]

Secondly, Kenya has a well-established local entrepreneurial class. The leather

[30] The relation between industrial policy and upgrading is further considered in chapter seven through a comparison between leather handbag and footwear manufacturing.

sector developed in Kenya during colonial times and already in the 20's and 30's the country was producing leather and trophies for export. In the post-independence period the country embraced a policy of export substitution, which allowed the country to become the East Africa leather hub until the early 90's (Okello 2016, p.14). Most of the current entrepreneurial class comes from generations of tanners, leather traders, and footwear manufacturers. Interviews with tanneries pointed to how most entrepreneurs have been involved in the business for more than one generation either as tanners or traders.[31]

Thirdly, the presence of a growing local market in Kenya and the COMESA region represents one of the main leverage for the value chain. According to Mwinyihija and Quiesenberry (2013b, p.523), the current market for footwear in Kenya is about 35 million pairs per annum, with the local supply providing fewer than 8 million pairs – though, according to a more recent and reliable estimation, local production is as low as 3.3 million pairs (World Bank 2015, p.ii) or even 2.6 million (FAO 2014, p.106). Most of the Kenyan market is represented by imports from China, India, and Ethiopia, along with second-hand shoes from Europe and the US.[32] Despite the higher production costs which makes producing shoes in Kenya 30% more expensive than Ethiopia, Kenya has been able to increase its production. Furthermore, Kenya fares much better than any other COMESA country in the export of leather goods (excluding footwear) with almost quadruple the export size of Ethiopia and a strong reputation for quality handbags and travelware (World Bank 2015).

[31] Of 24 actors, 8 tanneries have a long family tradition within the industry, 4 have been set up over 40 years ago through a mix of foreign investments and local support, while most of the remaining firms were established recently by entrepreneurs previously involved in skins and hides' trading.
[32] In 2014, Kenya was the second export country for Ethiopian leather shoes for a total value of 3 million USD (around 350,000 pairs).

To the extent that an agro-based value chain fulfils the three conditions listed above, the theoretical propositions presented here are likely to be corroborated. In this respect, it is expected that agro-based value chains in developing countries sharing Kenya's characteristics will present similar dynamics as those described here.

2.6 Methodology

This study adopts a mixed methodology combining semi-structured interviews with firm-level export data for the period from January 2006 to December 2015.

Data was collected over 15 months between July 2015 and September 2016 in the Nairobi and Mombasa areas, as well as 9 interviews in Kampala and Jinja (Uganda). Interviews were carried out with 65 manufacturers, 24 tanners and 15 among experts, traders and institutional bodies. Quantitative export transaction data for the period 2006-2015 was obtained, organised, and cleaned in collaboration with the Kenya National Bureau of Statistics (KNBS).

By looking at export transactions in combination with qualitative assessments from market practitioners and institutional bodies, this study helps to bridge the gap between qualitative and quantitative methods of data analysis in the GVCs tradition. Quantitative evidence in this literature has been limited to macro studies of participation in GVCs and its correlation with employment rates and wages (Maertens & Swinnen 2009), demand for skilled labour-force and female employment (Shepherd & Stone 2012), and country-level assessments of economic and social upgrading within selected sectors (Bernhardt & Milberg 2011; Milberg & Winkler 2013). Further research has been conducted on measures of participation and integration of countries into value chains based on inter-country input-output tables (ICIOs) (Timmer et al. 2014; OECD & WTO 2012; Kowalski et al. 2015; Baldwin 2013) and, more recently, indicators have

been developed to quantitatively assess the impact of participation in GVCs using firm trade level data (Taglioni & Winkler 2016, chap.6).

However, as stressed by Dallas (2015, p.4; Mayer & Milberg 2013), the literature has been dominated by empirically rich case studies that, despite lending themselves to insightful theory building, have encountered a "macro-micro aggregation problem" limiting the descriptive and causal inferences that firm-level studies can make: "[w]e suspect that the case study literature may suffer from a selection bias whereby researchers take up success stories rather than a random sample of value chains." (Milberg & Winkler 2013, chaps.23–24). In a similar way, Bamber et al. (2013, p.39) contend that limited sample sizes make it difficult to derive conclusions for policy development: "[t]his type of analysis calls for a mixed-methods approach combining firm-level interviews at different segments within chains with analysis of investment and trade flows..." In their recent study of the Ethiopian apparel value chain, Staritz and Whitfield (2017b, p.15) further show how a combination of quantitative and qualitative indicators is crucial to prevent a "bias towards what can be counted." Finally, Coe et al. (2008, p.290) call for a combined use of qualitative and quantitative research to appreciate both "the prevalence of particular structural dynamics and the ability of individual actors to exert their agency and alter the prevailing *modus operandi* of the GPN."

The process of data collection and analysis was conducted in accordance with the Oxford Department of International Development's Research Ethics Committee. Written or oral consent was sought before each interview and a memorandum establishing the anonymous usage of quantitative data was signed with KNBS. Throughout the study, actors' names have been anonymised to preserve confidentiality and protect the identity of the interviewees.

The content and structure of the data, as well as the quantitative and qualitative process of data analysis are explained in detail throughout the study at the beginning of each chapter. This approach is adopted to facilitate the independent reading of each chapter and avoid the impracticality that a single methodological section would represent.

2.7 Conclusion

This chapter provided an overview of the main concepts, literature, and methodology underpinning the analysis in the following chapters.

Section 2.2 defined economic upgrading as a firm capacity to improve its competitiveness and profitability by means of increased unit values and market-share. Furthermore, social upgrading has been conceptualised as an improvement in the quantity and quality of labour. Both these concepts can be consequential to the adoption of new products, processes, and/or functions across the value chain to the extent that the latter can (but not necessarily does) increase profitability and boost wages to retain a skilled labour force.

Section 2.2 further defined *governance* as a twofold concept. On the one hand, the hierarchical relationship between buyers and suppliers at different stages of the value chain (i.e. *internal governance*); on the other, those regulatory and institutional dynamics surrounding to the value chain – i.e. industrial policy, working unions, and civil society (i.e. *external governance*). With the exception of chapter seven and part of chapter four, most of the study focuses on *internal governance*, its relationship to upgrading, and the way this is shaped across different market trajectories.

The literature review in section 2.3 analysed the interrelation of the concepts explored in section 2.2 across the literature on GVCs, GPNs, trade, and innovation.

Table 2.3 summarises how participation in value chains with different market trajectories has been linked to different degrees of economic and social upgrading, as well as governance of buyer-supplier networks. The literature review introducing chapters five and six deal with these aspects in more detail.

Section 2.4 described the criteria for case selection. In this respect, three main considerations were made: (i) the leather sector is low-hanging fruit for several developing countries with more potential for value creation then other agro-based value chains; (ii) by spanning all three market trajectories, the Kenyan leather value chain represents an ideal case for a comparative analysis; lastly, (iii) to the extent that most global linkages with the Kenyan leather industry involve SMEs at up- and mid-stream stages of the value chain, the case is original with respect to a literature which overemphasises downstream linkages within large manufacturing clusters. Furthermore, as explained in section 2.5, findings are generalizable to other agro-based value chains characterised by a similar environment – i.e. the presence of an established entrepreneurial class, a government commitment to support the sector, and a growing domestic market.

Finally, section 2.6 provided an overview of the methodology for data collection and analysis used throughout the study. Drawing on disaggregated export transaction data over a 10-year period and more than 100 semi-structured interviews, the dissertation presents an innovative framework that bridges the gap between qualitative and quantitative methods characterising the GVCs and GPNs scholarship.

Building on the concepts introduced in the previous sections, chapter three presents a descriptive account of the Kenyan leather value chain, its history, and the governance and upgrading dynamics characterising actors' interaction at a sectorial level.

3.

The Kenyan leather value chain:

A descriptive approach

3.1 Introduction

The leather value chain is characterised by high levels of specialisation and integration into GVCs. Previous research on this sector in various regions of the world describes it as having one of the longest value chains, along with the apparel and textile industry. In fact, it is among the top-five industries by length of its value chain and the most fragmented in the light-manufacturing category (De Backer & Miroudot 2014, p.14).[33] In this context, the leather sector has been identified as a buyer-driven value chain where global branders occupy powerful positions in a structure that mimics a "perfect market" with a reduced tendency towards oligopolistic vertical integration (Dallas 2015, pp.8–11; Roy 2013, pp.42–43; Hesselberg & Knutsen 2002). However, as observed in chapter two, several developing countries tend to enter the value chain further upstream in South-South and regional linkages where governance and upgrading dynamics do not necessary liken those described in these studies.

The aim of this chapter is to provide a descriptive account of the Kenyan leather

[33] The authors adopt an index of fragmentation, which indicates the number of production stages involved in a specific value chain. The index takes the value of 1 if there is a single production stage in the final industry and its value increases when inputs from the same industry or other industries are used (De Backer & Miroudot 2014).

value chain based on the study's main concepts – i.e. governance and upgrading. As presented in chapter two, upgrading is defined in terms of increasing profits and better working conditions linked to productivity and value-added activities (Barrientos et al. 2011; Milberg & Winkler 2010). Governance, in turn, has been generally defined as the way in which the flow of products, knowledge, and resources is coordinated in the relationship between buyers and suppliers (Gereffi 1999; Navas-Alemán 2011).

The description presented in the following sections provides an account of the structure and organisation of the leather sector in Kenya to inform the data analysis carried out in chapters four to seven. In addition, it provides contextual information to augment understanding of the dynamics underpinning intra-chain linkages and the institutional framework surrounding them.

The chapter is structured as follows: section 3.2 presents a brief history of the Kenyan leather sector, while section 3.3 further describes its main actors. Drawing on the GVCs literature, section 3.4 assesses governance linkages and sourcing practices among practitioners. Finally, section 3.5 looks at economic and social upgrading across different segments of the value chain and presents a graphic overview of value addition across the chain.

Whilst most of the data presented in this chapter was acquired directly through interviews and secondary data analysis, its purpose remains solely descriptive and accessory to the subsequent chapters.

3.2 Brief history of the Kenyan leather sector

The leather value chain represents a crucial source of wealth creation and employment for African countries. Africa accounts for over 21% of the global livestock population, supplying 14% of the world raw hides but contributing to less than 4% of the

total value of leather and leather goods' trading (Mwinyihija & Quisenberry 2013b). Although Kenya's share is only a small proportion of total African exports, the country has grown to become the second greatest exporter (after Ethiopia) of semi processed hides and skins in the COMESA region and the first main producer of leather goods (excluding footwear). That said, Kenya's overall global share of exported leather and leather products is still minimal (around 0.14% of the global output). The COMESA region, despite a potential market of 365 million pairs of shoes per annum, can barely fulfil 20% of its demand internally (Mudungwe 2012) – the same statistics drops to around 10% for Kenya.

The Kenyan leather sector has a long tradition dating back to 1905. Two of the operative tanneries were founded during the colonial period when most of the production consisted of game-trophies and vegetable tanned leather for the British Empire. The first legislation in the sector was promulgated in 1947, however it was not until the ban on export of raw skins and hides in 1980 that the local tanning and manufacturing industry took over. Through a policy of import substitution with 100% duty on imported leather, a ban on export of intermediates, and a 22% export compensation-scheme to local manufacturers of finished products, the leather industry flourished, becoming one of the most vibrant in the continent. It is estimated that by 1990 Kenya had 19 tanneries with a capital investment of 47.5 million USD,[34] employing 4000 workers and operating at 80% of their capacity (Mwinyihija 2014b, p.14).

In the early 90's, under the umbrella of the International Monetary Fund (IMF) and the World Bank, the Kenyan government embraced a Structural Adjustment Programme (SAP) in order to qualify for the allocation of international subsidised loans.

[34] Calculated at 2013 exchange rates.

Adopting a logic of export-led growth, the government ventured into a process of privatisation, liberalisation, and export promotion policies that led to the abolition of the export compensation scheme, the partial removal of duties on imported goods and foreign exchange restrictions, and the lifting of internal price control mechanisms (Chemengich 2013).[35]

Market liberalisation along with the low purchasing power of the local population allowed the second-hand market of footwear (*mitumba*) coming from Europe, the US and Asia to prosper and, in many cases, to outperform local producers with dramatic implications for the local manufacturing economy.[36] As of 2000, the Kenyan leather sector depended almost exclusively on the export of raw material, with only 5 operative tanneries and a footwear market entirely dependent on foreign imports: "[b]y 2000, despite the UNIDO project and the creation of TPCSI, the Kenyan leather industry had been wiped out under the tenet of liberalisation, traders of raw hides and skins replaced tanners and manufacturers" (*int.* KLDC). Due to the inflow of cheaper products, most tanneries closed down while exports were downgraded to raw, unprocessed materials. According to Shirley (2011), employment in the leather value chain decreased by almost three times in this period, with the consequent drop in value-added income.

The change of government in 2002 sparked a vibrant debate on how to revive the local manufacturing sector. This climaxed in the launch of the Vision 2030 in 2006 and its implementation in 2008 (wherein the leather industry was identified as a flag-ship sector). As a result, a major change was brought about in 2006 with the introduction of

[35] The SAP came into effect in Kenya through the promulgation of the Sessional Paper No 1 of 1986, however it was implemented only in the early 90's with the formal establishment of the Export Promotion Council (EPC) in 1992.

[36] A total of 8.5 million pairs of shoes are imported through the second-hand market; this compares to about 3 million pairs of local production (World Bank 2015, p.17). Refer to chapter seven for a more accurate coverage of this aspect.

an export tariff of 20% on the value of raw skins and hides, doubled to 40% in 2007 and further increased to 80% in 2012.[37] The export tariff was the consequence of a reform started in 1987 with the enactment of Cap 359 of Kenya laws, which fell into oblivion in the post-liberalisation years. The aim of this act was to allow for an inclusive platform where private and public stakeholders could oversee licensing, conduct research, and define common marketing approaches. This was finally achieved with the creation of KLDC in July 2010, a coordinating board uniting private and public stakeholders with the clear goal of favouring value addition and forward-integration.

[37] Supplement number 221, Act number 57 of Finance Act 2012.

Table 3.1: Status of the Kenyan leather industry upon liberalisation

	1996-2000	2001-2005	2006-2010	2011-2014
Export trends	15% processed 85% raw	75% processed 25 % raw	90% processed 10% raw	98% processed 2% raw
Livestock (million heads)	10 cow 7 sheep 11 goats	12 cow 9 sheep 13 goats	17 cow 17 sheep 25 goats	20 cow 19 sheep 30 goats
Production (million pieces)	6.3	7.82	8.25	8.65
Processed leather (million sqf)	45 hides 35 skins	45 hides 50 skins	75 hides 65 skins	90 hides 70 skins
Footwear production (million pairs)	1.3	1.6	1.9	2.4
Tanneries	17 (4-5 operating)[38]	9	13	15-16
Cottage Units[39]	15	17	24	>30
Leather Goods Units[40]	15	12	47	200
Employment	1700	2500	16740	22000[41]
Total Earnings[42] (million USD)	23	33	69	140

Source: Author's elaboration based on COMESA LLPI and the Statistical Compendium for Raw Hides and Skins (FAO 2014). Part of this table is published in Mwinyihija and Quiesenberry (2013b, p.523) and Mwinyihija (2014a). Employment and wages data is from KNBS (2014).

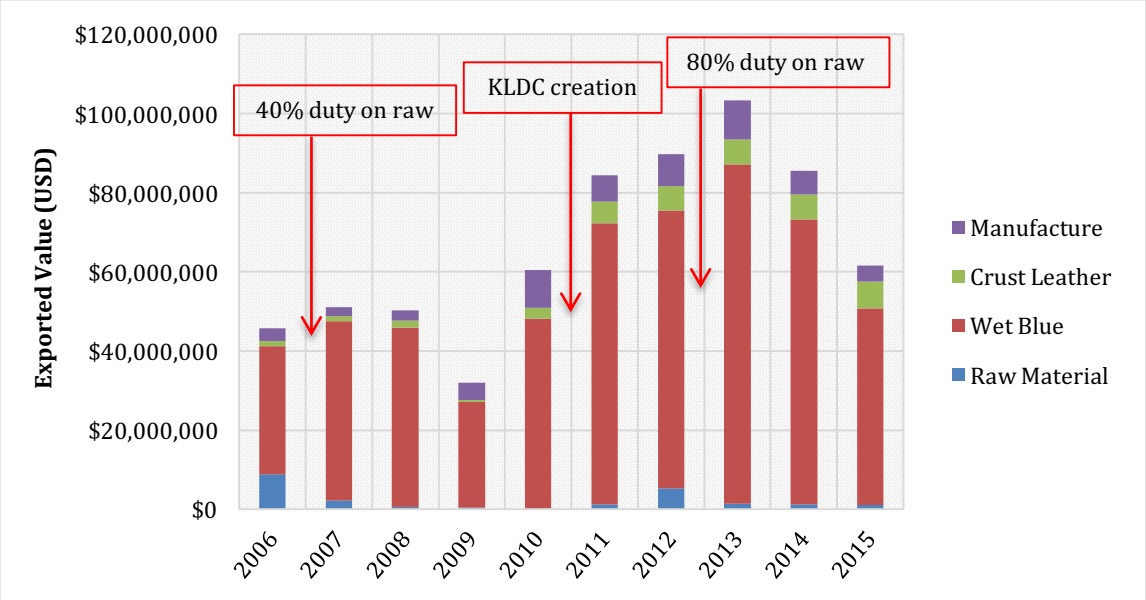
Table 3.1 illustrates how the industry changed since liberalisation. From 2000, not only has the amount of livestock slowly increased, but so did the number of processing units and their final output. Employment further exploded following the government's new protectionist measures in 2006. According to Mwinyihija (2014a), this was the result of various national polices strategizing the leather sector's economic growth – such as the Strategy for Revitalizing Agriculture, the Economic Recovery

[38] In this period of time, most registered tanneries were not processing- but rather trading-units. At the time, the government was running an export compensation programme, which favoured the emergence of "false operators" taking advantage of the policy (Mwinyihija 2014a).
[39] Includes rural tanneries, cobblers, and leather utility areas (leather soles, shoe linings etc.) other than leather goods (e.g. handbags, travelware, belts, apparel, etc.) – see chapter seven for a clear definition.
[40] Includes leather goods manufacturers other than footwear (e.g. handbags, travelware, belts, apparel…)
[41] A similar estimation made in 2014 for the previous year by the government sets this number at 14,000. This could be due to the exclusive focus on formal businesses. The current estimation comes from COMESA-LLIP and Mwinyihija (2014a) – confirmed in an interview with the author.
[42] Earnings are calculated only on exports for the last year of each interval.

Strategy for Wealth and Employment Creation, and, as already mentioned, the Vision 2030.

Whilst the consequences of the export tariff and the coordinating work of KLDC have been described elsewhere (Curtis 2010), figure 3.1 points to the changes in terms of exported value-added between 2006 and 2015. This period has witnessed an increase in the overall production and export of semi-processed leather, with a drastic reduction in the export of raw material. Furthermore, according to KNBS statistical abstract for 2014, the value of leather exports has doubled since 2009 with over 90% of it deriving from exports of semi-processed wet blue material. As stressed by Mwinyihija (2014a, p.23), the role of KLDC in this context has been crucial: "[t]he progress so far achieved has been through the public-private participation. For instance, the taxation regime was reached through a stakeholder forum where the period of implementation was agreed upon together with the roadmap of the leather subsector towards Vision 2030".

Figure 3.1: Yearly Kenyan exports by functional stage



Source: Author's elaboration based on official export figures (see chapter four).

3.3 Actors and major constraints

The following paragraphs present the main actors operating in the Kenyan leather value chain from the most upstream agricultural pre-slaughtering stage to processing and manufacturing downstream activities.

The pre- and peri-slaughtering stages are common to both the meat and the leather value chains and include all activities from livestock farming to the abattoir.

According to KNBS (2014), there are about 20,000 workers involved in cattle raising, and another 32,000 dealing with other support activities for animal production. This data translates into about 700-800 ranches of various sizes, 100 of which responded to the survey on the leather value chain conducted by KLDC in 2013. The major concern in this sector is access to finance, which relates to the incapacity of producers to engage in preventive actions to counter skin diseases, pay for veterinary support, and finance artificial breeding. The survey also shows a high degree of competitiveness due to the scarcity of livestock and the large number of herdsmen, which generates a "scramble" on the few animals available for slaughtering (Mwinyihija 2014a; Mwinyihija 2014c; Mwinyihija 2014b).

Concerning the slaughtering stage, COMESA-LLIP estimates there are approximately 2000 slaughtering facilities across the country, of which only 20-30% are equipped with appropriate flaying tools. In the survey conducted by KLDC in 2013, 40 slaughterhouses responded to the questionnaire showing a high degree of competitiveness in ensuring a slice of the livestock take-off. Moreover, lacking other sources of credit, a high dependence on traders' soft-loans obliges slaughterhouses to supply at a price predetermined by negotiations between tanners and traders.

In the absence of specific external policies, farmers and slaughterhouses are prone to protect the quality of the meat over the health of the hide. In this respect,

according to the Veterinary Department, the lack of coordination in the regulation of the meat industry, which falls under the Kenyan Meat Commission and those of the leather industry scattered between the Ministry of Agriculture and the Ministry of Industrialisation, has a negative impact on the quality of the raw material. An example is the fact that workers in many slaughtering facilities are paid on a piecework basis, lacking incentive to assure quality in the flaying procedure (World Bank 2015, p.30).

The post-slaughtering stage includes all the activities that follow the separation of the hide from the carcass – i.e. trading, tanning, and manufacturing.

Based on the KLDC survey and this study's interview with COMESA-LLIP, the number of traders ranges around 200-250. A vast majority of actors are involved in the trading of raw hides and skins. However, since the introduction of an export tariff in 2006, most of them went from exporting raw material to becoming middlemen between producers and tanners. In some notable cases, such as those of Tan-2 and Tan-6, they moved into tanning themselves. Traders operate under high competition and reduced profits that they transfer upstream through fixed prices and soft-loans to producers. Many traders operate across very large distances with collection centres sparse around the country, acquiring raw material even from neighbouring countries such as Somalia and Tanzania. Traders therefore require consistent knowledge to inspect quality, select grades and, in some cases, advise slaughterhouses on flaying techniques.

The tannery is where skins and hides are processed into wet blue, a semi-finished product obtained using chromes and other chemicals. In some cases, tanneries may also continue the transformation process to crust and finished leather. Tanning is the most capital-intensive stage in the value chain and the one that requires the largest investment in terms of machineries, water processing infrastructure, and chemical inputs. This notwithstanding, depending on the level of processing achieved, margins are quite

narrow with raw material constituting up to 50% of total production costs and profits ranging between 10% for wet blue to 20-30% for crust and finished leather. As of 2016, there were 15 operative tanneries in Kenya. This number has been steadily increasing since 2006 when the tariff on the export of raw hides incentivised local processing. All tanneries depend for most of their revenue on the export of wet blue, although an increasing number of actors are integrating crust and finished leather for the local and regional market. Moreover, in the last few years, some tanneries have upgraded into footwear manufacturing.

At present, tanneries represent the last segment of the Kenyan chain for almost 85% of total exports across the chain. Of this 85%, 90% is constituted by wet blue and 7-8% by crust and finished leather.[43] Most tanneries are concentrated in the Nairobi area, where they have easy access to traders and manufacturing markets (Mwinyihija 2014b, p.21). Tanners' major complaint concerns the uncertainty of international wet blue prices, the instability of the local and regional market, and the scarce quality and comparatively high prices of raw material.[44]

Whilst for most of its total value, the chain terminates at the tanning stage with the export of wet blue, about 10% of production is finished and enters the manufacturing stage in the local and regional market. In this respect, manufacturers are divided in two main groups: footwear producers and handbag manufacturers.[45] Moreover, wholesale leather suppliers are often present in-between tanneries and small manufacturers who

[43] Data calculated for 2013 and 2014 based on KRA single entry dataset (see chapter four).
[44] According to Mwinyihija (2014a, p.24), irrespectively of the 10.6 million skins and hides produced in the country in the period 2011-2013, tanners still voiced an inadequacy in the supply of raw material. As their capacity should have been fulfilled with about 7 million pieces, this phenomenon casts doubts on the availability of raw material for local transformation and manufacturing.
[45] Refer to chapter seven for more information.

cannot purchase the large quantities required to deal directly with tanneries.[46]

According to KFMA, there are over 500 footwear producers in the country, 200 of which are located in Kariokor Market. The vast majority of footwear entrepreneurs operate in the informal economy with few or no machineries. According to recent government research, Kariokor Market alone produces around 2.7 million pairs of shoes per year, 90% of which are sold locally and the remaining 10% regionally. Footwear manufacturers are the actors in the chain that are most exposed to foreign competition under the import of second-hand and low-quality shoes. This is exacerbated by the lack of skilled labour, the high cost and low bargaining power in purchasing finished leather, as well as the unavailability of components locally and the cost of importing them – the current import duty on components at 25%.[47]

Footwear production includes office shoes, military and safari boots, school shoes and sandals. These are all *capsule* products, characterised by constant designs and low development costs. In terms of profit margins, according to the World Bank (2015), a pair of shoes made in Kenya has an average production cost of about 9.4 USD, compared to 7.2 USD in Ethiopia, the regional champion in the footwear industry. The main factors explaining the higher production costs are the price of leather and other inputs, which are in turn a consequence of the lower procuring and tanning costs upstream the value chain (1.60 USD for a Kg of hide vs. 0.72 USD in Ethiopia). Table 3.2 shows the local vs. imported market shares for leather footwear by market segment.

[46] According to the World Bank (2015, p.25), there are three main formal stores in Nairobi and about 10-20 middlemen who sell directly to small manufacturers in Kariokor Market. Several other stores are present around the country in Mombasa, Nakuru, Kisumu, and Nanyuki.
[47] Soles are now available form Kenyan producers.

Table 3.2: Quantity of imported vs. locally-produced footwear by market tier (million pairs)

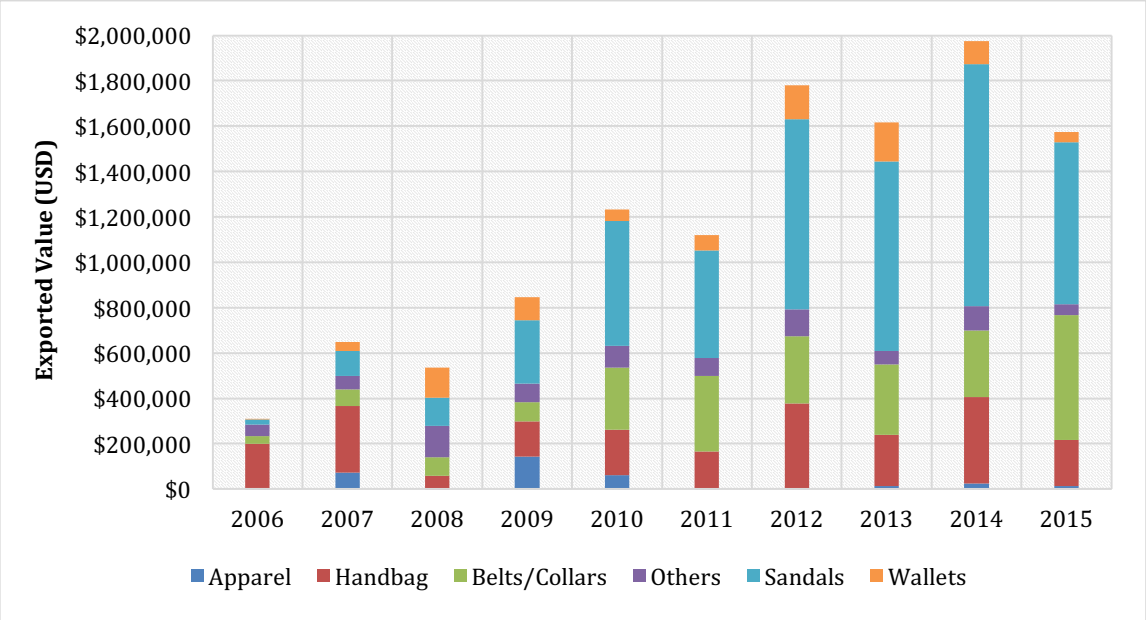
Footwear type	Leather imported	Leather Kenyan
Second-hand	8.5	-
Low-price	2.2	2.6
Mid-price	0.9	0.7
High-price	0.2	0.0
Total	11.7	3.3

Source: World Bank (2015, p.14).

According to the Leather Articles Entrepreneurs Association, there are over 500 units manufacturing different kind of leather goods around the country. These are concentrated mainly in Nairobi (60-70 informal workshop in Kariokor Market) and the Malindi coastal region, which alone accounts for more than 300 workshops. Over 90% of these workshops are mini enterprises with fewer than 10 workers, the majority of which are informal. At present, no producer has yet managed to grow the business into a large enterprise with more than 100 employees. Nevertheless, a few actors have developed large workshops with 20 to 90 employees and increasingly growing business perspectives. Leather goods production has no established tradition in Kenya and is considerably smaller than the leather footwear subsector. Nevertheless, it is the most competitive in global markets, having grown by 5.5 times between 2007 and 2013 and by another 50% in 2014 (compared to 2007).[48] Figure 3.2 displays the export growth of the sector by good and chapter seven further illustrates the data in comparison to the footwear segment.

[48] 2007-2013 data is from World Bank (2015) based on COMTRADE data. 2014 data is based on the study's dataset (see chapter four).

Figure 3.2: Exports of leather goods (excluding footwear and footwear components)



Note: Sandals are classified as non-footwear leather goods for reasons clarified in chapter seven.
Source: Author's elaboration based on official export figures (see chapter four).

While KLDC constitutes the first and only cross-sectoral institution operating in the value chain, other organisations exist to represent the interest of stakeholders at specific levels of the chain. This is the case of LAEA, KFMA, the Kenya Tanners Association (KTA), and the Kenya Association of Manufacturers (KAM).

KFMA has been in place since the 80's with the aim of bringing together the footwear sector and providing a forum to support the industry. As of today, however, the association has scarcely brought together more than a handful of producers, mainly in the Nairobi area (50 out of over 300, with very few of them committed in the association). The main constraint faced by the organisation is the informality of the sector where most producers fear potential repercussion from public listing.

LAEA was created in 2013 under the aegis of KLDC. It brings together players involved in the production and commercialization of handbags and other leather articles (excluding footwear) made in Kenya. Their current goal is a complete profiling of

industry players across the country in order to define their challenges and up-scale the sector through cluster creation, marketing initiatives, and mentoring.

KTA was funded in the early 60's to represent the interests of Kenyan tanners vis-á-vis the government. Recently, the association has played a pivotal role in lobbying the government towards the introduction of a duty on the export of raw hides and skins. It works closely with KLDC and has been at the forefront of the campaign against the illegal export of raw material in the last few years. Moreover, KAM spans all manufacturing sectors acting as a private body and representing the interests of its members at the ministerial level. However, due to the costs involved, so far only 5 tanneries and 5 manufacturers in the leather sector are part of the association.

Along with these organisations, there is a set of public institutions whose scope is to conduct research, share knowledge, and provide training to both tanners and manufacturers. These are mostly the inheritance of the import substitution era and, according to the World Bank (2015, p.42), they are often plagued by a lack of coordination and overlapping of their respective agendas. Created in 1965 by FAO and controlled by the Ministry of Agriculture, the Animal Health and Training Institute (AHITI) provides training in leather technology and hides inspection as part of a 2-year programme. The Kenya Industrial Training Institute (KITI) was also founded in 1965, to provide practical skills in tanning, footwear manufacturing, and entrepreneurship as part of 1 and 2-year diplomas. However, unlike AHITI, KITI is under the sphere of the Ministry of Industrialisation.

Other institutions pursuing a similar curriculum are the Kenya Industrial Research and Development Institute (KIRDI) and the Training and Production Centre for the Shoe Industry (TPCSI). Created in 1979 under the Ministry of Industrialisation, KIRDI's leather department provides a research and development hub for the tanning

industry. So far, however, it has mostly engaged in consulting and outsourcing activities for finishing leather. KFMA, along with KTA, KAM, and UNIDO started TPCSI in 1994 to provide training courses in footwear and handbags design and manufacturing. However, as with KIRDI, at present TPCSI is used mainly by manufacturers as an outsourcing workshop to rent labour and machineries.

In the last decade, several universities and private institutes have introduced classes and courses related to leather sciences, as well as fashion and design. Two universities in the country provide degrees in Leather Science (University of Nairobi and Dedan Kimathi University) and at least five other institutes offer programmes in fashion design (Kenyatta University; Mcensal School of Fashion and Design; Buruburu Institute of Fine Arts; Evelyn College of Design; Technical University of Kenya). Furthermore, when it comes to quality control, the Kenya Bureau of Standards Certification Body issues KEBS certifications on leather, as well as on manufacturing products such as shoes, sandals, and belts. The costs and bureaucracy to acquire such certificates is often quite cumbersome for local producers who lament that standards are often not enforced on imported goods, generating unfair competition.

Finally, when it comes to labour rights and environmental protection, the Kenya Shoe and Leather Workers Union (KSLWU) and the National Environment Management Authority (NEMA) are the main institutions of reference. Created in 1960, KSLWU defends the right of permanent workers who are members of the union under Art. 41 of the Kenya Constitution, which allows for voluntary membership in working unions. The union constitutes a link between workers and employers to protect the interest of the former not to be victimized and exploited, especially in terms of retribution, working hours, and general labour conditions. Every two years they sign separate collective bargaining agreements with formal employers defining all aspects of

workers' contracts, applying to permanent workers only (though in some cases clauses for casual workers are negotiated). As of 2016, the union represented approximately 850 workers across the tanning and leather manufacturing sectors within 8 companies – see table 3.3.[49] Participation in KSLWU however is often banned in many large tanneries and it is more consistent among footwear factories where employment conditions and salaries tend to be higher. Moreover, while membership to the Union was quite broad during the 80s and 90s, with liberalisation the numbers dropped as increasing competition led to cuts in labour costs (*int.* KSLWD).

Table 3.3: Numbers of KSLWU members as of 2016 by firm

Firm	Function	Unionised members
A	Footwear manufacturer	350
B	Footwear manufacturer	150
C	Footwear manufacturer	14
D	Footwear manufacturer	120
E	Tannery	130
F	Tannery	25
G	Tannery	25
H	Tannery	Ongoing

Note: Data for 2016.
Source: Author's elaboration (survey data).

3.4 Policy environment

Section 2.4.3 in chapter two pointed to the importance of state midwifery and husbandry polices in triggering successful upgrading in GVCs. This section identifies the major industrial policy measures undertaken by the government of Kenya in recent decades and categorises them based on Talbot's (2002) and Evan's (1995) framework. According to Evans' (1995, pp.3–18), developmental outcomes within specific sectors of the economy depend on qualitative differences of state intervention. Looking at the IT

[49] The total number of members is 2650; this, however, further includes the plastic footwear industry.

industry in three developing countries, Evans conceptualises four roles of the state in defining industrial policy. These are: (i) a *custodian role* whenever the government enforces rules aimed at preventing or limiting initiative of private actors; (ii) a *demiurge role* whenever the government establishes companies under its direct control; (iii) a *midwifery role* whenever the government assists new or existing entrepreneurial groups "to venture into more challenging kinds of production" by protecting new sectors from external competition; and (iv) a *husbandry role* whenever the government cajoles private entrepreneurial groups in meeting business challenges by setting up organisations to take over risky tasks such as environmental plants and research and development.

Drawing on a set of case studies, further supported by subsequent literature in agricultural and manufacturing value chains (Talbot 2002; Nickson 2008; Buur et al. 2011), Evans (1995) suggests that a combination of midwifery and husbandry roles is the most effective in fostering industry development. Talbot (2002) reinforces Evans' theory by applying it to agro-based processing industries across developing countries, demonstrating how midwifery and husbandry approaches are more conducive to functional upgrading and value addition.

As displayed in tables 3.4 to 3.6, after an initial period characterised by a demiurge and custodial role of the state, the Kenyan government abandoned the protectionist approach that characterised the import substitution era. After a decade of export oriented industrialisation characterised by deregulation, liberalisation, and non-intervention in the 90s and early 2000s, the Vision 2030 and the recently approved Leather Value Chain Strategy inaugurated a set of *midwifery* and *husbandry* policies aimed at supporting the upgrading of current players while nurturing new-comers.

Ever since the creation of KLDC in 2010, there has been a growing call for the definition of a coherent leather value chain strategy to identify initiatives for value addition and establish institutional coordination across the chain. It is in this optic that the Leather Value Chain Strategy was formulated through the common effort of COMESA-LLIP, KLDC, the government of Kenya and a set of selected stakeholders, in accordance with the broader COMESA Regional Strategy for the Leather Value Chain (2011; UNECA 2015, p.105). Approved in 2015, its main pillars identified a set of policies and implementation instruments to be adopted by the government to support value addition across all segments of the value chain. The core strategy spelled out in the new agenda aims at supporting three key areas of value addition – export of finished leather; increase production of high value-added products for EU and US markets; and increased production of low value-added footwear for the local and regional market.

The evolution of the institutional framework is described in the tables 3.4 to 3.6 below and classified according to Evans and Talbot's threshold. Chapter seven builds upon this classification to illustrate how different policies impacted on the economic and social upgrading of footwear and leather goods manufacturers. Furthermore, chapter four evaluates the impact of the 2007 and 2012 government's decision to introduce duties on the export of raw material. Institutional measures are broadly categorised here under the concept of *external governance*.[50]

[50] Notice that the following sections refer to industrial policy and external governance to indicate the same concept (see chapter two).

Table 3.4: Measures implemented during import substitution (70s – 1994)

Midwifery role
22% export compensation-scheme to local manufacturers of finished products
Custodial role
100% duty on imported leather garments
Complete ban on the export of raw skins and hides in 1980
Complete ban on export of intermediate goods (including semi-processed material)
Demiurge role
Creation of state owned and managed training and supporting units such as AHITI, KITI and KIRDI
State intervention and public subsides towards the creation of tanneries in the periphery (e.g. Tan-10 in 1982 and Tan-9 in the late 70's)

Table 3.5: Reforms implemented under the Vision 2030 (2004-2014)

Midwifery role
Imposition of a 20, 40 and 80% export tariff on raw skins and hides respectively in 2006, 2007 and 2012 – according to Curtis (2011), this was done with a promotional intent and not with the aim of raising revenue.
EAC duty remission for inputs if production is exported outside EAC (2008)
Definition and approval of a plan for the creation of the Leather City as an industry park in Athi River, Machakos under the coordination of the Task Force (2014).
Husbandry role
Creation of KLDC (public-private partnership) under State Corporation Act Ch. 446 of the Law of Kenya to promote, coordinate and harmonise activities within the leather value chain, oversee licencing, define common marketing strategies, provide advisory services to the ministry and coaching to actors throughout the chain (2010).
Creation of LAEA (private organisation) and strengthening of other horizontal associations such as KFMA under the aegis of KLDC.
Formation of a Leather Task Force for the development of a five-years plan to define a coherent strategy towards value addition in line with the Vision 2030 (2010-2015).
Creation of a training centre for footwear manufacturing in Thika (1994) and further strengthening of other research and training institutions such as AHITI and KIRDI (though their coordination remains scattered across different ministries).
Partnership with COMESA-LLIP which favours research and data dissemination as well as networking between the government and value chain stakeholders.
Programme aimed at genetic improvement of the national livestock herd under the Livestock Policy Strategy issued in 2008
Demiurge role
Creation of a 2 million USD fund for the development and upgrading of medium sized tanneries in rural areas to favour local processing and value addition – now incorporated in KLDC project for the development of 7 mini tanneries in the periphery (2012).

Table 3.6: Newly approved measures (2015-ongoing)

Midwifery role
Development of a leather industry park (already approved in 2014) to lower barriers to entry for emerging companies and favour economies through the creation of shared infrastructure such as the

costly water effluent treatment plants for tanneries.
Husbandry role
Creation of the Leather Cluster Working Group with 100 stakeholders across the chain to identify and implement actions aimed at positioning Kenya in higher value-added segments and improving linkages and coordination across different levels of the chain.
Decreasing import duties on leather tanning and manufacturing inputs from 25% to 10%.
Address the short supply of designers and leather product marketers through the institution of specific professorships at the main Business Schools and the creation of an HR placement service at KLDC with a list of skilled artisans across the various tasks so that enterprises in need of skilled labour can easily reach out.
Promote participation of tanneries into the Leather Working Group international certification (currently 2 tanneries) and the institutionalisation of other standards and certification in cooperation with KNBS.
Creation of recognition and award programs to foster competition and quality at different segments of the chain, promote innovative business models, facilitate market segmentation and provide low-cost information.
Promote a system of geographical indications to link a specific locality to a segment of the chain where it excels. This is to be done through competitive tenders.
Developing a Leather Marketing Entity to create a business-to-business e-commerce platform, define and promote the branding and facilitate the access of local producers to the domestic market through public procurement contracts.
Establishment of 2 business accelerators (one for the formal sector and one for the informal sector in Kariokor Market) to foster growth of companies by offering physical space and equipment, a pilot tech centre, support in creation of shoe design, joint production and marketing projects and information exchange.
Strengthening KLDC with sufficient resources to coordinate all leather institutions (TPSCI, AHITI and the leather departments of KITI and KIRDI, currently under the supervision of different ministries that results in inefficiencies and efforts' duplication)
Restructure and upgrade of TPCSI with internal boarding facilities
Institutionalise public sector procurement of Kenyan footwear in collaboration with manufacturers. This allows manufacturers to draw on a guaranteed market to reach a certain level of scale and promote their product.
Custodial role
Enforcing of COMESA rules of origins to prevent the access of sub-standard imports in the market by means of third party pre-shipment inspections.
Enforcing the environmental regulatory framework across the sector.

Source: Author's elaboration based on Evans (1995) and Talbot (2002).

3.5 Governance of the Kenyan leather value chain

Governance has been defined as the way in which the flow of products, knowledge, and resources is coordinated in the relationship between buyers and suppliers. Section 2.1.3 in chapter two outlined a framework to understand governance in terms of relational linkages between actors. Within the leather value chain, sourcing

occurs at three levels: raw material; semi-processed wet blue; and crust and finished leather.

Sourcing of raw material: The control over the supply of raw material impacts on the quality of the final product, especially in the wet blue market where corrections cannot be made until the *buffing procedure*. Competition to secure skins and hides does not involve only tanneries, but also traders of raw material and smugglers.[51] Having to compete with illegal trading means that tanneries have to pay a higher price to secure supplies of comparatively low quality material.[52]

Illegal export of raw material is often managed by foreign traders who set up collection and storage points in remote areas, smuggling the material into containers officially as *wet blue* to avoid tariffs. Smugglers are usually general-traders with no knowledge of the industry whatsoever. In many cases, it is a matter of reinvesting local currency obtained through the importation of goods from abroad (*int.* KRA). This allows traders to have a cash flow to pay producers and butchers within two to three weeks and outperform tanneries in the acquisition of raw material. As most smugglers do not possess the knowledge to inspect and select raw hides, there is no control or integration with farmers and abattoirs (*int.* Tan-2, KLDC). In these circumstances, suppliers are "dis-integrated" from the chain and the chain "re-starts" abroad upon stocking and distribution of the raw material (*int.* Tan-9).

Sourcing of semi-processed wet blue: Over 80% of Kenyan exports in the leather value chain are semi-processed leather in wet blue form. Depending on the end-market, the type and quality of export changes. The trading channels also vary considerably. The

[51] KLDC estimates that around 20% of the total production in 2012 may have been smuggled (*int.* KLDC). Having to compete with illegal traders implies that local tanners have to pay higher prices to secure provisions (World Bank 2015, p.53).
[52] According to both the World Bank (2015, p.52) and Mwynihija (2014d, p.112), procurement of raw hides and skins accounts for about 50% of the tannery costs.

Chinese market relies mostly on traders with limited or no direct contact with Kenyan suppliers. Conversely, the Italian market buys almost exclusively directly or through entrusted agents. As observed in chapter five, this aspect has a considerable impact on the way the chain is governed. Some smaller tanneries are involved in sub-contracting activities for other major tanneries or traders. In these cases, the contractor manages the procurement of raw materials while the contracted unit is paid a fee per tanned lot.[53] Subcontracting activities, at least at the beginning, are monitored closely by contractors to ensure quality and speed of delivery.

Sourcing of crust and finished leather: The local and regional markets acquire almost exclusively crust and finished leather. Sourcing occurs by three main channels (Mwinyihija 2014b). Firstly, there is a platform for informal purchasing via traders who buy directly from tanneries and re-sell their leather to small producers in informal hubs (e.g. Kariokor Market in Nairobi). Whereas the quality of the leather here can vary greatly, it is provided on a randomised basis with limited space for producers to dictate specifications. Secondly, larger producers purchase leather directly from tanneries. This allows them to make customised orders with grade, colour, size, and pattern specifications. The process usually works through the development of samples in strict cooperation with the tannery. Finally, there is a third group of vertically-integrated tanners. These players have recently emerged as a consequence of several factors that will be considered in the following chapters. At this stage, it is sufficient to mention that around six to seven tanneries have undergone an upgrading process into footwear production with leather sourced directly from their finishing plants.

Considering the sourcing relationships described above and the framework of section 2.1.3, table 3.7 points to the governance structure underpinning suppliers'

[53] One lot is equal to 4000 Kg of raw material.

market relationships. The outcome shows how different modes of governance coexist at different levels of the value chain depending on aspects of quality control, price, market trajectory, and firm size. Chapters five and six consider these linkages and explain their relevance in terms of value distribution and upgrading.

Table 3.7: Actors and governance of the Kenyan leather value chain

	Actor	Activity	Governance relation
Pre-slaughtering	Farm / herdsmen	Livestock breeding.	**Market based:** Farmers sell at auction rings where quality is evaluated based on price and inspection (no formal contract). Assistance, when present, is externally provided by the veterinary department and the ministry of agriculture. There are many buyers and many producers; although in remote areas, few traders limit herders' bargaining power. Dependence on intermediaries is therefore low.
Peri-slaughtering	Abattoirs and slabs	Separation of meat and by-products / flaying of hides.	**Multiple (from network to hierarchy):** Most of the time, the slaughterhouse is contracted: upon slaughtering it takes the hide and the interiors as a payment for the procedure, while the producer takes the payment for the meat. Slaughterhouses are sometimes integrated with curing premises to increase efficiency and value (e.g. Kirugoya). Otherwise, slaughterhouses agree with curing premises the price beforehand and the price is paid on loan by the curing premises (hides per Kg / skins per piece). The procedure may imply supervision by traders who need to salt the material within 6 hours upon slaughtering to prevent putrefaction.
	Curing premises + Skins and hides traders	Preserve the hides through wet salting / air-drying / ground-drying and delivering to tanneries (or direct export as raw).	**Multiple (from market to hierarchy):** Depending on the tannery traders are dealing with, the level of control and assistance may vary considerably. Traders gain from their capacity to provide tanneries with high quality material. For this reason, they assist slaughterhouses and, in some cases, provide equipment and machineries. The flaying procedure is crucial and entails experience, training, and tacit knowledge that cannot be easily codified. The failure of public institutions to guarantee this procedure has pushed some tanneries to invest directly to assure the supply of quality material through training and soft-loans to traders. Traders, in turn, extend loans to butchers and producers, fixing prices over time with pre-paid contracts. Traders may also establish collection points, (sometimes financed by tanneries). This creates a bias in the supply chain, with some tanneries securing high quality hides and others having to deal with constant uncertainty.
Post-slaughtering	Tanners	Salt removal, grading, tanning and crust/finishing.	**Multiple (from market to network):** Tanneries establish different relationships with different buyers. Concerning the export of wet blue and crust, more relational forms of governance tend to characterise the exchange with northern markets (e.g., Italy), while more indirect and market-based exchanges characterise the link with southern markets (e.g. India and China). The price fluctuates in global markets.

	Wholesale suppliers	Stores sourcing leather from tanneries and retailing it to small manufacturers.	**Network based:** Wholesalers buy finished leather from tanneries. They make specific orders based on quality, colour, printing etc. Tanners establish prices. Wholesalers have low bargaining power due to the limited number of tanneries they can source from. Assistance is limited to codified information and samples' sharing. Material is usually pre-ordered based on sporadic but regular exchanges.
	Manufacture	Footwear and leather goods' producers.	**Multiple (from market to hierarchy):** a few tanneries have integrated footwear production into one single hierarchical unit. Depending on their size and market trajectory, local and regional manufacturers establish with tanneries network- or market-based relationships. The first is more likely among larger and/or high-end manufacturers, while the second tend to be the case for small and informal producers. Price is usually controlled by the tanner due do the scarce availability of alternative options and the inconvenience of importing leather (25% duty and time-constraints).

Source: Author's elaboration based on table 2.1 in chapter two.

3.6 Economic and social upgrading in the Kenyan leather value chain

The concepts of economic and social upgrading have been defined in chapter two. Whilst economic upgrading refers to value creation through improved products, processes and functions, social upgrading has been used to indicate advances in labour conditions (Barrientos et al. 2011).

Chapter two stressed how functional upgrading is expected to have a positive impact on market development to the extent that "sustainable income growth can only be achieved by developing the capacity to identify and move into those economic activities that provide the higher potential for value accretion across each specific GVC" (Kaplinsky 1998, pp.14–15). Yet, section 2.2.1 also pointed to case studies questioning this hypothesis and illustrating how functional downgrading is, in some cases, more desirable than upgrading (Ponte & Ewert 2009; Gibbon 2004b).

This section looks at the relationship between functional, economic, and social upgrading within the Kenyan leather value chain, examining whether increasing functional stages are indeed characterised by higher economic and social returns. The analysis is limited to a macro-sectorial approach. Chapters four to seven extend the

research to aspects of functional, product and process upgrading within, rather than just across functional linkages in the chain. The goal here is to understand the extent to which, in the Kenyan case, downstream activities are more profitable and/or associated with higher wages and employment than upstream stages. If this were not the case, there would be limited scope in questioning why firms do (or do not) functionally upgrade.

3.6.1 Economic Upgrading

In their seminal work *Outsourcing Economics*, Milberg and Winkler (2013, p.240) introduce the concept of vertical specialised industrialisation as the new paradigm of economic development: "[n]ow the issue facing firms and governments is less that of finding new, more capital-intensive goods to sell to consumers in foreign countries. Instead, it requires moving up through the chain of production of a particular commodity [..] into higher value-added activities." Table 3.8 and figure 3.3 show how "moving up through the chain" has the power to generate positive economic externalities in the Kenyan leather value chain.

A review of value distribution and gains across the chain suggests a correlation between functional and economic upgrading to the extent that higher stages of value additions attract increasingly higher prices and profit margins. Columns three and four show that profits increase as more value is added to raw hides, while columns five and six indicate the respective share of world trade and Kenya exports. The values in column six further point to the potential available to the leather sector in the country.

Note that profitability is understood here in terms of *net revenue* as a percentage of *total revenue* – i.e. the item's selling price minus the cost of labour, taxation, and intermediate inputs. It therefore excludes the depreciation of fixed capital, inventory

costs, as well as any risk estimation. The relationship between risk and revenues at is further addressed in chapters six and seven. [54]

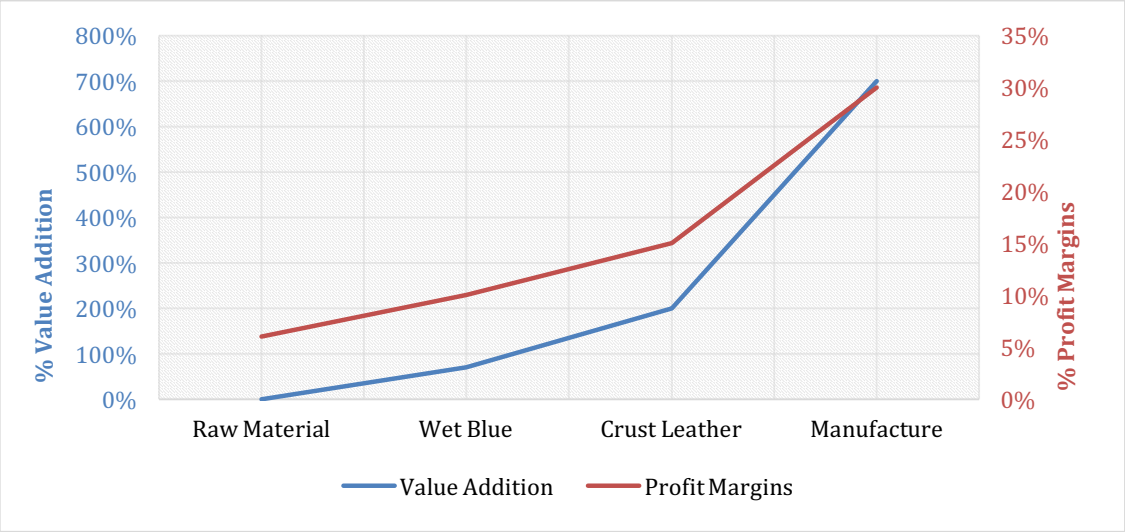
Table 3.8: Value addition across functional stages

	Market value (Kenya)	% Value Addition[55]	Profit margins	% World Market Trade	% Kenya Export
Raw material	0.90 USD/Kg[56]	+ 0%	6-8%	6.5%	3.4%
Wet blue[57]	0.85 USD/sqf	+ 70%	8-10%	4.5%	82.2%
Crust and finished leather	1-2 USD/sqf	+ 200%	15-20%	15.3%	5.8%
Manufacture[58]	3.6 USD/sqf	+ 700%[59]	20-200%[60]	73.7%[61]	8.5%[62]

Source: Data on market value are calculated from average unit values and interviews with tanners and manufacturers. As quantitative data in the dataset are expressed in Kg (whose equivalent in sqf differs across products and HS coding), an average has been calculated and compared with the data provided by tanners. Shares of value addition are calculated based on price for 1Kg of material at each stage. Data on profit margins is based on interviews and should be interpreted as net revenue. Data on the percentage of total world trade is based on ITC. The percentage of Kenya export is derived from the author's dataset for 2014 – this reflect the data provided by the World Bank (2015).

[54] The data on value addition and profit margins in table 3.8 were acquired during informal interviews with small and micro businesses with no access to the firms' financial statements. This represents the *mark-up* made by the producer and it is obtained dividing net revenues by total sales (it is therefore different from the return on investment, which is the result of total revenue divided by capital investment). A similar definition of profitability is adopted in other value chains studies targeting similar respondents (Mekonnen et al. 2014; Beuchelt & Zeller 2011; Sánchez-Ancochea 2013, p.7; Staritz & Whitfield 2017a).
[55] Calculated as a percentage of value addition and profits by each function compared to raw material.
[56] About 0,50 USD/sqf.
[57] Raw material and wet blue data is for cow hides.
[58] A footwear manufacturer requires about 2.8 sqf of finished leather to produce a pair of shoes; in turn, a pair of shoes was sold at 14 USD on average in the Kenya export market in 2014 (the price in the local market is of about 10 to 12 USD, not considering sandals). Without the cost of components (3 USD per pair), the average value of a pair of shoes is 10 USD, which correspond to 3.6 USD per sqf utilized.
[59] This figure is for footwear only. As shown in chapter seven, calculating value addition for leather goods depends on several aspects such as branding, own retail store, and export vs. local prices.
[60] As observed in chapter seven, profits vary from 20% in the footwear informal sector to about 200% of premium leather handbags.
[61] 46.8% for footwear and 26.9% for other leather goods.
[62] 6.9% for footwear and about 1-1.5% for other leather goods (depending on the items included).

Figure 3.3: Percentage of value addition and profits across functional stages



Source: Author's elaboration (survey data) (see table 3.8).

3.6.2 Social Upgrading

Concerning social upgrading, table 3.9 shows employment and wages figures aggregated at the pre-tanning, tanning, and manufacturing stages. Furthermore, the table points to capital and labour intensiveness (in terms of workers' ratio) at each stage.

Although the bulk of exported value is concentrated within the tanning industry, both employment figures and workers' salaries are higher in the manufacturing segment. This points to a positive relationship between downstream stages of value addition, increasing employment, and better wages. Interviews with formal and informal footwear manufacturers confirm how higher wages are a consequence of higher skills and the need to retain them. For instance, in Nairobi Kariokor Market, where informal labour is employed in the manufacturing of footwear and other leather goods, an experienced worker can earn between 1000 and 2000 KhS per day, whereas a trainee gains around 700 KhS per day. This compares to 500 KhS per day of general workers in a tannery.

According to KSLWU, in formal manufacturing firms, salaries are about 40% to 50% higher than in the tanning industry. This trend is confirmed by tanners such as Tan-13 and Tan-5, companies that recently upgraded into footwear manufacturing. Both

Tan-13 and Tan-5 stressed how functionally upgrading has allowed them to increase marginal gains and provide further employment at higher wages. Tan-5's CEO said in this respect: "[t]he profits from the shoe-making are going to reflect in the salaries of the workers at the end of this year. Not only on the salary of those working in the shoes unit, but also in those working in the tannery. There is a consistent rise foreseen for July 2016, as the profits of the shoe-making will reflect in the financial account".

As reported by the secretary of KSLWU, casualization is a common phenomenon especially among tanneries. As observed in section 3.3, unionisation is discouraged by the latter: "companies often adopt outsourcing practices where casual labour is employed… It allows them to make three-months contracts on minimum wage without any interference from the Union. In fact, the company outsourcing will not renew the contract after the first three months if they find out that the workers of the suppliers are unionised." As far as they are concerned, tanners blame competition, low profit margins, and increasing production for the low labour standards. As reported by Tan-1, "labour costs are much lower in Ethiopia and Uganda, making it cheaper to produce there…" Similarly, Tan-13 reveals: "I had a problem with the Union. I decided to outsource labour procurement through an agent. It costs me 10% more, but in the end, it is cheaper as I avoid having to deal with the Union…"

As reported in table 3.9, nevertheless, companies engaged in more downstream stages tend to pay higher salaries on a higher worker-to-output ratio. This appears to be a consequence of the higher skills required, the labour-intensiveness of the task performed, and the consequent need to retain labour force. As reported by KSLWU, "workers are paid more in the shoe industry [than in tanneries] because of the higher level of specialisation required and the consequent need to retain employees…"

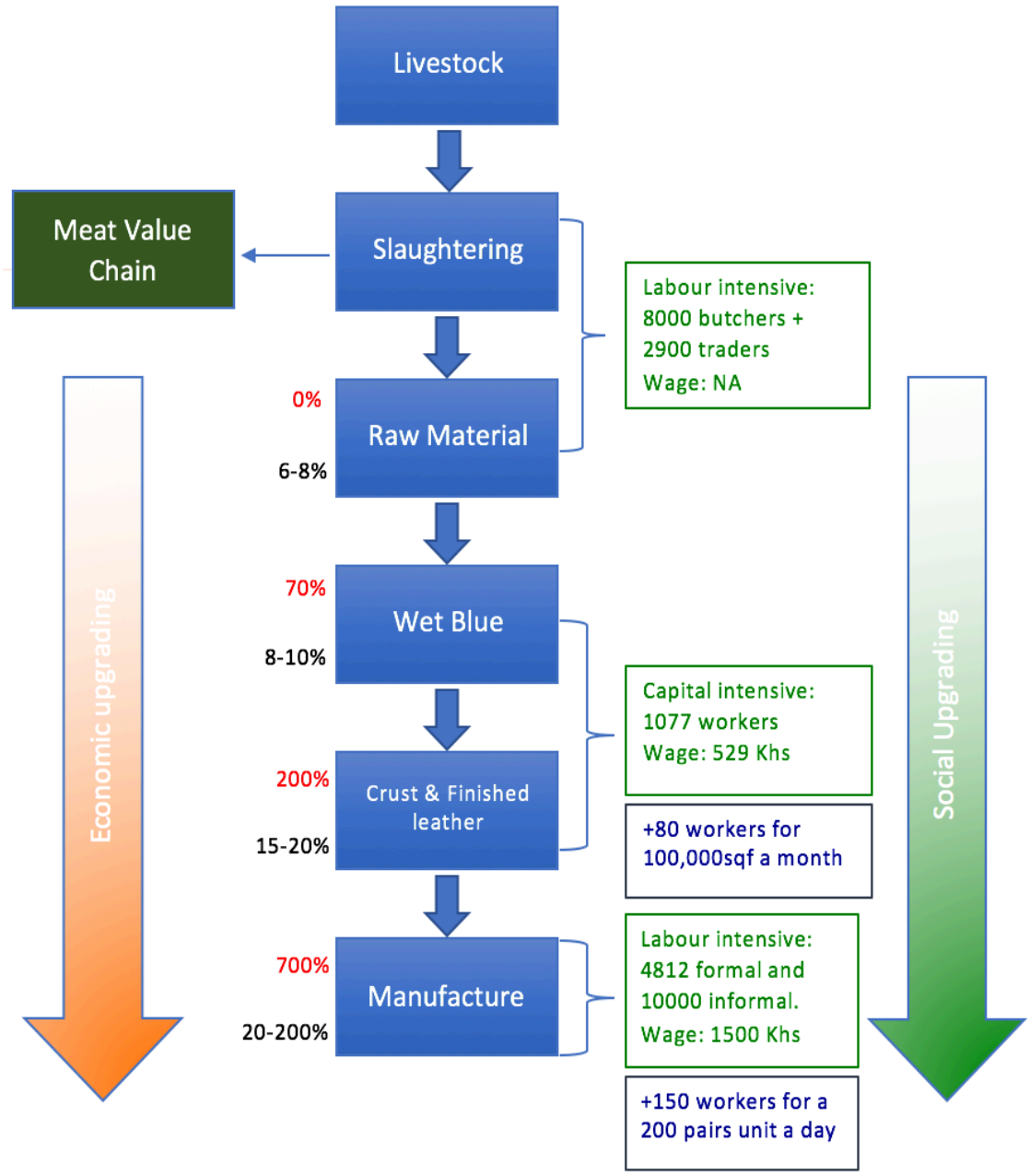
Table 3.9: Employment and wages average figures across functional stages (aggregated)

	Pre-tanning	Tanning	Manufacturing
Employment	8000 butchers 2000 traders	15 tanneries 1200 workers	+500 informal units 100 formal units 14000 workers
Wages	N.A.	500-600 general	700-1500 informal 800-2500 formal
Ratio	-	80 workers for 100,000 sqf/month	100-150 workers for 200 shoe pairs a day

Source: Author's elaboration based on KNBS (2014) for employment figures, COMESA LLPI and KLDC data. Wages calculations are based on researcher's interviews across the chain.

Figure 3.4 summarises the outcome of tables 3.8 and 3.9 across different functional stages. On the left side, the red percentage indicates value addition from raw material and the black percentage indicates the profit margins at each functional stage (using raw material as the base category). On the right side, the green boxes report the estimated number of employees and the average wage at each functional stage. The blue boxes, meanwhile, indicate the relative employment generated at the tanning and manufacturing stages.

Figure 3.4: Aggregated economic and social upgrading across functional stages



Notes: Data on economic upgrading is derived from average unit values on exports at different segments of the chain, as well as from interviews with tanners. Data on social upgrading is derived from KNBS (2014) statistics on employment, interviews with tanners and data shared by Loyal Small Scale Industries Ltd with regard to employment figures.
Source: Author's elaboration.

The data presented in figure 3.4 display an association between functional, economic, and social upgrading. In other words, higher stages of value addition are associated with increasing economic and social gains in terms of value added, profitability, wages, and employment.

3.7 Conclusion

The scope of this chapter was purely descriptive. Its intention is to provide a contextual background to the analytical work that follows. The analysis of governance and upgrading in chapters four to six draws on the actors' sourcing practices and upgrading dynamics presented here. Moreover, references to the government's industrial policy and the distinction between footwear and handbag producers, both in terms of upgrading and governance practices, are essential to the argument developed in chapter seven. The following paragraphs summarise the content of the previous sections.

Section 3.2 presented a concise history of the leather sector in Kenya from its roots in the colonial and import substitution era to the decline of the post-liberalisation period, as well as the revival experienced in the last decade. Furthermore, section 3.3 described the various actors operating at different stages of the value chain including private companies, informal business units, public institutions, and other external bodies such as universities and working unions.

Drawing on Evans (1995) qualitative evaluation of state market interventions and its application to aspects of upgrading in GVCs by Talbot (2002), section 3.4 provides an historical account of the main industrial policies adopted by the Kenyan government to support the leather value chain. In this respect, the government moved from a demiurge and custodial role during the import substitution period to a tentative combination of husbandry and midwifery approaches in the aftermath of the Vision 2030. Such an approach is considered more likely to favour GVC integration and trigger value addition and upgrading.

Section 3.5 presented an analysis of governance among actors within the value chain. Relationships between buyers and suppliers display different hierarchical structures depending on the complexity of the function executed, the quality demanded,

the market power and size of buyers and suppliers, and the market trajectory (i.e. export vs. local market). Sourcing practices are indicative of how power dynamics influence value capturing in the chain. Moreover, their structure further informs the inquiry presented in chapters six and seven on the tanning and manufacturing stage respectively.

Finally, section 3.6 established the link between functional upgrading on the one hand and economic and social upgrading on the other. This premise may seem trivial to the extent that some scholars have defined economic upgrading as a necessary consequence of functional upgrading. However, in light of recent evidence casting doubts on the relationship between these forms of upgrading (Schmitz 2006, p.563; Ponte & Ewert 2009; Barrientos et al. 2011; Taglioni & Winkler 2016), assessing the link between value addition, labour creation, and functional upgrading is a fundamental exercise to understand the relevance of this study in a broader development perspective. Furthermore, although several scholars have stressed the idiosyncratic relationship between economic and social upgrading by focusing on single functions within value chains (Goto 2011; Bernhardt & Milberg 2011; Goger et al. 2014, p.3), our data shows that, at least from a cross-functional perspective, the two forms of upgrading walk hand in hand. Yet, while the linkage may stand across functional stages, questions remain regarding changes within single functions and single firms. These aspects are further addressed in the upcoming chapters.

4.

Governance and upgrading:

Evidence from export data

4.1 Introduction

This chapter analyses the correlation between suppliers' participation in South-South, North-South, and regional value chains and the level of product, process, and functional upgrading they experience. The association between *internal* and *external governance*, firm size, and market trajectories is further considered.

Using firm-level export transaction data, the chapter points to some significant differences in the way firms relate to southern, northern, and regional markets both in terms of upgrading and governance. Whilst northern markets are associated with higher product and process upgrading, they appear to limit rather than encourage functional upgrading. Conversely, most trade in value-added products occurs regionally among small, rather than large firms. South-South value chains are associated with the lowest functional upgrading. When it comes to process and product upgrading, we observe a distinction between the Chinese market—which displays a North-like structure—and other southern economies whose product and process standards are much lower. The chapter further highlights how South-South and North-South value chains display a similar governance structure, casting doubts on the association between premium export markets and more relational buyer-supplier ties. Finally, the analysis of *external*

governance shows that the introduction of government duties on the export of raw material had only a partial effect in stimulating functional upgrading and value addition.

The chapter is structured as follows. After an overview of the literature and the main hypotheses, section 4.3.1 defines and operationalises the variables used to code upgrading, market trajectories, firm size, and governance. Sections 4.3.2 and 4.3.3 present the empirical models and the estimation strategy respectively, while section 4.4 provides a series of descriptive statistics on suppliers' overall upgrading and governance. Section 4.5 focuses on the correlation between market trajectories and *internal governance*, and section 4.6 examines the link between the former and product upgrading. Functional upgrading across different market trajectories is further assessed in section 4.7, while the impact of *external governance* is presented in section 4.8. Finally, sections 4.9 and 4.10 discuss the results and point to some methodological and structural limitations.

4.2 Literature review and hypotheses

Building on some of the insights in chapter two, this section illustrates the different upgrading and governance dynamics characterising North-South, South-South, and regional value chains. In this respect, five hypotheses are presented.

Let us first begin with the association between market trajectories and governance. Here, the literature unveils a relationship between higher product and process standards of northern markets and more relational and long-term buyer-supplier bounds (Kaplinsky et al. 2011, p.14; Navas-Alemán & Bazan 2001). In this context, several authors have stressed how buyers in developed economies tend to establish more stable contracts with their suppliers, share knowledge, and encourage product and process improvements (Roy 2013, pp.117–120; Dallas 2015, p.19; Fessehaie 2012).

Compared to North-South value chains, the lower product and process standards of southern economies are expected to correlate with less relational, market-based forms of governance (Bazan & Navas-Alemán 2004; Kadarusman & Nadvi 2013; Cattaneo et al. 2011).

Hypothesis-1: *trade in North-South value chains is characterised by more relational forms of governance compared to trade in South-South and regional value chains.*

Concerning the correlation between market trajectories and upgrading, according to Humphrey and Schmitz (2000; 2002, p.1025; 2004b, pp.356–359), suppliers in North-South value chains are likely to experience higher product and process upgrading along with limited access to functional upgrading. By contrast, although it has been ascertained that higher standards and quality-driven markets call for increasing value chain integration, according to Gereffi (1999, p.19; 2005; Fromm 2007, pp.15–16) this is not meant to prevent functional upgrading but rather encourage it, favouring the upstream transfer of tacit knowledge to decrease costs and share risks (Gereffi 2014; Yeung 2009; Schmitz 2006; Palpacuer et al. 2005). Kaplinsky et al. (2011) further stress how participation in North-South value chains favours functional upgrading to the extent that higher labour and environmental regulations encourage outsourcing practices among buyers in premium northern economies. Moreover, whilst mostly silent on the impact of South-South trade, the literature on *learning-by-exporting* has stressed the importance of export-oriented strategies over local trade in triggering innovation and upgrading (Fafchamps et al. 2007; Mengistae & Patillo 2004; Bigsten et al. 1998; Lileeva & Trefler 2010; Aw et al. 2008).[63] Finally, studies on trade and innovation

[63] Most of this literature claims that firms' initial efficiency leads to "self-selection" into export activities (Clerides et al. 1998). Yet, evidence from Ethiopia shows that exporting firms tend to experience a surge

portray South-South value chains as a potential source of deindustrialisation and resource course for smaller economies supplying raw material to larger global player such as China and India (Gallagher 2012; UNCTAD 2010; Rangel 2012).[64]

Hypothesis-2: *trade in North-South value chains is characterised by higher degrees of product and process upgrading compared to trade in South-South and regional value chains.*

Concerning regional value chains, the literature on GVCs fails to trace a distinction between South-South and regional trade. Most studies identify regional value chains as either part of the global South (Barrientos, Knorringa, Evers, Margaaret Visser, et al. 2016; Evers, Opondo, et al. 2014; Barrientos & Visser 2012)[65] or as downgraded platforms for suppliers who struggle to access and compete in unspecified global markets (Evers, Opondo, et al. 2014; Goger et al. 2014, p.5; Barrientos 2012; Barrientos, Knorringa, Evers, Margaaret Visser, et al. 2016; Schmitz 2006, p.568; Gereffi & Frederick 2011). Only recently, some authors have pointed to the fact that not all developing countries behave equally when entering trading relationships, with power relations often pending towards East Asia (Saad-Filho 2013; Horner 2016). In this sense, there have been some attempts at showing how regional and domestic markets with less integrated value chains may represent a better platform to achieve functional upgrading for local producers (Navas-Alemán 2011; Berg & Markarian 2013, chap.5; Lutz 2012; Ponte & Ewert 2009; Kadarusman & Nadvi 2013; Sturgeon & Kawakami 2010; Pérez-Villar & Seric 2015). In particular, a recent study among Kenyan firms showed how

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in productivity suggesting a link between upgrading and participation in GVCs (Bigsten & Gebreeyesus 2009).

[64] These studies are not unchallenged. As observed in chapter two, several scholars working on trade and innovation present South-South relations as a testing ground for structural innovation and knowledge transfer (Amsden 1986; Fu et al. 2011, p.1209; Fu et al. 2014, p.13; Acemoglu 2002).

[65] Focusing on the divide between North-South and South-South GVCs, these authors fail to operate a comparison between the global South and regional value chains, often conflating the latter concept into the former.

regional trade is more conducive to upgrading (Graner & Isaksson 2009). According to the authors, this is because regional technology increases the skill and capital content of production more than northern technology.[66] Despite this evidence, no comparison has been established on a South-South trajectory, rendering it unclear the extent to which regional value chains do (or do not) reflect the South-South dynamics described in the literature.

Hypothesis-3: *trade in North-South value chains is more likely to trigger functional upgrading compared to trade in South-South value chains. Yet, it is less likely to do so than trade in regional value chains.*

Firm size is usually related to the ability in catalysing gains from trade as it takes away large shares of a country's export market from less efficient firms, triggering a reallocation of resources and favouring innovation (Dallas 2015, p.11; Gebreeyesus & Mohnen 2013, p.309; Mairesse & Mohnen 2010). The GVCs and GPNs literature has pointed to a process of consolidation of lead-firms' market power (Goger et al. 2014; Nadvi 2004, p.25) accompanied by increasing competition among suppliers in developing countries (Sánchez-Ancochea 2013). In this context, firm size has been adopted as an indicator of high entry costs in premium value chains (Otieno & Knorringa 2012; Sheldon 2012; Henson & Humphrey 2010; Ouma 2010; Essaji 2008). Stable governance ties between global buyers and local suppliers are increasingly the consequence of higher standards and more complex information sharing that require suppliers to upgrade production facilities and technical expertise, increasing exit costs for global buyers (Gereffi & Frederick 2011; Dolan & Humphrey 2000). In this context, only large firms can afford the entry costs and reach the economies of scale demanded

[66] The study does not distinguish between trade with the global South (China, India) and trade with the North, comparing instead regional trade with global trade. South-South trade is used by the authors as a synonym of regional trade.

by these markets. Such an effect is expected to be more severe on a North-South trajectory dominated by more complex standards and regulations (Cattaneo et al. 2011).

In their study of Kenyan manufacturers, Graner and Isaksson (2009) find that firms exporting regionally are smaller in size compared to firms exporting globally. According to the authors, this is due to the lower costs of entering regional export markets both in terms of product quality and quantity.

Hypothesis-4: *firm size is expected to be positively correlated with product, process, and functional upgrading, as well as more relational forms of governance characterising North-South value chains.*

Finally, the Kenyan government's decision to introduce a 40% duty on the export of raw material in 2007 (then raised to 80% in 2012) was aimed at supporting value addition and favouring functional upgrading at the bottom of the value chain. The role of industrial policy in facilitating upgrading has been extensively discussed in chapter three and is therein unnecessary to repeat here.

Hypothesis-5: *the government restrictive policy on the export of raw material is expected to favour value addition and functional upgrading.*

As shown in chapter two, some of the hypotheses presented here have been criticised and questioned in the literature. Table 4.8 in the appendix summarises the expected characteristics of each market trajectory in terms of product, process, and functional upgrading, as well as governance and firm size.[67]

[67] The reader should consider this table along with table 2.3.

4.3 Methodology

4.3.1 Measurement of variables

This chapter represents a first attempt to quantify aspects of upgrading and governance in RVCs and GVCs using firm-level export transaction data.

The use of disaggregated export data in value chain studies is still at an early stage. While Winkler and Taglioni (2016, pt.II) have recently introduced a set of quantitative indicators to evaluate GVCs participation both at a macro country- and micro enterprise-level, most datasets do not allow for a sector- and firm-level analysis in countries like Kenya. If at all, trade data are considered only in their aggregate form as a reference for "[a] first assessment of a country's global value chain participation" (Taglioni & Winkler 2016, p.55). As Dallas (2015) points out, disaggregated trade data have been almost exclusively applied to traditional trade theory, ignoring their relevance for the GVCs literature as a result of their combination of firm-level details and aggregated indicators.

The analysis in the following sections is built on a dataset of export transactions from 2006 to 2015 covering the entire leather value chain from raw material to manufactured goods. Every export transaction from Kenya was coded based on quantity, real value in USD,[68] date of transaction, name of exporter and importer, country of destination, 6-digits HS code, and a tag describing the nature of the exported goods.[69]

Building on the concepts presented in chapter two, a set of variables were created to operationalise upgrading, market trajectory, governance, and firm size.

[68] Export value are reported as nominal Free-On-Board. Conversion to real values has been done using a monthly USD deflator with January 2006 as base month. As prices are reported both in USD and KhS, models (2) and (3) were also run using a KhS deflator. Results were consistent.

[69] The lack of input-output tables for Kenya makes disaggregated export transactions the best available data to identify upgrading and governance dynamics. The dataset was created with the support of 3 employees of the Kenya Revenue Authority (KRA) over a 3 months' period between October and December 2015.

Functional upgrading: The functional stage occupied by a firm is observed from the goods' description tag and the respective Harmonises System (HS) code. In some instances, the tag does not match the HS code attributed by the revenue agent in accordance with the World Customs Organisation's normativity.[70] This raises the question of which between the HS code and the tag should be considered correct. According to Kenyan revenue agents, the description should always take precedence over the HS code, as mistakes are often made during the coding process. Using tags as the main reference, each observation was coded based on the specific product exported and the respective functional stage it belongs to. Drawing on chapter three, the leather value chain can be divided in four functional stages, form the most to the least upstream: raw material, wet blue, crust and finished leather, and manufactured production.[71] Table 4.9 in the appendix displays the categorisation of each functional stage with the respective products it includes.

Product and process upgrading: Product and process upgrading are operationalised in terms of unit values. Unit values are calculated dividing the total exported real value by the quantity exported.[72] They are expected to reflect aspects of quality, design, brand, and profitability, which are associated with the notion of product upgrading. For instance, to the extent that 1 Kg of raw material is sold at a higher price, this is expected to give us some information about it being of better quality. Yet, whilst adopted by other scholars (Dallas 2015; Wacker 2016a; 2016b; Keane 2008, p.15; Humphrey & Schmitz 2004a; Jansen & Landesmann 1999), unit values represent an

[70] Whereas the categories are the same, the amount of observations they are associated with slightly varies. The variation is lower than 1.5% at the macro category-level, but it is close to 20% at the 6-digit product-level.
[71] In this and the following chapters, crust and finished leather are often referred to as just *crust leather* or, more simply, *finished*.
[72] Different goods use different units of measurement (e.g. Kg for raw material, squared feet for wet blue, pieces for footwear and handbags...).

indicator of product upgrading that should be taken with a grain of salt. Curran and Nadvi (2015, p.10) define unit values as "a very blunt indicator", to the extent that they may reflect inefficiencies in the firm rather than improvements. This notwithstanding, within the same product group, unit values can be used as a rather accurate indicator of process and product upgrading pointing to higher value addition within the same functional stage.[73]

Market trajectory: Based on the country of destination, the analysis defines four trajectories: North, South (except China), China, and the Region. Whereas the North/South classification is consistent with the literature review and the conceptualisation presented in chapter two, the definition of *Region* and the singling-out of China from the *South* deserve further explanation.

The category *Region* indicates the entire African continent. Whilst 87% of regional exports in the Kenyan leather value chain were conducted within the free-trade area of the East African Community (EAC) and the Common Market for Eastern and Southern Africa (COMESA),[74] this study follows Graner and Isaksson (2009) in considering the rest of the continent as part of the *Region*. In contrast to global southern economies such as China and India, whose stage of value addition likens them to major exporters of leather manufacturing, other African economies appear to have a supply chain structure similar to that of Kenya (Radwan 2013), and are therefore included in the same category.

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[73] Table 4.9 in appendix relates each product to its specific function. While the categorisation is often straight forward (e.g. wet-blue cow and wet-blue goat are two different kind of semi-processed wet-blue, as much as leather boots and leather handbags are manufactured products), the relationship between such neat categorisation, upgrading, and governance is further questioned in chapters five to seven.

[74] The EAC is a regional intergovernmental organisation including Kenya, Tanzania, Rwanda, Uganda, and Burundi promoting cooperation in political, economic and social affairs among its members. With the goal of creating of a monetary union (protocol signed in 2013) and a political federation, it has established a custom union in 2005 and a common market for the free circulation of capital, labour and commodities in 2010. Similarly, COMESA established an economic and trading union in 2000 and a custom union in 2008 among 19 countries in northern, eastern and southern Africa.

The exclusion of China from the global South category is rooted in qualitative accounts provided by interviewed practitioners.[75] Asked to define their export markets, most suppliers identified four main clusters based on aspects of quality, quantity, and processing: China, India and Pakistan, Europe, and Africa. Whereas this classification is spelled out in chapter five and six, China was defined as a very different market trajectory compared to other southern markets, which made it crucial to categorise it independently. The following sections further assess how and to what extent China is (or is not) tantamount to the rest of the South.

Firm size: Studies on exporting firms tend to use the number of employees as a proxy for firm size (Bigsten & Gebreeyesus 2009; Graner & Isaksson 2009; Wagner 2002). However, companies' employment figures are not available from the dataset. For this reason, drawing on Dallas' (2015) operationalisation of firm size in the analysis of export transaction data, this study adopts an indicator that is firm-specific and corresponds to the total exported value divided by the number of years in business.[76] As the outcome entails large positive integers with considerable variation, the natural logarithm was further computed.

(a) $$SI_s = \ln\left(\frac{Total\ Sales_s}{Y_s}\right)$$

Where SI stands for *Size Index* of a supplier *s*, *Total Sales* represents the real exported value of a firm across the entire dataset, and *Y* is the number of years in business of a supplier *s*. Since the dataset spans over a period of ten years, the minimum amount of years in business for a firm is one and the maximum is ten. The SI is therefore time-invariant for each firm across the dataset.

[75] See the methodology of chapters five and six.
[76] Dallas (2015, p.12) uses export values in a specific year. However, since our dataset includes 10 years and there could be firms that entered the market only in the last few years, the average export value per year is computed.

Governance: Having defined governance as the more (or less) integrated form of coordination underpinning the relationship between buyers and suppliers, scholars have explored the determinants of vertical relations among chain actors both from a theoretical perspective (Gereffi et al. 2005; Ponte & Sturgeon 2013; Bair 2008; Humphrey & Schmitz 2000; Pilbeam et al. 2012) as well as through case studies (Navas-Alemán 2011; Bazan & Navas-Alemán 2004; Gibbon 2008; Staritz & Morris 2013; Morris & Staritz 2014; Barrientos, Knorringa, Evers, Margaaret Visser, et al. 2016).[77] Due to the complexity of governance frameworks and the difficulty in operationalising their concepts in a quantitative methodology, most of the literature has relied on qualitative observations.

Drawing on Palpacuer et al.'s (2005) concept of "sourcing channel", this study attempts a first *quantification* of governance as the dyadic relationship between buyers and suppliers.[78] In their comparative study of British, French, and Scandinavian firms' sourcing patterns, Palpacuer et al. (2005) distinguished between direct and indirect sourcing channels, depending on whether buyers sourced directly from manufacturers or through an intermediary – i.e. a trader or middleman. According to the authors, "direct sourcing" is adopted by buyers to reduce lead times and increase control over product quality and contract compliance. In this respect, while direct relationships imply the formation of more relational ties, the presence of traders is an indicator of arm-length markets, where quality is evaluated based on price rather than complex product and process specifications. As stressed by Gereffi et al. (2005), whenever transactions are

[77] The amount of case studies dealing with the concept of governance and operationalising its indicators is conspicuous. The authors mentioned here have dealt with this topic within a logic of South-South and regional trade.

[78] By doing so, this chapter does not ignore the definition that the concept of governance has acquired in studies of intra- and inter-chain relationships, acknowledging the unavoidable simplification and generalisation that accompanies any attempt to quantify more complex qualitative categories (Ponte & Sturgeon 2013). However, this approach is used to inform rather than to substitute an in-depth qualitative inquiry of how integration affects suppliers' upgrading patterns.

easily codified and product specifications rather simple there is no need for the creation of buyer-supplier direct links.[79]

The assumptions underpinning the difference between direct and indirect sourcing in the Kenyan leather value chain was further confirmed by local suppliers. Tanners and manufacturers interviewed under the scope of chapters five and six pointed to how traders constitute a breach in the information-flow between local suppliers and foreign manufacturers. For this purpose, a dummy variable was generated to take the value of 1 whenever the buyer-supplier dyadic relationship happens to be direct – i.e. neither the importer nor the exporter are traders or third-party mediators. Conversely, the variable was coded as 0 whenever the dyadic relationship happens to be indirect – i.e. either the importer or the exporter (or both) are traders. The exact procedure used to code direct and indirect dyadic relationships is further explained in the appendix to this chapter (see table 4.10 and figure 4.3).

To further account for the stability of direct dyadic relationships across time, a *Governance Index* (GI) was created. The index represents an indicator of how consistently a buyer interacts with the same supplier directly. In the dataset, this is computed by counting buyer-supplier dyads (indicated in (b) as $D_{b\text{-}s}$) and multiplying them by the number of months the dyads are protracted for (indicated in (b) as $M_{b\text{-}s}$):[80] the outcome is higher whenever the buyer-supplier relationship occurs more often and protracts for a longer period. As the outcome includes large positive integers with a large variation, the natural logarithm is computed. The result is interacted with the dummy variable indicating whether the relationship is direct or indirect (indicated in (b)

[79] Similarly, according to Ponte and Sturgeon (2013; Ponte & Gibbon 2005), whenever quality cannot be judged upon price and/or direct inspections, more relational forms of control are required to reduce the risk of opportunistic behaviour.

[80] For each buyer-supplier dyad, the variable $D_{b\text{-}s}$ and $M_{b\text{-}s}$ are time-invariant.

as $X_{b\text{-}s}$).[81] This is done to partial out indirect relations, whose stability over time is irrelevant to the scope of the analysis. Following Dallas (2015, p.13), the indicator has been computed not to be sensitive to the absolute size of firms in terms of exported value, allowing for cross-firm comparisons independent of their size.[82]

(b) $$GI_{b-s} = \ln(D_{b-s}M_{b-s})\, X_{b-s}$$

Where GI stands for *Governance Index* of a dyadic buyer-supplier relationship (*b*-*s*), *D* indicates the dyadic association between the same buyer *b* and supplier *s*, and M is the number of months the dyad is protracted for (this goes from a minimum of 1 to a maximum of 120 months over the ten-year period covered by the dataset). *X* represents a dummy equal to 1 if the buyer-supplier dyad is direct and 0 if it is indirect. Since governance is an index reflecting the length of the dyadic buyer-supplier relationship, the value of the coefficient is not particularly relevant to the interpretation.[83]

Unfortunately, due to a specific policy adopted by the main exporting firm, the GI could not be computed for about 30% of all transactions (accounting for 50% of the total exported value).[84] For this reason, model (1) in section 4.5 is estimated excluding this portion of the data.[85]

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[81] For each buyer-supplier dyad, the dummy variable $X_{b\text{-}s}$ is time-invariant.
[82] Nevertheless, the indicator is much more complex than the one used by Dallas. It accounts for dyadic relations rather than just firm's participation in the market across time.
[83] Section 4.5 focuses instead on the sign of the coefficients and their statistical significance.
[84] About 95% of the firm's exports were channelled through a holding-company that prevents us from acquiring information on whether the buyer-supplier relationship was direct or indirect. Despite constituting a weakness in our model, the qualitative inquiry carried out in the next chapter shows how the company whose data is missing displays a buyer-supplier structure that reflects the one presented in figure 4.2.
[85] This affects only the results of section 4.5. The rest of the analysis in sections 4.6 to 4.8 is not affected by the problem.

4.3.2 Empirical models

This chapter examines the correlation between governance, upgrading, and market trajectories using four empirical models. [86]

1) $GI = \alpha + \beta_1 Region + \beta_2 South + \beta_3 China + \lambda_1 SI + \gamma_i Fct + \gamma_i Prod + \gamma_{ii} Year + \varepsilon$

Model (1) in section 4.5 regresses the *Governance Index* on dummies for each market trajectory (the reference category is the North), the firm *Size Index*, a vector *Fct* of functional stage dummies, a vector *Prod* of product dummies, and a vector *Year* of year dummies.[87] Note that in this model the unit of observation is the time-invariant dyadic relationship between buyer and supplier

2) $ln(U_Val) = \alpha + \beta_1 Region + \beta_2 South + \beta_3 China + \lambda_1 SI + \gamma_i Prod + \gamma_{ii} Year + \varepsilon$

Model (2) in section 4.6 regresses unit values on dummies for each market trajectory (the reference category is the North), the firm *Size Index*, a vector *Fct* of functional stage dummies, a vector *Prod* of product dummies, and a vector *Year* of year dummies.[88]

3) $Function = \alpha + \beta_1 Region + \beta_2 South + \beta_3 China + \lambda_1 SI + \gamma_{ii} Year + \varepsilon$

Model (3) in section 4.7 regresses a discrete ordered variable for functional stages on dummies for each market trajectory (the reference category is the North), the firm *Size Index*, and a vector *Year* of year dummies.

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[86] Whilst this does not appear in the equation, it is assumed here that the error term in the PCS model is the composite error that includes the unobserved firm-fixed-effect *a*. This last term is eliminated in the FE model.

[87] Note that in models (1) and (2), a vector of product dummies is used. Products are subcategories of functional stages, yet specific products (even within the same function) can be characterised by different standards and unit values (e.g. footwear and handbags are both manufactured items, yet as described in chapter seven they are characterised by very different standards and unit values).

[88] As the dependent variable is in logarithmic form, multiplying the exponential of the coefficient minus unity by 100 gives the approximate percentage change in unit values when exporting to the Region, the South, or China compared to the base category "North" (Wooldridge 2006, p.190). The formula is: $100[\exp(\beta_x) - 1]$.

The dependent variable (i.e. function) is coded by transaction (equal to 1, 2, 3, and 4 for raw material, wet blue, crust and finished leather, and manufacturing respectively). For this reason, in order to account for the total value of each transaction, the estimates of model (3) are weighted by their respective transaction real value.[89] This is to make sure that results are not biased by small transactions constituting a tiny fraction of the total exported value.

4) $Function = \alpha + \beta_1 Post07 + \beta_2 Treat07 + \beta_3 Post07 * Treat07 + \delta_1 Post12 + \delta_2 Treat12 + \delta_3 Post12 * Treat12 + \varepsilon$

Model (4) in section 4.8 reports a *difference-in-differences* estimator regressing a discrete binomial variable *function* (raw material=0 vs. wet blue, crust leather, and manufacturing=1) on two post-policy time dummies *Post '*07 and *Post '12*, two dummies equal to unity for the treatment group *Treat07 and Treat12* (i.e. firms exporting raw material before 2007 and 2012 respectively), and the interaction terms of the *Post* and the *Treat* dummies. As for model (3), this model is also weighted by transaction real values.[90]

The *Post* coefficients indicates the *between-firm* effect (i.e. whether there was an overall shift in the total exports from raw material towards more downstream functional stages); whilst the interaction terms *Post*Treat* indicates the *within-firm* effect (i.e. whether firms exporting raw material before the policy experienced functional upgrading following its implementation). The *Treat07* and *Treat12* variables are controls for the *difference-in-differences* (interaction term), yet their coefficient is

[89] The weighting is done using the natural logarithm of the transaction real value.
[90] Note that the FE models in (3) and (4) do not use weights as FE models cannot be estimated using STATA *importance weights (iweight)*.

meaningless under the scope of the analysis in section 4.8.[91] In fact, the control groups (i.e. firms coded as 0 in *Treat07* and *Treat12* respectively) are nothing but wet-blue, crust, and manufacturing exporting firms. While intuitively very different from raw exporters, they are used as a control group since the policy is not aimed at them, so no change in the dependant variable is expected following the introduction of the policy.

4.3.3 Estimation strategy

The subsequent sections refer to upgrading and governance in a broader sense that encompasses both differences across firms (e.g. firm A exporting wet blue to the North vs. firm B exporting manufacturing to the Region) and differences within firms (e.g. firm A exporting wet blue to the North as well as manufacturing to the Region). Conceptually, this may create some confusion to the extent that the notion of *upgrading* implies a dynamic change within the same firm. For this reason, the chapter distinguishes between *functional* and *product stages* when referring to a static cross-firm comparison while using the term *upgrading* for the dynamic within-firm definition.

In the dataset, each observation is an export transaction. Some firms transact more than others, engaging in more (or less) stable dyadic relationships with buyers over time. For instance, of 1252 firms exporting between 2006 and 2015, 566 have exported just once, while 280 have exported two or three times only. Only about 210 firms have exported more than 10 times. To understand whether different market trajectories correlate with more (or less) stable governance, and more (or less) upgraded products and functions, each transaction is treated as a unit, independent of who the transacting firm is. This is defined as the *between-firm* effect. Yet, we may be interested

[91] The Treatment variables indicates the *within-firm* upgrading of raw material exporters compared to all other firms (i.e. control group) in both the pre- and post-policy periods. To the extent that the control group consists of firms specialising in wet blue, crust leather, and manufacturing, these variables are simply telling that firms exporting raw material are in a lower functional stage compared to these firms.

in understanding how a firm that switches market trajectories experiences a change in terms of governance, product, and function. We refer to this as the *within-firm* effect.

1) Pooled cross-sections and fixed-effect linear models

Methodologically, to account for both *between-* and *within-firm* effects, this study analyses the determinants of governance and upgrading by means of pooled cross-sections (PCS) and fixed-effects (FE) estimators. Models (1) and (2) are estimated using PCS and FE linear models.

PCS mirrors the methodology for ordinary cross-sectional data, with the main caveat that time-shifts are accounted for by means of year-dummies. This method allows for a *between-firm* analysis, to the extent that each observation is considered independently of the firm carrying out the transaction. This notwithstanding, to account for the fact that market trajectories do not affect each firm uniformly, standard errors (SEs) are clustered by firm. In other words, to the extent that exports within the same firm are likely to be endogenous and, therefore, correlated with their respective error term (e.g. trade and social networks, skills, machineries…), clustered SEs are used to account for this aspect by assuming independence across but correlation within firms.

Yet, by pooling all the observations together, including both *between-* and *within-firm* transactions, PCS assumes that unobserved constant factors affecting the dependent variables (i.e. governance and upgrading) are uncorrelated with the independent variables (i.e. market trajectory and the other control variables). This is particularly the case for firm-specific effects that shape the governance and upgrading paths of suppliers. For this reason, despite providing a good indicator of cross-firm variation, PCS is biased and inconsistent.

The adoption of FE estimators helps overcome firms' heterogeneity, allowing for unbiased and consistent estimates when firm effects are arbitrarily correlated with the

explanatory variables (Kristal & Cohen 2017, p.196).[92] In our case, for instance, it is very likely that the size of the company, its proximity to the raw material, its history, skills, and networks may affect its capacity to access certain markets, achieve new functional stages, or implement more or less stable governance ties. FE coefficients represent a cross-firm average of the longitudinal *within-firm* effect where unmeasured and time-invariant factors influencing the dependent variable are partialled out. In other words, to the extent that unobserved variables exert their effect only between (and not within) firms, by reflecting exclusively *within-firm* changes, FE overcomes the PCS omitted variable bias (i.e. heterogeneity bias) (Wooldridge 2006, p.457).[93]

2) Logistic and generalized ordered logistic models

Model (3) evaluates the correlation between market trajectories and functional upgrading. Here, the dependent variable is categorical and follows a discrete order, where 1=raw material, 2=wet blue, 3=crust and finished leather, and 4=manufacturing. In order to allow for both the intercepts and the coefficients to vary across the categories of the dependent variable (i.e. functional stages), a *generalised ordered logit* (gologit) model was used (Williams 2016). The gologit works as a cumulative logit model comparing the categories greater than the current one to those less than or equal to it. In our case, the four categories of the dependent variable are collapsed into three groups: (1) comparing raw material vs. wet blue, crust, and manufacturing; (2) comparing raw

[92] Note that no time fixed-effect is included in the models. As explained in section 4.3.2, time is accounted for through year-dummies, yet the unbalanced structure of the dataset does not allow for a combined used of firm- and time-FE without necessarily losing several observations.

[93] The adoption of FE estimators has been preferred over first-differenced (FD) estimators due to the longer-run effect expected in the correlation between independent and dependent variables. For instance, the use of FD in the difference-in-differences used in table 4.5 to assess the effect of the government restrictive industrial policy in 2007 and 2012 would reduce the variation in the explanatory variable (Wooldridge 2006, p.459).[93] Moreover, considering the presence of very large firms dominating the export market and the 10-year time defining the dataset, the use of *within-firm* analysis through FE is particularly suited to the research question.

material and wet blue vs. crust and manufacturing; and (3) comparing raw material, wet blue, and crust vs. manufacturing.[94]

Gologit coefficients are often difficult to interpret in any intuitive sense (Williams 2006). For this purpose, table 4.4 reports the average marginal effect (AME) of the gologit model – i.e. the probability that a certain functional stage is exported to the Region (or China or the South) rather than to the North.[95]

Model (4) further uses *difference-in-differences* with a logistic regression (logit) to evaluate the impact that the introduction of a 40% duty on raw exports in 2007 (raised to 80% in 2012) had on the functional upgrading of raw material suppliers.[96] For this purpose, the model indicates firms exporting raw material before the policy (pre-2007 and pre-2012) as treatment groups and further compares them to the firms in the other functional stages (control groups).[97] The time dummies for the post-policy periods indicate whether the average exports of raw material increased or decreased compared to other functional stages after the policy implementation (i.e. *between-firm* upgrading). The interaction term of the time dummy and the treatment group indicates whether firms that engaged in the export of raw material before the policy did (or did not) functionally upgrade after the policy implementation (i.e. *within-firm* upgrading). The interpretation of the results using AME in table 4.6 is the same as for the gologit model.

Note that, as per point (1) of this section, the gologit and the logit models can be interpreted as non-linear PCS to the extent that they account for both *between*- and

[94] For an explanation on how to interpret gologit coefficient's signs and significance refer to Williams (2016).
[95] For a discussion on whether AME is preferable to the marginal effect at the means when using discrete independent variable, refer to Williams (2017).
[96] For an explanation of the difference-in-differences method and its application in PCS refer to Wooldridge (2006, p.450).
[97] Each transaction is coded as 1 if it involves raw material, 2 if it involves wet blue, 3 if it involves crust leather, and 4 if it involves manufacturing. Firms in the treatment group are those with an average code below 1.5 before the policy implementation. This is done to account for the fact that, at times, some firms may have exported higher functional stages (i.e. mostly wet blue), yet they are still specialised in the export of raw skins and hides.

within-firm effects. The models are followed by a linear probability model (LPM) with FE estimating the *within-firm* effect only.[98] The coefficients of the FE regressions in tables 4.3 and 4.5 can be directly interpreted without any transformation. They indicate the *within-firm* probability that, whenever a firm functionally upgrades, the new functional stage will be exported to the South (or the Region or China) rather than to the North. In this respect, the FE model indicates functional upgrading in its dynamic definition, since it infers the correlation between market trajectory and functional stages as a firm decides to venture into such stages.[99]

4.4 Data overview and descriptive statistics

Between January 2006 and December 2015, there have been 1250 exporters that officially engaged in 28,515 trade transactions. About 50% of the total export value is traceable to one single company, the main tannery in the country producing mostly wet blue. 86% of total exported value refers to 10 companies and 90% to 15 companies. About 100 companies account for 99% of the total exported value.

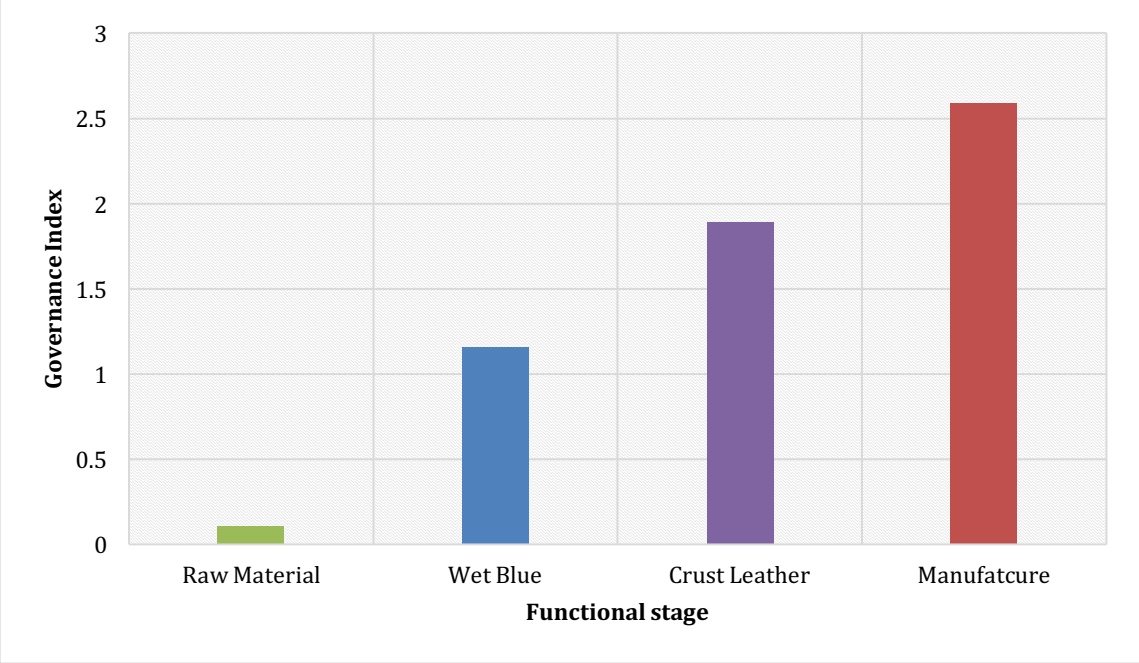
In the overall 10-year period covered by the data, Kenya exported 3.4% of raw material, 82.24% wet blue, 5.83% crust and finished leather, and about 8.53% manufacture.[100] Of this, 42% went to the North, 8.1% to the Region, 30% to China, and 19.9% to the rest of the global South (almost exclusively India and Pakistan).

Concerning governance, figure 4.1 shows the GI score for the four main functional stages. This is the outcome of 4961 dyadic relationships (indicated as $D_{b\text{-}s}$ in equation *(b)* in section 4.3.1), of which 848 were classified as direct (indicated by $X_{b\text{-}s}=1$

[98] Methodologically, it is not possible to run a gologit model with fixed effect. Yet, using a FE linear model along with a gologit and logit can be interpreted as a robustness check on the outcome.
[99] Notice, however, that no time information is provided on whether such upgrading happened before or after entering further upstream stages.
[100] Data calculated as a percentage of real exported values, as per figure 4.6 in appendix.

in equation *(b)* in section 4.3.1) across all trajectories. The figure confirms how higher levels of processing within the chain are associated with more relational modes of governance. The adoption of direct sourcing practices across higher stages of value addition is not surprising and it is in accordance with the GVCs literature: to the extent that higher stages of value addition require more capital and labour inputs, buyers will increasingly implement strategies to ensure that such inputs are provided in line with their process and product standards (Gereffi & Lee 2012; Trienekens & Willems 2007). This is also part of a strategy to access and share information about crucial knots in the chain (Wei & Rehme 2012; Pilbeam et al. 2012): the need for information sharing is close to zero at the raw material stage and increases as we move downstream.[101] Figure 4.7 in appendix displays the average GI score by market trajectory.

Figure 4.1: Percentage of exported value by market trajectory and form of governance



Notes: Missing about 50% of the data in terms of exported value.
Source: Disaggregated export data.

[101] Such considerations are related to the leather value chain. It is acknowledged here that technological requirements within different industries are associated with distinct forms of value chain governance (Rothaermel et al. 2006).

Concerning product and process upgrading, the large number of products makes a representation of unit values across market trajectories rather complex.[102] Figure 4.8 in the appendix compares unit values for two main products: wet blue and crust leather.[103] The outcome shows how the North and China display similar unit values, whereas products directed to the Region and the South are associated with lower degrees of product and process upgrading. This outcome is however restricted to two products only. Model (2) allows for a comparison that considers unit values' differences across all products and functional stages.

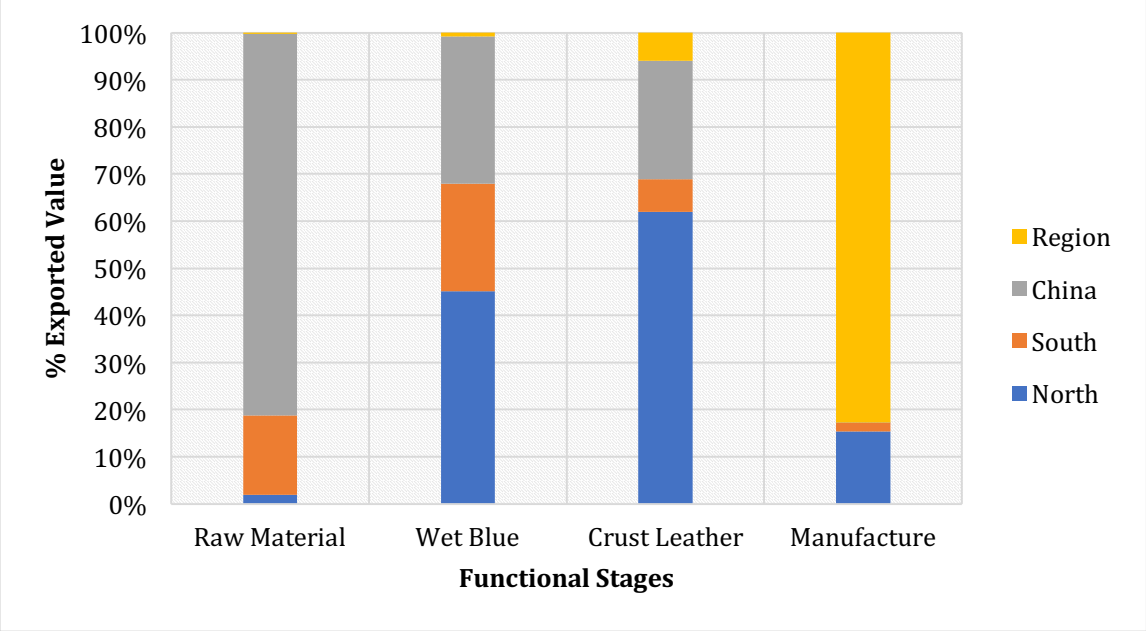
Finally, concerning functional upgrading, figure 4.2 reports the value acquired by northern, southern, and regional markets as a percentage of the value exported in each functional stage. Figure 4.6 in the appendix further presents the total exported value by functional stage, showing how most of Kenyan exports in the 2006-2015 period have been characterised by wet-blue (82%), followed by manufacturing (8.5%), crust leather (6%), and raw material (3.5)[104]

Figure 4.2 suggests that most of the export value of raw material and manufactured goods is appropriated by the global South and the Region respectively. Conversely, exports of wet-blue and crust leather are more evenly distributed between the North and the South. Nevertheless, as shown in table 4.11 in the appendix, in terms of total exported value, the North and the South are both concentrated on the wet blue stage. The most surprising aspect emerging from figure 4.2 concerns the regional market whose participation in downstream functional stages is the highest. According to our

[102] See table 4.9 in appendix for a list of products by functional stage.
[103] Wet blue is the only product for which a cross-trajectory comparison is meaningful, as it is exported across all markets except for the Region. Crust leather is mostly exported to the North, the Region, and China (almost none is exported to the South). Raw material and manufacturing are almost exclusively exported to the South (including China) and the Region respectively. These two functional stages are therefore not included in figure 4.8 (in appendix).
[104] Tables 4.12 to 4.14 disaggregate values by year and trajectory.

data, regional markets have been acquiring essentially finished manufactured production, with a share of 83% of the total export in manufacturing.[105]

Figure 4.2: Percentage of exported value by functional stage and market trajectory



Notes: Values expressed in percentage of total sales for each functional stage.
Source: Disaggregated export data.

4.5 Governance across market trajectories[106]

Table 4.1 presents the results of the PCS and the FE linear regressions of the governance index on market trajectories, the SI, and functional stages as per model (1) in section 4.3.2.

According to table 4.1, there is no statistically significant difference in the governance of buyer-supplier relationships between North-South, South-South, and regional value chains. China is the only trajectory displaying a significantly lower GI compared to the North. This is only slightly significant at a 10% level and in line with

[105] Within the Region, EAC and COMESA accounted for the overwhelming majority of the manufacturing exports, acquiring the bulk of footwear and leather products; whereas the rest of Africa has purchased about 1% of the total export-value mainly in the form of wet blue and fully processed leather.
[106] As per section 4.3.1, the data computed here are missing about 30% of the entries in the dataset, accounting for about 50% of the total value over the 2006-2015 period.

the outcome of figure 4.7 in appendix, showing how China is dominated by indirect relationships.

The result of the FE model is mostly consistent with the PCS, suggesting that, once time-invariant and firm-specific characteristics are partialled out, the *within-firm* effect does not differ from the *between-firm* one.

Concerning firm size (SI), this is positively and significantly correlated with stability at 1% significance level, suggesting that larger firms are more likely to engage in direct and stable relationships with foreign buyers. The coefficient is not reported in the FE model as the SI is time-invariant.[107]

In accordance with figure 4.1, the control dummies for functional stages show how increasing value addition is correlated with more stable forms of governance. Whilst wet blue is not significantly correlated with the GI, further stages of value addition (i.e. crust leather and manufacturing) are. The outcome is consistent for manufacturing across both PCS and FE models, yet crust leather is significant only in the FE model. Since most firms exporting crust belong to a small group of large tanneries engaging also in wet blue exports, the outcome of the FE model is more reliable as it accounts for firm time-invariant characteristics.

The most surprising outcome from table 4.1 is the similar degree of governance characterising regional, South-South (except China), and North-South value chains.[108] As observed in the literature review, regional value chains are often likened to South-South sub-standard markets where costs of implementing direct control across the chain would be unjustified. Even studies conceiving of regional markets as separate platforms fail to account for this aspect, relating the latter's functional upgrading to the less

[107] Including it would result in collinearity. The same aspect emerges in the next models too.
[108] The difference evidenced in figure 4.7 in the appendix may be due to the functional stage rather than the market trajectory itself. For instance, manufacturing is linked to more integrated forms of governance (as per figure 4.1), yet this stage is also more prevalent in regional value chains.

relational mode of governance defining them (Navas-Alemán 2011; Kadarusman & Nadvi 2013). Chapter five sheds further light on this aspect.

Table 4.1: Regression of GI on market trajectories, SI, and functional stages

Dependent Variable: Governance Index		
	PCS	**FE**
Region dummy	0.340 (0.529)	0.501 (0.319)
China dummy	-1.186* (0.624)	-1.167* (0.697)
South dummy	-0.216 (0.562)	-0.499 (0.546)
SI	0.523*** (0.0797)	-
Wet blue dummy	-0.719 (0.512)	0.313 (0.398)
Crust dummy	0.775 (0.706)	1.501*** (0.417)
Manufacture dummy	3.505*** (0.797)	1.286** (0.603)
Constant	-5.738*** (1.285)	0.340 (0.885)
Observations	18,135	18,135
R-squared	0.2793	0.0792 (within)

Notes: SEs clustered by firm are reported in parenthesis.
P-values (***, **, * indicate significance at 1%, 5% and 10% levels).
Control variables not reported in both PCS and FE are year-dummies (2006-2015) and product dummies.
In the FE model, the R-squared is within-firm.

4.6 Product and process upgrading across market trajectories

This section presents the results of the PCS and the FE linear regressions of unit values on market trajectories and the SI as per model (2) in section 4.3.2. Table 4.2 shows whether and how northern markets are correlated with higher product and process upgrading compared to the other market trajectories. PCS and FE models are estimated for three of the four main functional categories: wet blue, crust leather, and manufacturing. Raw material is excluded since no value is added at this stage.

4.6.1 Region

Controlling for years, product, and SI, wet blue exported to the Region is on average 21.4% (PCS) and 28.1% (FE) less expensive than wet blue exported to the North. Crust leather exported to the Region is 100% (PCS) and 61.4% (FE) less expensive than the crust leather exported to the North, and manufacturing is on average 95% (PCS) and 35.3% (FE) less expensive than the one exported to the North. These results show how regional value chains are positively and significantly correlated with lower product and process upgrading across all functional stages. Though with different levels of significance, the results are consistent across the PCS and FE models.

While the PCS compares all transactions, the FE averages *within-firm* unit values for firms that operate in both regional and North-South value chains. In the manufacturing category, whilst the PCS coefficient for the Region is significantly negative at 1% level, the FE outcome is only slightly significant at 10% level. This suggests that, despite the overall gap, firms exporting manufactured goods to both the Region and the North may still maintain a similar level of product upgrading across these two markets. Chapter seven sheds further light on this aspect.

4.6.2 China and the South

Controlling for years, product, and firm size, wet blue exported to China is not associated with any statistically significant product and process upgrading compared to wet blue exported to the North. The outcome is even more surprising for crust leather, where China-led value chains attract 18.6% (PCS) and 23.6% (FE) higher unit values compared to northern markets – both statistically significant at 1% level. The results for

manufacturing, though coherent with an expected negative correlation, are irrelevant due to the negligible amount of manufacturing exported to China.[109]

Both results for wet blue and crust leather are unexpected considering the initial hypotheses and suggest that the Chinese market demands similar product and process standards to the North. This may reflect the recent efforts by China to promote overall upgrading through higher environmental standards.[110] Yet, the result for crust leather should be taken with a grain of salt as its export to both China and the North remains very marginal and restricted to two large exporters. Moreover, it is also possible that the crust leather exported to China is further used as input for manufactures later exported to the North.

Controlling for years, product, and SI, wet blue exported to the South is on average 25.2% (PCS) and 25.7% (FE) less expensive than wet blue exported to the North. This is consistent across the PCS and FE models and significant at a 1% level. The result suggests that, in contrast to China, the South conforms to our initial expectations of lower product and process standards. The results for crust and manufacturing are irrelevant due to the negligible amounts exported to the South.[111]

4.6.3 Firm size

The SI control variable is positively and significantly correlated with unit values at 1% and 5% level. This suggests that larger firms are more likely to engage in product

[109] Less than 0.09% of the total exported manufacturing value.
[110] No late than 2014, the Chinese government forced the shutdown of 8300 companies in the northern region of Hebei in a crackdown on water and air pollution, several tanneries were among them (Leatherbiz 2014). In a similar way, tanneries in southern Guangdong have been put under increasing pressure to relocate or shutdown, accelerating the closure of several plants (Smith 2013; Silk & Craymer 2015).
[111] Only about 1.5% the total manufacturing exports and 6.5% of the crust leather exports went to the South – note that the overall export of crust leather from Kenya is considerably small (about 0.6% of the total value chain exports – see chapter 3). While the coefficients in regressions (2) and (3) denote a negative impact, the reduced number of observations and firms engaging in crust leather and manufacturing trade with the South further increases the clustered SEs.

upgrading compared to smaller firms across all functional stages. The result speaks in favour of the literature associating economies of scale to product upgrading.

4.6.4 Considerations

Overall, this section prompts three major considerations. Firstly, the outcome of table 4.2 confirms the higher level of product and process upgrading characterising North-South compared to South-South and regional value chains. This result may indicate a pattern of *learning-by-exporting* or simply that more efficient and larger firms enter value chains characterised by higher standards and entry barriers.

Secondly, according to the *within-firm* analysis in the FE models, product and process upgrading has occurred mostly within North-South and China-led value chains. Concerning manufacturing, the outcome remains unclear: whilst the North attracts higher value-added products compared to the Region (the South and China are practically not involved in this functional stage), firms that operates both regionally and with the North may upgrade only slightly within this last trajectory. The causal aspect linking product upgrading and market trajectories is further explored in chapter six for semi-processed hides and chapter seven for manufactured goods.

Finally, the results in table 4.2 point to a difference between China and the rest of the South, with the former increasingly featuring the quality and price characteristics of premium northern markets for both wet blue and crust leather. This result casts doubts on the definition of South as a single category and, more specifically, on the role that China is playing within South-South value chains.

Table 4.2: Regression of unit values on market trajectories and SI

Dependent Variable: Ln Unit Values						
	(1) Wet Blue		**(2) Crust Leather**		**(3) Manufacturing**	
	PCS	**FE**	**PCS**	**FE**	**PCS**	**FE**
Region	-.194** (0.093)	-0.248*** (0.066)	-0.695** (0.301)	-0.479*** (0.156)	-0.668*** (0.200)	-0.302* (0.182)
China	-0.018 (0.031)	-0.014 (0.025)	0.171*** (0.0598)	0.212*** (0.006)	-1.283*** (0.417)	-1.028** (0.496)
South	-0.225*** (0.045)	-0.229*** (0.05)	-0.268 (0.334)	-0.141 (0.296)	-0.401** (0.191)	-0.086 (0.172)
SI	0.101*** (0.021)	-	0.078** (0.032)	-	0.116*** (0.022)	-
Constant	2.335*** (0.254)	1.067*** (0.121)	1.003* (0.578)	1.481*** (0.134)	1.915*** (0.276)	1.243*** (0.256)
Observations	12,373	12,373	1,208	1,208	13,334	13,334
R-squared	0.4919	0.4435 (within)	0.8180	0.2403 (within)	0.4301	0.0888 (within)

Notes: SEs clustered by firm are reported in parenthesis.
P-values (***, **, * indicate significance at 1%, 5% and 10% levels).
Control variables not reported in both PCS and FE are year-dummies (2006-2015) and product dummies.
In the FE model, the R-squared is within-firm

4.7 Functional upgrading across market trajectories

This section focuses on the correlation between functional upgrading and market trajectories as per model (3) in section 4.3.2. The objective of the PCS gologit regression is to show whether different functional stages are sold to different trajectories. Whilst this relationship has already been presented in section 4.4 (figure 4.2), the analysis further controls for years and SI while using firm-clustered SEs to account for exports endogeneity. In addition, by focusing on the within-firm effect, the FE regression complements table 4.2 and the PCS pointing to whether different functional stages exported by the same firm are significantly correlated with different market trajectories. In other words, as explained in section 4.3.3, the outcome of the FE regression shows how firms that upgraded into an additional functional stage (whether up- or downstream) are more (or less) likely to export each produced stage to a different market trajectory.

Table 4.3 presents the results of the PCS gologit and the FE linear regressions.

4.7.1 Region

Concerning the Region, the PCS model shows that this trajectory attracts higher stages of value addition than the North. This is statistically significant at 1% level at all stages. Table 4.4 reporting the AME shows that raw material and wet blue are respectively -5.9% -43.8% less likely to go to the Region than to the North, while crust leather and manufacturing are respectively 13.7% and 36% more likely to go to the Region than to the North.

Results for the Region are consistent across the PCS and FE regressions. The FE regressions (2) and (3) show that, for firms that upgraded into crust leather and manufacturing from more downstream stages, such new functions are respectively

12.2% and 1.7% more likely to be exported to the Region than to the North. Both coefficients are statistically significant at 5% level. The non-significant coefficient of the FE model in regression (1) is not a major concern due to the very low amount of raw material sold both regionally and to the North.

4.7.2 China and the South

Concerning China and the South, the PCS model shows that both these trajectories are increasingly correlated with lower stages of value addition compared to the North. This is statistically significant at 1% level at all functional stages. Table 4.4 further reports that raw material is respectively 21.3% and 12.6% more likely to go to China and the South than to the North, while manufacturing is respectively -30.6% and -15.8% less likely to go to China and the South than to the North. Wet blue is equally likely to go North or South (including China), whereas crust leather is 7.3% more likely to be exported to China than it is to the North. This result is significant at 1% level and is surprising to the extent that it shows how China could be a hub for value-added material that is not demanded by the North. Yet, as already reported in the previous section, this result should not be overemphasised due to the overall small amount of crust leather exported and the very few firms involved in the business.

Results for China and the South are not consistent across the PCS and FE regressions. Whilst the direction of the effect remains negative, the FE models display statistically insignificant coefficients both in regressions (1) and (3). In regression (1), this indicates that for firms that upgraded from raw material into wet blue (and/or other downstream functional stages),[112] the probability of them exporting it South is about the same as that of exporting it to the North. In regression (3), the almost complete lack of

[112] The opposite is also possible though unlikely – i.e. firms that downgraded from wet blue to raw material (or, simply, firms that have been involved in both stages since the beginning).

manufacturing export to China and the South makes an FE *within-firm* comparison rather meaningless.[113] Finally, the FE outcome in regression (2) shows how firms that upgraded into crust leather and/or manufacturing from more downstream stages are -3.2% and -4.4% less likely to export to China and the South respectively than to the North. This is significant at 1% level and consistent with the PCS. Again, this last outcome should not be overestimated as it reflects the behaviour of very few firms.

4.7.3 Firm size

Concerning the SI, PCS results show that larger firms are correlated with more downstream functional stages up to crust leather. Conversely, firms involved in manufacturing are significantly smaller in size than firms operating more upstream the value chain. Overall, table 4.4 shows that as size increases, firms are 1.2% less likely to export raw material compared to more downstream functional stages. However, as firms get larger they are on average -2.6% less likely to export manufacturing. The results are all significant at 1% level. This suggests that wet blue and crust leather are more likely to present economies of scale where larger firms dominate, whereas raw material and manufacturing tend to attract smaller producers.

4.7.4 Considerations

The PCS regression pointed to the correlation between functional stages and market trajectories. Moreover, the FE model partialled out firms' time-invariant characteristics to estimate the likelihood that the same firm export different functional stages to different market trajectories.

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[113] In other words, there are almost no firms exporting manufacturing to the South and, whenever such transactions occur, they are normally carried out by traders who engage neither in the production of other upstream stages nor in trade of manufacturing with the North

Overall, recalling the literature review and hypotheses, the outcome presented in tables 4.3 and 4.4 is surprising in many aspects. Firstly, the tendency of the regional market to acquire more value-added products clashes with the inclination of the South towards lower stages of value addition. This result shows how regional value chains do not reproduce global South-South dynamics, casting doubts on the literature relating lower labour costs and standards to limited functional upgrading. Moreover, while this is in line with the literature pointing to a stratification in in the global South and the reproduction of North-South dynamics between developing countries (Thrasher & Najam 2012; Gallagher 2012), it suggests that de-industrialisation and resource course may not be an inevitable consequence as advocated by some scholars. This theme is further explored in chapter seven.

Secondly, whilst the South is correlated with lower stages of functional upgrading (i.e. raw material), this is only partially so. Table 4.3 is in line with the absolute figures in table 4.11 (appendix) showing that both South-South and North-South value chains concentrate on semi-processed wet blue. Moreover, the FE regression (1) shows that, for firms involved in both raw material and more downstream stages, the probability of exporting upgraded stages to the South is not statistically different from that of exporting them to the North. This provides mixed evidence on the positive relationship between South-South value chains and lower functional stages put forth in previous studies (Kaplinsky & Farooki 2010; Kaplinsky et al. 2011; Cattaneo et al. 2011). China's higher probability to acquire leather crust compared to the North casts further doubts on this literature.

Finally, firm size appears to exert a positive effect on functional upgrading both *between-* and *within-firm* up to crust leather. However, SI is negatively correlated with participation in manufacturing. To the extent that the Region acquires most of the

manufacturing production, this outcome speaks in favour of Graner and Isaksson's (2009) findings that firms exporting to Africa are smaller in size and encounter lower entry barriers compared to firms exporting globally. This aspect deserves further attention and is analysed in chapters six and seven.

Table 4.3: Regression of functional stages on market trajectories and SI

Dependent Variable: Function						
	(1) Raw Material=0; Wet Blue, Crust Leather, Manufacture=1		**(2) Raw Material, Wet Blue=0; Crust Leather, Manufacture=1**		**(3) Raw Material, Wet Blue, Crust Leather=0; Manufacture=1**	
	PCS (gologit)	**FE**	**PCS (gologit)**	**FE**	**PCS (gologit)**	**FE**
Region	4.056*** (1.229)	0.002 (0.006)	4.442*** (0.88)	0.122** (0.052)	3.728*** (0.956)	0.017** (0.007)
China	-4.105*** (0.601)	-0.046 (0.031)	-3.916*** (1.031)	-0.032*** 0.013	-5.613*** (0.796)	-0.005 (0.003)
South	-2.605*** (0.411)	-0.000 (0.011)	-2.624*** (0.705)	-0.044*** (0.012)	-2.749*** (0.585)	-0.003 (0.002)
SI	0.32*** (0.076)	-	-0.488*** (0.061)	-	-0.568*** (0.055)	-
Constant	0.67 (1.197)	0.897*** (0.013)	6.838*** (0.936)	0.443*** (0.335)	7.161*** (0.904)	0.460*** (0.005)
Observations	28,471	28,471	28,471	28,471	28,471	28,471
R-squared	0.6139	0.0452 (within)	0.6139	0.0344 (within)	0.6139	0.0037 (within)

Notes: SEs clustered by firm are reported in parenthesis.
P-values (***, **, * indicate significance at 1%, 5% and 10% levels).
Control variables not reported in both PCS and FE are year-dummies (2006-2015).
Weights – the PCS gologit regression is weighted by the ln of the respective transaction real value.
In the FE models, the R-squared is within-firm.

Table 4.4: AME of gologit estimates from table 4.3

Average Marginal Effect (gologit)				
	Raw Material	**Wet Blue**	**Crust Leather**	**Manufacturing**
Region	-0.059*** (0.012)	-0.438*** (0.055)	0.137*** (0.041)	0.360*** (0.064)
China	0.213*** (0.063)	0.02 (0.064)	0.074*** (0.026)	-0.306*** (0.051)
South	0.126*** (0.026)	0.025 (0.032)	0.006 (0.027)	-0.158*** (0.043)
SI	-0.012*** (0.004)	0.039*** (0.004)	-0.001 (0.004)	-0.026*** (0.007)
Observations	28,471			

Notes: The average marginal effect refers to the gologit regression in table 4.3.
SEs clustered by firm are reported in parenthesis.
P-values (***, **, * indicate significance at 1%, 5% and 10% levels).

4.7.5 Robustness

As a robustness check for model (3), table 4.15 in the appendix presents the results of a gologit model that excluded SI in regression (1) along with an LPM in regressions (2).[114] The outcome of both gologit and LPM are consistent with the one reported in table 4.3, with the LPM model reducing the significance of some coefficients from 1% to 5% level. The only major difference concerns the positive significant outcome for the Region in regression (1), which disappears in both the gologit and LPM in table 4.15. This result is however trivial and most likely due to the low amount of raw material exported to the Region and the North.[115]

[114] For the way it is computed, SI generates 1980 in-sample cases with a predicted probability that is less than 0. This is solved by either merging a category or dropping a variable (Williams 2015). We opt here for providing the two models with- and without SI, yet merging wet blue and crust leather into one category in the dependent variable would also solve the problem and produce an outcome that is consistent with the one presented in this section.
[115] The Region acquired less than 0.3% of the total exports of raw material, whilst the North only 1.9%.

4.8 Functional upgrading and government policy

This section presents the results of the PCS logit and the FE linear regressions of functional stages on government policy (i.e. *external governance*) as per model (4) in section 4.3.2. Table 4.5 shows whether the government introduction of a 40% and 80% duty on the export of raw material in 2007 and 2012 impacted on *between-* and *within-firm* functional upgrading.

4.8.1 Between-firm effect

Concerning the *Post* policy estimators, none of them is statistically significant. This suggests that, despite the introduction of a tariff on exports of raw material, the overall ratio between raw and processed exports did not significantly change. Table 4.6 shows that the AME of the policy introduction is very small and statistically insignificant in both years.

4.8.2 Within-firm effect

Concerning the *difference-in-differences* estimator (i.e. *Post*Treatment*), we would expect raw exporters to move into wet blue once duties on the export of raw material are increased. *Post*Treatment '07* confirms this hypothesis at 1% significance level. The AME in table 4.6 points to how firms exporting raw material before the policy were 3.5% more likely to export processed goods after than before the policy. This is significant at 5% level and consistent with the FE model once time-invariant and firm-specific effects have been partialled out.

The same positive outcome does not emerge from *Post*Treatment '12*, suggesting that an 80% increase in the export duty did not trigger functional upgrading as it did in 2007. The coefficient remains insignificant both in the FE model and the AME in table 4.6.

4.8.3 Considerations

Regarding hypothesis five, this section showed how the introduction of a 40% and 80% duty on the export of raw material did not stimulate value addition. This could be because a previous 20% duty in 2006 already achieved the purpose, suggesting that now it is less a matter of moving away from raw material into wet blue, and more about stimulating an upgrade from wet blue into crust leather and manufacturing. This conclusion however cannot be tested here as no data is available prior to 2006.

This notwithstanding, the 2007 reform favoured functional upgrading among firms that were predominantly exporting raw material before the policy. This outcome suggests that exporters of raw material may have been convinced by the policy to invest in knowledge and machineries to functionally upgrade.

The same phenomenon did not materialise after 2012. Out of 14 exporters of raw material at least 10 engaged in some sort of functional upgrading after 2007; by comparison, in 2012, 24 of 34 exporters preferred to exit the market rather than functionally upgrade. This may have been in part influenced by a global depression of wet blue prices and, in part, by the fact that most of the market was already dominated by a handful of large tanners growing steadily since 2007.[116] As presented in chapter six, several small exporters moved into crust leather and manufacturing around this time because of low profits and market instability. Yet, this pattern does not reflect on the data as it occurred mostly locally.[117]

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[116] The second biggest tanner in the country entered the market in 2010, while the main tanner more than tripled its market share between 2006 and 2012.

[117] Interestingly, a *difference-in-differences* run with a dependent variable equal to 0 for wet blue and 1 for crust leather and manufacturing shows that wet blue producers did in fact significantly upgrade in the Post '12 period. Yet, this was not due to the policy, which was aimed uniquely at raw material exports, but rather to the wet blue market crisis. The same model with frim FE shows a non-significant *Post*Treatment '12* coefficient, suggesting that elements internal to the firm (e.g. size, procurement strategy, access to markets) allowed only certain exporters to upgrade into crust lather within profitable export markets.

Concerning this last aspect, it is important to remind the reader that the outcome of model (4) may not only capture the effect of the policy on the raw exporters' decision to upgrade. Other time-specific unknown variables may have influenced both the treatment and control groups' up-/downgrading – e.g. the 2012 price crisis mentioned in the previous paragraph is a known one. In particular, since the control group is constituted by Kenyan firms at different functional stages, rather than raw exporters in a different country (see section 4.3.2), the average treatment effect on the treated my capture international or regional market dynamics that affected the upgrading of raw material exporters in 2007 and 2012 (or, potentially, the downgrading of wet-blue exporters).

Table 4.5: Difference-in-differences regressing functional stages on government intervention

Dependent Variable: Function (raw material=0; wet blue, crust leather, manufacture=1)		
	PCS (logit)	**FE**
Post '07	0.792 (0.793)	0.010 (0.008)
Post '12	-0.548 (0.758)	0.018 (0.012)
Post*Treatment '07	2.338*** (0.805)	0.475*** (0.118)
Post*Treatment '12	0.81 (1.519)	-0.011 (0.029)
Treatment '07	-4.633*** (0.775)	-
Treatment '12	-7.544*** (1.026)	-
Constant	3.079*** (0.748)	0.924*** (0.010)
Observations	28,471	28,471
R-squared	0.4331	0.0943 (within)

Notes: SE are given in parenthesis, clustered by firm.
P-values in parentheses (***, **, * indicate significance at 1%, 5% and 10% levels).
SEs clustered by firm are reported in parenthesis.
The FE regression is a linear probability model, treatment variables are collinear with firm fixed effect.
In the FE models, the R-squared is within-firm.

Table 4.6: AME of logit estimates from table 4.5

Average Marginal Effect (gologit)	
	Logit (AME)
Post '07	.031 (0.04)
Post '12	-0.016 (0.024)
Post*Treatment '07	0.035** (0.0141)
Post*Treatment '12	0.017 (0.024)
Observations	28,471

Notes: The average marginal effect refers to the logit regression in table 4.5.
SE clustered by firm are given in parenthesis. Control variables not reported are *Treatment '07* and *Treatment '12*.
P-values in parentheses (***, **, * indicate significance at 1%, 5% and 10% levels).

4.8.4 Robustness

As a robustness check, table 4.16 in the appendix presents the results of the LPM for model (4). A comparison with the logit outcome in table 4.5 is consistent across all variables, except for the *Post*Treatment '12* where the result turns negative, though only slightly significant at a 10% level. Whilst this may constitute a methodological puzzle on which of the two models is more appropriate,[118] it further confirms that *within-firm* functional upgrading occurred only after 2007, whilst no overall *between-firm* functional upgrading took place either after 2007 or after 2012.

Running separate PCS and FE regressions for 2007 and 2012 (rather than having them within the same model as in table 4.5) confirms the same results, suggesting that controlling for each other policy does not affect the outcome.[119]

[118] A test to compare the goodness of fit based on the percentage of correctly predicted failures and successes shows that these models are equivalent.
[119] Furthermore, running separate LPM models confirms the outcome of the logit regression without any negative outcome for the *Post*Treatment '12* as in the joint regression in table 4.16.

4.9 Discussion

This chapter presented four quantitative models to analyse governance and upgrading dynamics among Kenyan suppliers in the leather value chain. By combining different statistical approaches, upgrading and governance were explored both as static *between-firm* as well as dynamic *within-firm* phenomena. Through PCS models focusing on single export transactions, upgrading and governance were evaluated independent of *within-firm* dynamics. To the extent that upgrading implies a dynamic move of a firm into improved products and processes, or new functional stages, the use of FE models further allowed to assess this phenomenon for single firms that (at some unspecified point in time) upgraded product, process, and/or function.

Table 4.7 summarises the chapter's outcomes in terms of the hypotheses presented in section 4.2. The +, -, and = signs indicates whether the outcome was higher, lower, or similar to the one registered for the North. Where *between-* and *within-firm* outcomes are not consistent or the results differ across functional stages, multiple signs are separated by a slash. A green sign implies that the outcome corresponds to the one expected from the hypotheses in section 4.2, whereas a red sign points to a contradictory result. Note that, since rows (2) and (3) refer to more than one regression, the sign indicates the outcome for the most relevant functional stage of that specific market (i.e. wet blue for the South and China, and manufacturing for the Region).

Table 4.7: Governance and upgrading by market trajectory and firm size

	South	China	Region	Firm Size
(1) Internal governance	=	-/=	=	+
(2) Product and process upgrading	-	=	-/=	+
(3) Functional upgrading	=/-	=/-	+	-
(4) External governance	No *between-firm* impact / Positive *within-firm* impact only in 2007			

Source: Author's elaboration.

4.9.1 Governance

Section 4.5 analysed the relationship between *internal governance* and market trajectories. As expected, increasing stages of value addition are associated with more stable forms of governance as more complex information is shared between buyers and suppliers. The results of model (1) in table 4.1 cast doubt on the literature associating quality-driven northern markets with more relational modes of governance (Humphrey 2003a, pp.18–19; Navas-Alemán 2011; Aykut & Goldstein 2006, p.99) and southern markets with arm-length, less hierarchical relationships (Bazan & Navas-Alemán 2004; Fessehaie 2012; Gereffi & Lee 2012, pp.3–4). The outcome of table 4.1 shows how both South-South and North-South value chains are characterised by similar levels of stability in their direct relationships to buyers. Results are consistent across PCS and FE models. This constitutes a puzzle for the current state of the literature to the extent that a certain degree of integration cannot be explained by higher quality standards and regulatory constraints alone. Therefore, hypothesis one is not confirmed here. Chapter five addresses this outcome through an analysis of governance across market trajectories based on elements of trust, standards, and quality conventions.

Concerning *external governance*, hypothesis five is only partially confirmed. Section 4.8 analysed the impact of industrial policy on value addition and functional upgrading. This was achieved using *difference-in-differences* with respect to the 2007 and 2012 introduction of a 40% and 80% duty on the export of raw material. None of the interventions produced *between-firm* functional upgrading, suggesting that no policy triggered value addition from raw material to more downstream functional stages. Nevertheless, the 2007 intervention proved successful in triggering *within-firm* functional upgrading of raw hides' exporters into wet blue and crust leather. Yet, the same did not occur in 2012. This may have been exacerbated by the 2012 price crisis in

the wet blue market which favoured functional upgrading at higher stages of the value chain (not captured by the model) rather than from raw material to wet blue. Results are consistent across PCS and FE models.

4.9.2 Upgrading

The results of the PCS and FE regressions in section 4.6 are mostly consistent and in line with hypothesis two. The results confirm the scholarship associating premium northern markets with product and process upgrading (Cattaneo et al. 2011; Kaplinsky & Farooki 2010; Kaplinsky et al. 2011). Nevertheless, the analysis further indicates how regional markets do not resemble southern markets and how southern markets are not uniform. Firstly, China emerges as an exception in the South, with upgrading dynamics similar or higher than the North in the wet blue and crust leather stages. Secondly, at the manufacturing stage the Region displays a less significant *within-firm* than b*etween-firm* upgrading. In this second case, the lower level of *between-firm* product upgrading in regional manufacturing value chains may speak in favour of the literature indicating these markets as downgraded platforms for suppliers who fail to access premium North-South value chains (Gereffi 1999; Goger et al. 2014; Barrientos 2012; Lin & Chang 2009). Yet, the less significant *within-firm* coefficient casts doubts on whether it is the firm, rather than the market itself, that shapes product and process upgrading. The differences between the global South and the regional market in terms of product and process upgrading are further addressed in chapter six.

The positive correlation between product and process upgrading and firm size presented in hypothesis four is confirmed in section 4.6. In this respect, larger firms are associated with higher unit values across all functional stages.

Concerning hypothesis three, according to which North-South encourage more functional upgrading than South-South value chains, section 4.7 provides mixed

evidence. Whilst it is true that the North attracts significantly more manufacturing production than the South (including China), the FE model in table 4.3 provides no evidence of *within-firm* functional upgrading linked to participation in northern markets.[120] Moreover, while almost the entire export of raw material went South, both South-South and North-South value chains are mostly concentrated on semi-processed wet blue, with China displaying a larger share of value-added crust leather. Yet, due to the low number of firms exporting crust leather and the possibility of further downstream linkages, readers should be wary of drawing precipitous conclusions.

Section 4.7 further points to the Region as the main market for processed crust leather and manufacturing products both *between-* and *within-firm*. This confirms hypothesis three according to which regional value chains are more conducive to functional upgrading. Yet, the explanation that the literature provides for this phenomenon is not corroborated. Accordingly, the notion that functional upgrading is enabled by lower degrees of governance integration does not seem to hold (Humphrey & Schmitz 2002; Navas-Alemán 2011; Bazan & Navas-Alemán 2004; Kadarusman & Nadvi 2013). Particularly, this approach does not explain why functional upgrading has occurred only on a regional and not on a South-South global trajectory. In other words, if relational forms of governance are supposed to have a direct impact on functional upgrading, why do regional and southern markets differ in this respect? This appears particularly striking if we consider that the Region displays more stable governance ties, which should, according to this literature, restrict rather than enable functional

[120] Drawing on the results of the FE model in regression (2) of table 4.3, it may be objected that the North has a positive effect in favouring *within-firm* upgrading into crust leather. However, the significant negative coefficients for China and the South in regression (2) of table 4.3 are more likely due to the dependent variable which codes manufacturing as 1 (along with crust leather). In fact, the AME in table 4.4 shows that neither the South nor China have lower probabilities of acquiring this functional stage compared to the North.

upgrading. Whether and how local and regional value chains enable functional upgrading is an aspect that deserves further attention and is considered in chapter seven.

Finally, section 4.7 questions the link between firm size and functional upgrading: whilst the former is positively correlated with participation in semi-processed wet blue exports, higher stages of value addition (i.e. manufacturing) are characterised by smaller firms. This is a surprising result showing that downstream functional stages associated with more profitable activities (see table 3.8 in chapter three) display lower entry barriers and/or economies of scale compared to less profitable upstream functions. Chapters five and six address the topic in more detail.

4.10 Conclusion

Overall, this chapter complements recent quantitative literature on GVCs, providing further insights and new tools to quantify governance and upgrading at the firm-level (Dallas 2015; Fessehaie 2012). The outcome strengthens the literature on upgrading and market access, unveiling a positive relationship between higher product and process standards of northern markets, though this may not correlate with more integrated and long-term buyer-supplier relations (Humphrey & Schmitz 2002; Gereffi et al. 2005; Kaplinsky et al. 2011, p.14; Dallas 2015, p.19; Roy 2013, pp.117–120). Moreover, firm size stands out as an indicator of higher entry costs characterising northern premium markets (Otieno & Knorringa 2012; Sheldon 2012; Henson & Humphrey 2010; Ouma 2010; Essaji 2008). Notwithstanding this evidence, the chapter presents several methodological and analytical limitations which point towards the need for further research.

One major limitation of the analysis is that it relies exclusively on export data. GVCs studies (Dallas 2015; Timmer et al. 2014; Haakonsson 2009; Kaplinsky &

Farooki 2010; Curran & Nadvi 2015) and research on *learning-by-exporting* (Vogel & Wagner 2010; Fernandez & Gavilanes 2016; Damijan & Kostevc 2010; Bloom et al. 2016; Melitz & Trefler 2012) have made extensive use of import data to assess developed and developing countries' integration into value chains, as well as firms' innovation and upgrading. Access to import data would shed light on whether inputs are sourced from the same countries and/or companies with whom suppliers entertain export relationships. Moreover, following Rangel's (2012, p.128) recommendation for a dualist approach in studying South-South trade, a potential ground for future research is to look at importing countries in the South to assess how governance relations are defined and sourcing strategies implemented.

A second limitation emerges from the use of quantitative models to assess the correlation between governance, upgrading, and market trajectory. Despite controlling for time, products, and firm size, there are other factors that may affect the dependent variable. For instance, lower unit values may be the consequence of innovation and commodification that reduces production costs. Moreover, unit values should be considered along with market share to the extent that a decrease in the former associated with an increase in the latter is not necessarily synonymous with downgrading (Kaplinsky & Readman 2005; Ponte & Ewert 2009). Similarly, buyer-supplier relations are often influenced by trade regimes in importing countries. For instance, importing in China was restricted to registered traders until 2004 (Fu & Xu 2012) and in India until 1991 (Sen 2009). While this precedes the time of our dataset, firms take time to develop the knowledge and ability to implement and consolidate direct sourcing channels. This aspect deserves further attention and constitutes a gap in the current analysis.

All in all, the evidence presented in this chapter displays a much more complex scenario than the North-South vs. South-South theories put forth by Kaplinsky and

Farooki (2010) and the comparison between regional and northern-led value chains advanced by Navas-Aleman (2011). Chapters five and six take their cue from the analysis presented here and attempt to disentangle some of these complexities through a qualitative analysis of the tanning sector. The main goal is to provide a causal explanation for the links between market trajectories, upgrading, and governance that emerged in this chapter.

In conclusion, two notes of caution in interpreting the results are required. Firstly, the distinction made between functions and products is shaped by the GVCs literature and further explained in chapters two and three. Whilst, this categorisation has been used to facilitate the quantitative analysis, it can hide or distort situations in which a product change within the same functional category becomes more (or less) risky/rewarding than a change in function. For this purpose, chapters six and seven use qualitative data to describe this dynamic for tanners and manufacturers respectively.

Secondly, although the data on exports of wet blue are quite accurate, the same cannot be claimed for raw material, crust leather, and manufacturing. Unfortunately, official export statistics do not account for local trade and ignore a big slice of regional exports embedded in the informal *jua kali* economy. As stressed in chapter three, the informal leather hub of Kariokor Market in Nairobi alone produces 2.5 to 3 million shoes yearly, of which at least 10% cross the border to Uganda and Tanzania. Leather retailers in Nairobi, as well as tanners, mentioned the presence of several Tanzanian buyers purchasing crust and finished leather and exporting it informally. As KFMA director stressed, "regional trade within EAC goes mostly unaccounted for. Only major companies use formal export channels, but the Kenyan leather economy is dominated by smallholders…"

Furthermore, the smuggling of raw material remains a major problem: this can

occur unaccounted for or masked under the label of wet blue (see section 3.5 in chapter three for more information). Yet, according to the qualitative evidence collected and presented in this research, information about informal and illegal trade seem to strengthen rather than weaken the correlations presented in section 4.7 – with the Region acquiring most of the informally traded manufacturing and crust leather, and the global South being involved in the illegal trade of raw material.

5.

Governance and market trajectories: A matter of trust

5.1 Introduction

Participation in export oriented value chains is understood to increase the overall potential for economic and social upgrading of producers in developing countries (Gereffi 1994; Gereffi 1999, p.39; Lall 2000). In this respect, entering GVCs is said to facilitate technology and knowledge transfer favouring innovation and human resources development (Altenburg 2000; AfDB et al. 2014, p.15; Gereffi 2014, p.18). As previously observed, however, there is still a major gap in the study of developing countries' participation in GVCs as final markets are gradually shifting South. Whereas most studies focus on a North-South trajectory, the theoretical frameworks and concepts developed by this literature have been useful to understand new dynamics within South-South and regional value chains (Horner 2016).

Chapter four identified links between market trajectories, governance, and upgrading. Drawing on this study's research question – i.e. how does participation in value chains with different market trajectories relate to the upgrading of local suppliers in developing countries? – descriptive statistics and correlations were contextualised within the GVCs and trade literature. In this respect, the current chapter undertakes an assessment of the dynamics impacting suppliers' decisions to entertain more (or less)

relational forms of governance with their buyers, while chapter six focuses on upgrading dynamics and their causes.

Contrary to the literature, the data presented in chapter four points to how northern and southern buyers display similar levels of stability and directness in the governance of their relations with Kenyan suppliers. This is particularly the case for the South (excluding China), which is mostly made up by the Indian and Pakistani markets. Conversely, the Chinese market appears to conform to initial expectations, with less stable and more indirect buyer-supplier governance. Why do southern buyers implement similar forms of relational governance as northern buyers? Moreover, how do Chinese buyers differ from their counterparts in the Indian and Pakistani markets? Drawing on semi-structured interviews with 24 Kenyan and Ugandan tanners, the following sections address these questions by means of a qualitative analytical framework.

Results show that more relational forms of governance can be the consequence of two almost contradictory processes: in some cases, tighter product, process, and environmental standards, and in others trust-bounds affecting *quality conventions*. In other words, while standards and regulations drive governance on a North-South trajectory, this also depends on (dis)trust and uncertainty in South-South value chains.

By analysing different characteristics of governance across market trajectories, the sections below address the dynamics underpinning the formation of more or less relational governance linkages among Kenyan and Ugandan tanners.

5.2 Literature review

Defined as the way in which the flow of products, knowledge, and resources is coordinated in the relationship between buyers and suppliers, governance has been identified by scholars as a determinant of upgrading that varies across market

trajectories. Chapter two defined the concept as it emerges from the GVCs and GPNs literature to include both *internal* and *external governance*. Chapter four operationalised the concept using a quantitative framework and confirmed how the relationship between market trajectory, governance, and upgrading put forth in the literature warrants further attention.

As chapter four highlighted, it is not clear why southern markets are in some cases characterised by direct sourcing practices similar to those registered in the North, while in others (i.e. China) they are more likely to display indirect and less relational governance ties. As observed in section 2.1.3, theoretical approaches in the GVCs tradition have concentrated on quality, standards, information coding, and suppliers' skills as determinants of hierarchical integration (Bair 2008; Gereffi et al. 2005; Humphrey & Schmitz 2000). Acknowledging these factors, Ponte and Sturgeon (2013; Ponte & Gibbon 2005) first analysed the social conventions underpinning GVCs linkages to understand how buyer-supplier relationships are shaped along notions of quality evaluation and trust. Before proceeding with the analysis, a brief conceptualisation of *social conventions* is required.

According to the authors (Ponte & Sturgeon 2013; Ponte & Gibbon 2005), the rules that govern economic transactions in a specific value chain are not pre-determined, but emerge through interactions between various actors across the chain (Cidell & Alberts 2006). Conventions to define quality become necessary when price alone is not informative (*market coordination*). In this respect, actors can resort to: (i) *domestic coordination*, by solving uncertainty through trust and repetition; and (ii) *industrial coordination*, by solving uncertainty via testing and inspection through the use of formalised standards and third party conventions (Raikes et al. 2000; Ponte & Gibbon

2005).[121] While market coordination is characteristic of arm-length non-relational market relations, industrial conventions underpin network types of governance, and domestic conventions emerge within more captive and hierarchical linkages (Ponte & Sturgeon 2013). In other words, according to Ponte and Sturgeon (2013, p.209), the convention used to define quality and reduce uncertainty in market transactions is an indicator of governance within the chain, expected to increase as the complexity inherent in the evaluation process raises and trust diminishes.

Trust is therefore related to the formation of *quality conventions* insofar as it solves uncertainty through *domestic coordination* by reducing transaction costs for both buyers and suppliers (Raikes et al. 2000; Ponte & Gibbon 2005; Fromm 2007). Drawing on Humphrey and Schmitz's work (1998), trust is therefore understood here as "processed-based" to the extent that it rests on the experience of co-operative interaction among buyers and suppliers. It relies on the benevolent and non-opportunistic behaviour of the parties without reference to any legal system (Sako 1998; Macneil 1985).[122]

The following sections show how elements of trust, standards, and quality conventions co-define sourcing practices and stability within both quality- and price-driven markets. While governance is shaped by higher environmental and quality standards in the North, it is often the consequence of mistrust, lack of standards, and uncertainty embedded in *market conventions* in the South. The Region, in turn, appears to span different categories depending on the segment considered.

[121] Other conventions (such as civic and inspirational) are mentioned in the literature but are not reported here as they did not emerge from the interviews.

[122] As already defined in chapters two and four, another element impacting governance is process and product standards. These represent an instrument for buyers to decrease risk and improve information sharing (Gereffi et al. 2005; Ponte & Sturgeon 2013; Humphrey 2005, pp.22–24; Otieno & Knorringa 2012). Since this was already discussed in previous chapters, it is not repeated here.

5.3 Methodology

This chapter focuses on the subsector linking the Kenyan leather value chain to each market trajectory (i.e. North, South, Region) – i.e. the tanning industry. Accounting for approximately 83% of total export-value in the chain, the tanning industry consists of 15 tanneries whose size, capacity, and engagement in export markets varies. The tanning sector is the only stage of the value chain where a cross-trajectory comparison is feasible, with about 50% of the total exported value between 2006 and 2015 going to the global South (of which 28% goes to China and 22% to the rest of the South), 48% going to the North, and about 2% to the Region.[123] All 15 tanneries officially operating in Kenya in 2015 have been interviewed.

To strengthen the validity and generalisability of the sample, 9 of 11 tanneries in Uganda were also consulted. This was enabled by the similar institutional and market conditions in which the Ugandan tanning industry operates: both countries apply 80% duty on the export of raw material;[124] their respective leather policies are harmonised under the COMESA-LLIP strategy; and they both present analogous internal infrastructures in terms of animal husbandry and environmental control (UNECA 2015, p.105). Whilst the same quantitative dataset is not available for Uganda, an aggregate analysis based on ITC data displays a similar market structure across the two countries: 50% of the total exported value in the Ugandan leather value chain goes to the global South, 45% to the global North and about 5% to the Region, with 6% raw material, 88% wet blue, 2% crust leather and 4% manufacturing. Kenya for the same years exported 3% raw material, 82% wet blue, 6% crust leather and 8% manufacturing. Moreover, the Kenyan and Ugandan leather value chains are profoundly interlinked to the extent that

[123] Regional data is underrepresented as most of the production for the local and regional market is not accounted by revenue datasets as it takes place internally through informal channels (*int.* KFMA).
[124] In Uganda, this is calculated as 80 cents per Kg rather than 80% of the value.

three main Kenyan tanners manage a branch in Uganda (Tan-1, Tan-2, and Tan-10), and two more subcontract work to Uganda on a regular basis (Tan-7 and Tan-6). As presented in figures 5.1 and 5.2, the similar market trajectories and allocation of functional stages across the two countries, as well as the tight interconnection of these two economies, justify the inclusion of Ugandan tanneries in the study.[125]

Figure 5.1: Exported value by functional stage

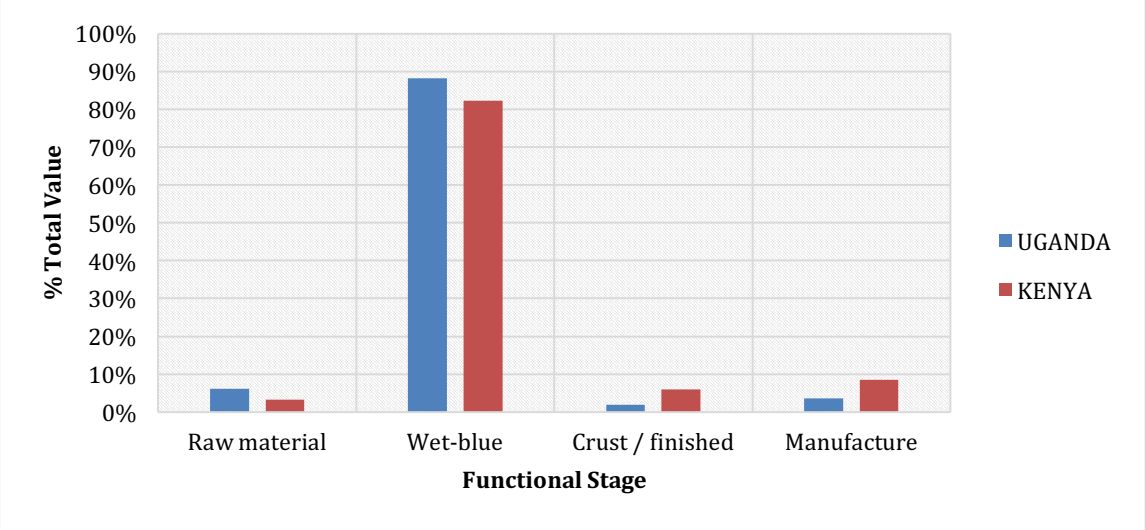
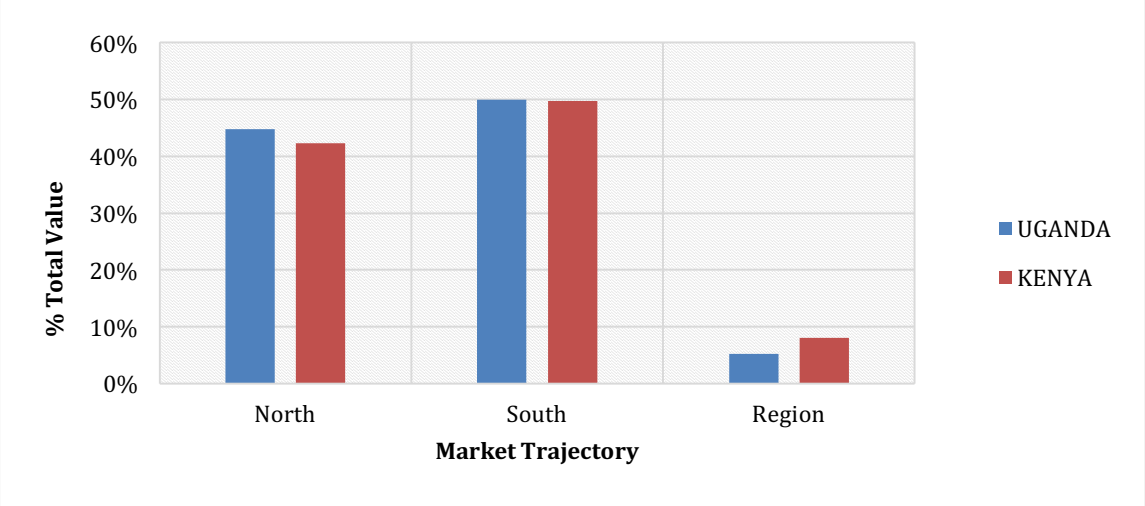


Figure 5.2: Exported value by market trajectory



Source: ITC data aggregated for 2006-2015 (percentage of total exported value).

[125] Uganda is included in the analysis of both chapters five and six. The case is not used as a robustness check, since data for Ugandan tanneries are analysed together with those for Kenya. However, results are often discussed separately for the two countries to further reinforce each other's outcome and address the risk associated with a *selection bias* (Collier & Mahoney 1996). The tables in the appendix further separate the two countries.

Along with 24 tanners, the author interviewed a set of other players along the chain with the specific aim of defining the institutional framework and its impact on upgrading (a list of interviewed institutions is presented in the appendix to chapter seven). In some cases, reference is made to manufacturers interviewed within the scope of chapter seven. The appendix to this chapter further reports an example of the questionnaire used during the interview process.

In the interview, tanners were asked to define their relationship with customers across different market trajectories in terms of governance and learning prospects. To avoid imposing the concept of *market trajectory* on the respondents, tanners were firstly asked to define their main export markets and provide an overview of their characteristics. Of 24 tanneries interviewed only a handful were dealing in all three market trajectories. However, independently of the market served, their knowledge of the sector extended to cover all potential markets and their specificities. It is not unusual to meet tanners working within the local market with extensive knowledge of the European market. In fact, the top-end northern trajectory, though unreachable in terms of quality and standards can still represent a goal of their market strategy.

As presented in table 5.1, the analysis uses five macro-themes derived from the interviews and ultimately rooted in the GVCs and GPNs literature. To define governance the study refers to sourcing practices, standards, relational stability, quality conventions, and trust. The selected themes reflect Gereffi et al. (2005, p.86; 2014, p.13) framework based on elements of information complexity, standards, and sourcing practices; Humphrey and Schmitz's (2000) focus on dependency and assistance embedded in aspects of relational stability; as well as Ponte and Sturgeon's (2013) account of "governance as normalising" focusing on quality convention as well as (un)certainty and trust (see section 5.2). Furthermore, drawing on Kaplinsky and Morris'

(2002) analysis of trust in value chain relations, *payment methods* are also included as an indicator in the assessment of trust ties.

Drawing on the themes reported in table 5.1, the rest of the chapter examines their relevance across North, South, and regional market trajectories.

Table 5.1: Governance themes

	Themes	Question	Literature	Section
GOVERNANCE	Sourcing practice	Is there any direct contact with the importing manufacturer? What kind of assistance is provided?	(Palpacuer et al. 2005, pp.417–418; Navas-Alemán 2011, p.1388; Humphrey & Schmitz 2000; Gereffi et al. 2005; Ponte & Sturgeon 2013; Staritz & Whitfield 2017b)	5.4.1
	Standards	What are the process, product, social and environmental standards? How are they codified and enforced?	(Kaplinsky & Farooki 2010; Fromm 2007; Otieno & Knorringa 2012; Aykut & Goldstein 2006; Palpacuer et al. 2005; Guarín & Knorringa 2013; Barrientos, Knorringa, Evers, Margaaret Visser, et al. 2016; Mainville et al. 2003; Funcke et al. 2014; Lee et al. 2012; Gereffi & Frederick 2011; Horner 2016)	5.4.2
	Stability	How stable is the relation with the buyer across time?	(Fromm 2007; Dallas 2015, p.19; Roy 2013, pp.117–120; Kaplinsky et al. 2011, p.14; Gereffi et al. 2005; Staritz & Whitfield 2017b)	5.4.3
	Quality conventions	How do buyers evaluate quality?	(Ponte & Gibbon 2005; Ponte & Sturgeon 2013; Raynolds 2002; Renard 2003; Murdoch et al. 2000; Wilkinson 1997)	5.4.4
	Trust and uncertainty	Do suppliers trust buyers and vice-versa? How is uncertainty in buyer-supplier relations solved (payment modality, contracts…)?	(Raikes et al. 2000; Ponte & Gibbon 2005; Fromm 2007; Kaplinsky & Morris 2002)	5.4.5

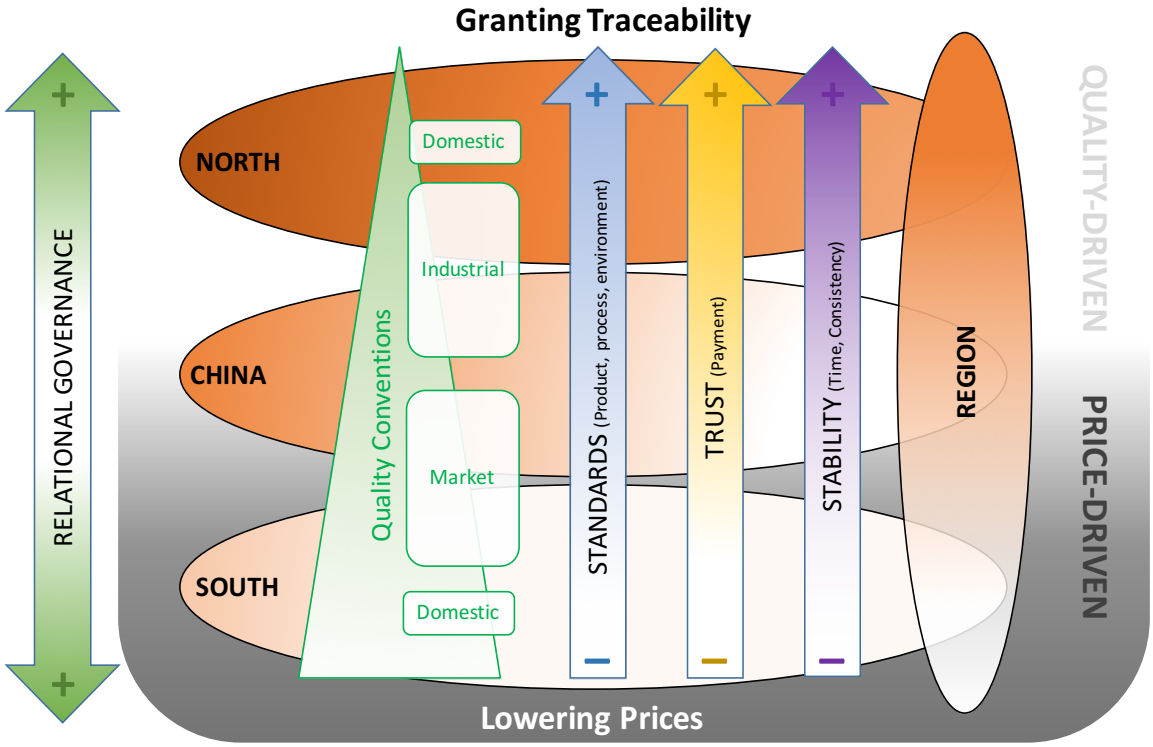
Source: Author's elaboration.

5.4 Governance and trajectories

Drawing on the themes outlined in the methodology, the aim of this section is to provide a cross-trajectory comparison of alternative governance approaches. To make sense of chapter four whereby the South and the North display very similar forms of

governance, the following paragraphs examine sourcing practices characterising southern, northern, and regional buyers. These are further explained in terms of standards, quality conventions, trust bonds, and stability. As a note from chapter four, while *North* is used here to indicate developed countries (in this case almost exclusively Europe and, more specifically, Italy), *South* refers to the Indian and Pakistani markets excluding China. China is included in the analysis and is directly referred to as such. Finally, *Region* is used to identify essentially COMESA and EAC countries with whom Kenya enjoys preferential terms of trade.[126]

Figure 5.3: Governance by market trajectory



Notes: The figure shows how domestic interactions and more relational modes of governance can co-exist at both ends of trust, stability, and standards within quality- as well as price-driven markets.
Source: Author's elaboration.

[126] In the following sections, North and Europe (and in some instances Italy) are used as synonyms; so are South and India/Pakistan.

5.4.1 Sourcing practice

Chapter four operationalised *sourcing practices* as an indicator of governance. Direct sourcing has been associated with increasing integration, whereas indirect sourcing has been linked to market-based relations. A more complex picture emerges from the interviews with tanners. When asked about the specific governance structure linking them to their final market, Kenyan and Ugandan producers dealing with European buyers stressed the importance of direct links and information sharing. Third party agents are used as a guarantee for smoothness in the transaction, though this does not prevent the formation of a direct link between tanner and manufacturer. As reported by Tan-1, "the agent knows what is happening in the market; they give a guarantee on payment, prices, decreasing risk for us. The relationship with the customer is at the product level, the agent plays more of a commercial role."

Conversely, all tanners dealing with the Chinese market report selling to traders with no contact or knowledge of final processors. As Tan-3 points out, "Chinese buyers buy through traders that come to the company. We have no direct contact and do not know the tannery." Nevertheless, the South does not emerge as a homogeneous category. Contrary to China and Hong Kong, the Indian and Pakistani markets are often dominated by direct relations where local tanners work directly with processors. In this respect, Tan-11 notices, "in China we deal only with traders, we don't know who will finish the wet blue… However, in India we deal mostly with tanneries who negotiate the price and material directly." Tan-4, Tan-1, Tan-3, Tan-2 and Tan-19 relate quality and standards to direct sourcing – as Tan-4 highlights, "Chinese buyers are not processors but traders so they don't understand the process and do not want to. Italians tend to give more feedback about the quality of tanning, but with the Chinese you do not get these

comments. You'll be surprised, but India and Pakistan work differently… They buy the lowest quality, yet they buy directly and do quality check more than the others!"

Concerning the Region, sourcing practices vary a lot with more formal businesses establishing direct channels with tanneries and smaller informal manufacturers buying leather indirectly through traders and middlemen.[127]

What emerges here confirms the quantitative analysis in chapter four, whereby China is characterised by indirect governance bounds while the North and South present more relational forms governance.

5.4.2 Standards

In accordance with the literature, relational ties and preferences towards more stable direct sourcing in the North are a consequence of environmental and quality standards. Their presence makes it unprofitable to acquire low-end material that requires a great amount of labour and processing. As an Italian tanner stressed, "a good tanner can turn low quality wet blue into gold, but the amount of work required to do so is insanely high and costly. Low-end material can be used for gloves, stripes and other small items whose profit margins are extremely low and do not justify the major costs we experience in processing [in Europe]" (*int.* V.I.). A leather agent working with Europe stressed the link between quality standards and relational governance: "Italian tanners get involved directly to reduce delivery times and ensure quality… The hide should not only be of high grade and without holes, but the size is crucial… They should be all the same size!" (*int.* B.C.)

It is not uncommon to have northern buyers dictating chemical recipes or even procuring inputs directly, as reported by Tan-4: "in a few occasions, we were asked to

[127] This aspect for the Region is further analysed in chapter seven.

change the recipe and use specific chemicals. Once, they even bought us a container of chemicals and deducted it from the price of leather! No change or specific processing request comes from the Chinese and Indian markets…" Along with quality specifications, the presence of strict environmental standards such as EU-REACH and the Washington Convention regulating the European market makes direct sourcing pivotal to guarantee traceability.

The same does not apply to the Chinese market, where lower labour costs and less complex environmental legislation allow sourced material to be processed at more competitive rates. China is the number one leather manufacturer and exporter in the world, covering all markets from luxury goods to low quality working gloves. Since all material can easily find a tannery willing to process it and, where needed, increase manpower in the finishing process, there is no need for the buyer to deal directly with the tanner. In accordance with GVCs governance theories, the costs of integration and direct negotiation would not be justified in these circumstances. As stressed by a European tanner and agent with a long experience both in the Chinese and European market, "the Chinese market has been gradually moving into import of more value-added material… As in Italy, they are increasingly interested in wet blue and crust leather, the quality however is different. They are much less rigorous when it comes to the TR 20-40-40 rule and weight-range.[128] A lower quality of wet blue can be processed into crust and corrected into finished leather or used for accessories items such as watch straps, gloves etc. This can be done in a profitable way in the Chinese market, but it is unthinkable in Italy" (*int.* V.I).

[128] Wet blue is internationally graded based on its overall quality from grade I (highest quality) to grade VI (lowest quality before reject). TR 20-40-40 is used to indicate a production-lot where 20% is grade I, 40% grade II, and another 40% grade III.

Within the South, India and Pakistan are according to all tanners the lowest-end market in terms of both quality standards and profitability. As Tan-6 highlights, "Chinese traders buy considerable quantities paying in advance and hardly complain on quality. They buy TR 20-40-40 as well as 5 and 6 grade. Italian buyers are picky and tend to complain on price. They buy rigorously only TR 20-40-40. Indian buyers purchase 6 and 7 grade at very low prices." Similarly, Tan-5 asserts that "India requests low grades of wet blue only, and they are those that insist the most on price." Tan-4 also emphasises how the South demands mostly low quality material at very low profit margins: "India and Pakistan buy the lowest quality... This market does not pay well at all…" Despite the low quality, India and Pakistan are associated with more direct and stable relationships. Low standards and labour costs do not therefore explain governance on this market trajectory, as much as they do for China and the North.

Concerning the Region, quality standards tend to change a lot, varying from low-quality scrap leather used in informal shoe-manufacturing, to high-quality finished leather for top-end handbags and travelware.[129]

5.4.3 Stability

Chapter four pointed to how northern markets are characterised by more stable long-term buyer-supplier relationships than China. This dynamic is confirmed in the interviews.

Tanners dealing with northern buyers tend to establish long-term relationships with few trusted clients. According to Tan-4, "you can plan long-term contracts with Italy, not with the Chinese. We work through trusted agents in Italy where clients are kept constant, whereas China works more through traders and sporadic orders." On the

[129] Regional standards are further analysed within the scope of chapter seven, therefore no direct quotes are reported here.

same note, Tan-1 stresses that "Italy offers more stable relations. It is a stable market with a constant growth… […] The Chinese market is more unstable with a big number of buyers and more sporadic relations." Tan-19 and Tan-2 confirm this trend, pointing to reputation and direct sourcing as an explanation for stability: "the Italian market is more stable in terms of length of the relationship with the client. There are fewer actors and the tanners are known directly by the supplier…"

In this respect, stability is linked to quality standards. As stressed in section 5.4.2, more complex regulations and product/process specifications require buyers to undergo long-term relations with their suppliers where information is shared directly and capacity is built across time. As reported by a Kenyan leather expert and trader, "the Italians have more stable contacts and know what is being produced and how […] They communicate with the agent but they come to check quality and process sometime. You have heard of REACH and all these declaration… You have a product where something goes wrong, suppose somebody finds Chrome-6 on this. At least they have traceability of where it comes from…" (*int.* A.S.)

Concerning the Region, interviews with tanners and manufacturers present a more mixed assessment. As pinpointed in the previous sections on standards and trust, formal and established businesses dealing with high-end leather goods tend to develop more stable ties with specific tanneries, while informal buyers and leather stockists are more likely to change provider over price considerations. As explained in chapter seven, this is often the consequence of more complex specifications demanded by the first, which in turn requires a closer relationship with the tanner to define and oversee quality. As stressed by the bag designer and manufacturer Hnb-8, "I buy directly and exclusively from Tan-1. I can define pattern, colour and quality and I place direct orders. I go there and get to know them and we work together to achieve what I want. When we tried to

leave, they called us and gave us a better treatment […] That means that they take our orders in high consideration!"

Whereas labour costs and higher product and process standards drive stability and integration in the North compared to China, it remains unclear why low-quality, price-driven markets in the South involve a certain amount of relational governance with levels of control that are comparable, if not higher than those applied by northern buyers. As stressed by Tan-3, "China works through traders and we have no clue who the material is going to, but Indian buyers come often directly, straight to the tannery." The answer to this question rests on the *price-driveness* of the Indian market and its consequences in terms of trust and quality conventions. These aspects are examined in the next two subsections.

5.4.4 Quality conventions

Relationships with India and Pakistan tend to involve vertically-integrated buyers who not only perform the leather finishing process, but also manufacture final goods. These are mostly low-end finishers for the South Asian market where, as stressed by Roy (2013), competition tends to be extremely high and profit margins low.[130] In this context, Indian and Pakistani vertically-integrated tanners prefer to acquire wet blue material directly so as to reduce costs to a minimum and eschew the mediation of a trader. These actors are aware that Kenyan tanners often face no choice regarding low grades and exploit this aspect to negotiate on price and quantity. As reported by Tan-21, "the margins on poor quality material […] are close to 0 and they have to go to India…" Focusing on the attitude of Indian and Pakistani importers towards middlemen, Tan-4

[130] Integrated tanneries account for 34% of the total sales to India (83.1% of direct relationships), while non-integrated tanneries constitute a mere 3% (9% of direct relationships).

reported that "many times I had Indian buyers coming and telling me the middleman tricked me, now we can deal directly…"

The importance of price as a driver of integration in the buyer-supplier relationship is reflected in the quality convention defining the exchange. Uncertainty here is solved by means of a *market convention*, where interaction is governed by *price*. Ponte and Sturgeon (2013) assert that, in price-driven markets, exchanges occur without multiple interactions and integrated governance linkages. Yet, the relationship between Kenyan producers and Indian buyers is characterised by direct and more stable interactions as it is typical of *domestic conventions*, in which uncertainty over quality is solved through interpersonal relationships.

The same is true within regional markets where, despite the higher value addition demanded by buyers (i.e. finished leather rather than wet blue), quality is often evaluated and negotiated through domestic conventions. As stressed by the bag producer Hnb-29, "we have been struggling to get good quality leather. Now, we had conversation about quality and we have seen it improving. It comes less from senior relationships and more from our production manager going there and physically meet with their production guy and build a relationship… Probably, if he was to stop going the quality would fall off again, because nobody would really care about us…." Hnb-18 pinpoints something similar: "I do ask for better quality and sometimes I refuse to take. Then the manager intervenes and I get what I want… The point is, I never order leather from the tannery for delivery. I always go there. It is not the top management, but the low management you need to deal with..."

When it comes to the North and China, quality conventions follow the traditional framework defined in the literature. Among northern buyers, quality conventions range between *domestic* and *industrial*, whereby high standards and more complex regulations

require buyers to implement more interpersonal direct bonds.[131] As it is further explored in the next section, this is accompanied by a need for more stable trust-based relations. By contrast, in China, where quality standards are higher than the rest of the South, buyers conform to *market-based* and *industrial* conventions where quality is assessed in terms of price and codified standards, such as the traditional TR-20-40-40. As stressed in the previous sub-section, this is hardly surprising. In fact, China's large market allows it to acquire and process different quality ranges, making it pointless to undertake direct relationship based on more domestic conventions.

At this stage, it may appear contradictory that China features less tight governance links than the North while maintaining a similar level of product quality – as reported in chapter four. Yet, by virtue of their large market and lower labour costs, despite applying similar quality standards as the North, Chinese buyers are much less rigorous in their implementation (see section 5.4.2). As stressed by Tan-9, "[the Chinese market] will take a TR 20-40-40 that has grade IV moved to III… They are looking at quantity, not quality as they have a market for it… Europeans are rigorous on the quality […] they know what they are buying…." Similarly, Tan-3 asserted that "Italy is requiring the highest quality in bovine and they are very picky in the size and measure. Whereas the Chinese are not rigorous in TR 20-40-40… India and Pakistan buy the lowest grades VI-V." Tan-8 further declared that "Chinese buyers […] were not picky about quality…"

In addition to this, the immediate cash payments characterising trading dynamics (see section 3.5 on sourcing of raw material) further implies that Chinese buyers can still afford to pay similar unit values to their northern counterparts: "in terms of payment

[131] While environmental standards are present (i.e. EU-REACH, Washington Declaration), these are codified within industrial conventions. There is therefore no sign of civic conventions being implemented at this stage of the chain.

China is the best. But in terms of stability and quality, Italy is the best. You can plan long-term contracts with Italy, not with the Chinese" (*int.* Tan-4). In the same way, Tan-11 asserted: "[the Chinese] have so far paid the best prices, as they pay cash. I don't know why but they often can pay higher prices than Italy, although recently this has changed…" This further explains why despite displaying similar unit values, buyer-supplier relationships with China are in general less stable than with the North.

5.4.5 Trust and uncertainty

The tendency towards *domestication* of market-driven conventions in the South is upheld by the low level of trust underpinning the relationship between Kenyan tanners and Indian buyers, fuelled by the number of post-delivery price complaints brought by the latter. Overall, tanners agree that business relations with northern buyers are based on trust and personal ties. However, despite the higher quality and specifications, direct control is not necessarily greater when compared to Chinese and Indian buyers. According to Tan-6, "more control and contact does not mean higher quality. Italian buyers do not contact us as much as Indian or Chinese and yet the quality is higher. More communication is often a consequence of less trust."

Echoed by several Kenyan suppliers, Tan-8 points to low trust and instability in buyer-supplier relations because of continuous negotiations and "dumbing-down" practices used by buyers: "Kenyan tanners got burned many times in deals with Indians where complaints were made when the container was gone and prices renegotiated to a loss. This generated a low level of trust that brings some tanners to refuse deals with Indian buyers." As Tan-21 reports, "trust is very low with Indian and Pakistani buyers and not knowing the tanner at the other side is often a problem… So, dealing directly is a necessary consequence…" Tan-3 likewise identifies this distrust dynamic: "if I send something wrong to Europe, they will tell me there is something wrong and won't think

I did it deliberately. But in India they will think I did it on purpose and will book another container and once it is on its way they will start blackmailing me! They always want to have the upper hand." Tan-20 echoes this concern, pointing to the continuous price negotiations and the consequent instability it generates: "the Indian market is troublesome in terms of complaints and constant price negotiations. For this reason, buyers tend to change a lot…"

As stressed by Kaplinsky and Morris (2002), trust is reflected in the payment method. European buyers are usually subjected to Cash-against-Documents (CAD) on arrival, while Indian and Pakistani buyers to letter of credits (LCs) with deposit. According to interviewed tanners, payment methods are often used as an indicator of trust in buyer-supplier relations. Some tanners tend to operate exclusively with letters of credit and pre-shipment deposits. However, major tanners exporting across all trajectories apply different methods depending on the level of trust enjoyed by the client. CAD on arrival is a practice that is reserved for long-term trusted buyers. Tan-21, Tan-4, Tan-1, Tan-10 and Tan-20 use CAD on arrival with buyers in Europe, whereas Tan-19 and Tan-2 requires a 30% deposit on CAD, apart from long-term trusted buyers in the North: "we have had the same agent in Italy for a long time and with him we operate through CAD… He has been guarantee of a long relationship with our clients there."

The lack of trust that characterises the Indian market translates in less flexible methods of payment. Several tanneries such as Tan-2, Tan-4, Tan-21, Tan-20 and Tan-19 require Indian and Pakistani buyers to inspect the material upon delivery and provide an LC upon shipment. According to Tan-4, "Indian buyers are always requested to pay a deposit; no shipment is done without a deposit because they often break contracts…" As outlined by Tan-21, "trust is higher with European buyers and their agents… We can use

CAD payment method; however, we cannot do the same with Indian companies where we often request a deposit…"

The Chinese market, on the other hand, is often characterised by instantaneous bank transfers, a practice that is typical of many traders in this market and greatly appreciated by local suppliers. As pinpointed by Tan-4, "Chinese traders pay more for lower quality and often pay immediately…" However, direct payments are often a consequence of low trust, as Tan-3 reports: "Chinese traders offer line of credits for certain cargos. They provide anticipated money to buy on their behalf! However, once we were asked to provide material in advance based on trust and lost all the cargo and never got the money… This was a business with a trader… Now we lack trust…" Trust issues emerge on both ends of the chain, with the buyer also lacking trust towards the supplier: "the Chinese are those with tighter controls because they buy in place and they make their own delivery paying cash. Also, they lack trust towards the system and prefer to have their agents in place..." (Tan-5) In this respect, Tan-19 explains the lower trust in the relationship with Chinese traders as a natural consequence of market instability where traders tend to change often and orders are much more sporadic compared to North-South value chains..

Concerning the regional and local market, trust becomes less of an issue as buyers are required to pay cash-on-delivery. As stressed in section 5.4.4, clients are usually local manufacturers placing direct orders and collecting from the tannery's door. The tanner personally knows them and trust is built on long-term *domestic conventions*. When the relationship is well established and the client's orders are constant and substantial, a line of credit can be granted by the tanner. As stressed by Tan-11, who sells low-quality leather to the informal Kariokor Market, "cash on delivery is the method for local purchases of finished material…" However, tanneries like Tan-1 and

Tan-7 do allow delayed payment to long-term trusted clients – usually high-end handbag producers placing constant orders with personalised specifications. In this respect, multiple levels of trust exist depending on the type of client, with more formal and high-quality businesses enjoying privileged trust ties with tanneries.

5.4.6 Summary

The analysis of governance carried out in this section explained the results of chapter four whereby northern premium markets display more relational and stable bounds than China, but do not yet significantly differ from other South-South value chains.

In the North, higher product and process standards require buyers to define closer and more stable relationships where quality is evaluated based on *industrial* and *domestic conventions* underpinned by high degrees of trust. Conversely, the Chinese market presents more indirect and mediated forms of governance, which goes hand in hand with its capacity to attract all quality and product ranges by virtue of lower processing costs and a vast national and international market. Yet, when it comes to the South, more relational forms of governance underpinned by *domestic conventions* appear to ensue from lower quality standards, lack of trust, and price-driven market preferences. Unlike China, in fact, Indian and Pakistani buyers are inward oriented and their quality range is limited to very low-end leather for the price-driven internal market.

As in the North, relational governance in India and Pakistan is a consequence of quality, the main caveat being that the former is driven by low rather than high quality. As a Kenyan-Pakistani tanner with production units in both Kenya and Uganda noticed, "many Indian tanneries dealing with Kenya are integrated-glove and boots manufacturers whose margins are low… They complain a lot on price and try to re-negotiate… For this reason, we now ask them to inspect the material before shipment."

(*int.* Tan-2) Another Indian tanner with business both in India and Kenya observed, "these are people who work on tiny margins… They make direct deals to be able to negotiate on price." (*int.* Tan-22) In these conditions, it is lower margins and low quality that drives governance.

In a nutshell, whereas both the European and Indian-Pakistani markets are characterised by more relational forms of governance, the explanation behind this phenomenon differs considerably. In the case of the former, it is a quality-driven integration process. In the latter case, it is a price-driven one. This result, summarised in figure 5.3, is quite striking in light of the GVCs and GPNs literature, which likens increasing relational forms of governance to higher quality standards and more *domestic* and *captive conventions*. This section showed how lower standards can indeed drive governance between global buyers and local suppliers. However, such forms of governance are built on market- rather than trust-based linkages: despite acquiring low-end material with no major process and product specifications, buyers from the South (and in some cases the Region) seem to privilege more direct and time-consuming sourcing practices.

As presented in figure 5.3 and table 5.2, the regional and local market presents a more multifaceted outcome that encompasses different levels of standards, quality conventions, trust, and stability depending on the segment we focus on. This aspect, which distinguishes this market trajectory from the global South, is further explored in subsequent chapters.

5.5 Conclusion

Through interviews with 24 tanners across Kenya and Uganda as well as several other experts and institutional bodies, this chapter shed light on some of the causal links

underpinning the study's research question – i.e. how does participation in value chains with different market trajectories relate to the upgrading of local suppliers in developing countries? Specifically, building on the outcome of chapter four, the previous sections showed how patterns of value chain governance differ across market trajectories. Table 5.2 summarises the main governance characterisations as they emerge from the chapter.

Section 5.4 compares sourcing practices, standards, stability, trust, and quality conventions across different market trajectories to explain similar levels of relational governance within North-South and South-South value chains. In accordance with the literature, governance on a North-South bound is driven by higher environmental and quality standards as well as increasing labour costs. This in turn generates a propensity towards *domestic* and *industrial conventions* within a framework of trust-based, long-term, and direct relationships.

The situation is different for the Indian and Pakistani market where integration is price- rather than quality-driven. In this context, the mistrust characterising buyer-supplier relationships facilitates the creation of direct linkages that lead to the formation of *domestic* and *market conventions*. Here, price rather than quality drives governance in the value chain. Such outcome casts doubts on the literature linking governance to standards and knowledge sharing on the one hand (Gereffi et al. 2005), and quality evaluation on the other (Ponte & Sturgeon 2013). Moreover, it shows how relational links in value chains are not necessarily related to suppliers' dependency on buyers and/or limited access to alternative markets (Humphrey & Schmitz 2000; Navas-Alemán 2011, p.1388). Lower standards and sub-optimal markets bring about relational ties between global buyers and local suppliers. *Domestic conventions* emerge here as a mean to reduce buyers' mediation costs while countering uncertainty about quality and quantity.

The phenomenon described here is not new to the literature. A similar scenario is purported by Fessehaie's (2012) analysis of the Zambian copper value chain, whereby southern buyers tend to rely on arm-length governance while their northern counterparts implement more relational ties with their suppliers. In this context, Fessehaie also notices how the Indian value chain is comparatively more price-driven and characterized by low trust and weaker loyalty ties among suppliers. Nevertheless, whilst according to Fessehaie this scenario translates in squeezed profits and lower opportunities for upgrading among suppliers, the next chapter shows how this could indeed achieve the opposite consequence of stimulating, rather than hampering, upgrading.

For the most part, this chapter provides a clear picture of the effect that markets have on governance in the relationship between global buyers and local suppliers, highlighting causal links where chapter four established only correlations. Nevertheless, the analysis contains several limitations and space for future inquiry.

Further research should focus on upstream linkages in South-South value chains to shed light on how value is negotiated and extracted through governance practices that rely more on personal than institutionalised forms of coordination. How governance ties relate to the meso- and macro-level of the value chain and the extent to which different markets affect upstream linkages would have significant implications for policy makers interested in increasing the local share of value addition. The analysis of tanners' procurement strategies conducted in chapter six goes exactly in this direction.

Moreover, as stressed both in chapter four and here, the relationship between market trajectories and local suppliers is further driven by characteristics that are peculiar to such markets. For instance, the Chinese government has long prevented companies from trading directly in intermediate goods with import-rights being restricted to registered traders till 2004 (Fu & Xu 2012). Due to a lack of reliable legal

protection and property rights, Chinese companies developed a very hierarchical decision-making structure within a trust-based business system that surely impacted on their relations to foreign suppliers within GVCs (Redding & Witt 2009; 2013). For this purpose, carrying out fieldwork in the importing regions and studying their respective trade regimes would shed more light on the dynamics influencing lead-firms' governance relations with upstream suppliers.

Table 5.2: Summary of governance characteristics by market trajectory

	GOVERNANCE				
	Sourcing practice	**Standards**	**Stability**	**Quality convention**	**Trust**
North (42%)[132]	Direct 	High 	High 	Domestic, Industrial	High 
Region (8%)[133]	Direct / Indirect 	Low to high 	Low to high 	Domestic	Low to high 
China (36%)	Indirect 	Low to high 	Low 	Market, Industrial	Low 
South (14%)	Direct 	Low 	Low 	Domestic	Low 

Source: Author's elaboration.

[132] Percentage of total exported value aggregated for 2006-2015.
[133] Computing a percentage for this market based on the available data is trivial as local trade is unaccounted and regional trade underestimated (see chapter three).

6.

When upgrading goes South: The case of Kenyan and Ugandan Tanners

6.1 Introduction

Studies on international trade and innovation transfer have concentrated on factors productivity and their impact on skills composition and functional upgrading (Linder 1961; Amsden 1976; Klinger 2009; Hausmann et al. 2008),[134] as well as income inequality on a South-South vs. North-South trajectory (Davis 1996; Gourdon 2011). However, as already discussed in chapter two (section 2.2), they have mostly ignored the micro dynamics characterising supplier-buyer relationships within value chains and, as such, how intra-chain relations impact on firms' decision to upgrade. In their quantitative analysis of how innovation is transferred within trade relations in Ghanaian firms, Fu et al. (2014, p.29) acknowledge the pre-eminence of value chains, highlighting the persisting literature gap underpinning the interaction between innovation systems and GVCs (Fu et al. 2011, p.1209). Similarly, Brach and Kappel (2009, pp.16–17) and

[134] In these studies, functional upgrading is often referred as beneficiation or, more simply, forward integration (Hausmann et al. 2008; Gillson et al. 2007).

Rabellotti et al. (2007) pointed to the lack of research combining GVCs studies and innovation debates at the firm-level.

Chapter four identified links between market trajectories and suppliers' upgrading. Drawing on the study's research question – i.e. how does participation in value chains with different market trajectories relate to the upgrading of local suppliers in developing countries? – descriptive statistics and correlations were contextualised within the GVCs and trade literature. Three themes emerged that are further explored in this chapter: (i) when transacting with northern markets, firms tend to display higher product and process standards;[135] (ii) large firms are more likely to experience product upgrading and engage in transaction with northern markets; and (ii) functional upgraders into manufacturing are small firms targeting the local and regional markets. Drawing on these themes, this chapter undertakes an assessment of the tanners' decisions to upgrade in terms of product, process, and functions.

Exploring the dynamics underpinning suppliers' up- and downgrading, the following sections point to two main outcomes: (i) participation in northern markets is linked to product and process upgrading and is conducive to higher profits. However, only large firms with the capacity to control upstream stages manage to access these markets, while smaller competitors are excluded from the profits and stability associated with them. In such a context, (ii) the decreasing quality, standardised production, instability, and lowering profit margins characterising South-South and regional value chains are the driving force of functional upgrading in the Region. This occurs as suppliers dealing with these markets adopt a more *explorative* strategy compared to the *exploitative* approach characterising larger firms embedded in North-South value chains.

[135] China is an exception in this case. However, chapter five explained how, despite the results of the quantitative analysis in chapter four, products going to China are of lower quality than those going to the North at all functional stages.

6.2 Literature review

The ambit of this section is to summarise the literature linking upgrading and market trajectories already explored in chapter two. Furthermore, drawing on the scholarship on business management, the concepts of *exploration* and *exploitation* are introduced.

A major theme emerging from chapter four concerns suppliers' different upgrading patterns. Failing to differentiate between South-South and regional value chains, the literature is not clear on the dynamics underpinning upgrading across different market trajectories. GVCs scholars explain lower levels of functional upgrading in developing countries either as a consequence of power distribution and concentration of core competences in northern economies (Humphrey & Schmitz 2004b; 2002; Humphrey 2003a) or as the result of lower process and product specifications, reduced labour costs, and less complex regulations (Kaplinsky & Farooki 2010; Kaplinsky et al. 2011; Cattaneo et al. 2011). Whereas the first group of scholars identify product and process as essentially independent from functional upgrading, the second posits that functional upgrading occurs once firms have consolidated their position in lower segments of the value chain, achieving high competences in process and product upgrading (Gereffi 1999; Kaplinsky et al. 2002; Fernandez-Stark et al. 2011, pp.23–24; Jean 2014; Schmitz & Knorringa 2000; Kaplinsky & Farooki 2010, p.4; Kaplinsky et al. 2011, p.2).

Drawing on the first scholarship tradition, Navas-Aleman (2011; 2004) and Barrientos (Goger et al. 2014, p.12; Barrientos, Knorringa, Evers, Margaaret Visser, et al. 2016; Evers, Opondo, et al. 2014) attribute increasing participation and functional upgrading in regional markets to less stringent standards and less relational forms of governance, which allow suppliers to seize learning opportunities and functionally

upgrade.[136] Reinforcing the claims made by these studies, chapter four confirmed the positive link between regional markets and functional upgrading, as well as between northern markets and product and process upgrading. Nevertheless, more evidence is needed to shed light on its triggers. Questions remain – i.e. how do market characteristics relate to suppliers' decision to upgrade? Is it indeed a consequence of value chain governance as suggested by these authors?

In chapter four, firm size has been associated with a more efficient reallocation of resources and innovation (Dallas 2015, p.11; Gebreeyesus & Mohnen 2013, p.309; Mairesse & Mohnen 2010). This process eases access to GVCs (Taglioni & Winkler 2016, p.27), as well as participation in more profitable and regulated markets with more stringent process and product standards (Otieno & Knorringa 2012; Sheldon 2012; Henson & Humphrey 2010; Ouma 2010; Essaji 2008). In this respect, section 6.4 confirms the positive relationship between firms' participation in North-South value chains, larger firm size, and product and process upgrading.

Section 6.5 challenges the link between functional upgrading and firm size without, nevertheless, conforming to the governance-based explanation put forth in the literature. In the Kenyan leather value chain, functional upgrading has been limited to smaller producers engaging in sub-optimal southern and regional markets with low levels of product and process upgrading. Here, the link between market trajectory and functional upgrading has been rooted in elements of market stability and profitability, whereby prospects of increased and consistent profits favour firms upgrading (Gereffi 2005, p.171; Schmitz 2006, p.563). This chapter argues that profitability and stability are at the origins of an *explorative* behaviour that favours functional upgrading among

[136] In chapter seven, market knowledge and closeness to consumers emerge as triggers of upgrading. The scope in this chapter, however, is to focus on how upgrading occurred, rather than why it succeeded.

smaller and less successful firms, while simultaneously delaying it among larger actors.

In this way, the study complements the GVCs and GPNs frameworks with concepts from the business management and entrepreneurship literature. According to March (1991, p.85), firms' learning experiences revert around the *exploration* of new possibilities and the *exploitation* of old certainties. *Exploration* is defined here as "experimentation with new alternatives", characterised by risk-taking and whose returns are "uncertain, distant and often negative", whereas *exploitation* refers to the "refinement and extension of existing competences, technologies and paradigms" whose returns are "positive, proximate and predictable". According to Levinthal and March (1993; Sato 2012), to the extent that rapid adaptation by one section of the firm reduces the likelihood of adaptation by another, successful business outcomes decrease *explorative* and increase *exploitative* practices, whereas failures tend to have the opposite effect. In other words, the higher the success rate, the higher the level of confidence in future success (Miller et al. 2006, pp.711–712).

As this chapter argues, increasing competition among tanners has generated a struggle for scarce resources that is in turn fuelling *exploitation* among actors near the top and *exploration* among underperformers at the bottom.

6.3 Methodology[137]

As with chapter five, this chapter takes the tanning industry as its focus. Accounting for 83% of the total chain export in the last 10 years, this sector has been defined as the dominant export linkage across the value chain and the only one combining a North, South, and regional trajectory. In addition to 15 Kenyan tanneries, 9 of 11 tanneries in Uganda were consulted to increase the robustness of the outcome. The

[137] The methodology of chapter five presented in section 5.3 is an essential part of this chapter and needs to be considered along with the present section.

rationale and methodology underpinning the inclusion of Uganda and the interview procedure is tantamount to the one outlined in section 5.3 of chapter five, and is therein unnecessary to repeat here.

During the interview process, tanners were confronted with a set of semi-structured and open-ended questions addressing their level of product, process, and functional upgrading – achieved and planned. A copy of the questionnaire used during the interview process is included in the appendix to chapter five.[138]

Tanners were asked whether they introduced any change to their processing system (i.e. machineries and waste treatment plants, process-standards, managerial techniques and skilled technicians) or product (i.e. product-standards, quality and lines). Table 6.1 displays the indicators of upgrading, while table 6.8 in the appendix shows the main product and process upgrading activities implemented by each tannery. A score from 1 to 3 (+; ++; +++) was attributed to each tannery based on the average unit value as an indicator of quality for 2015 and the number of innovative steps introduced both in terms of process and product upgrading.[139] Whenever the unit value is above average and the tannery has implemented 3 or more upgrading steps, they are attributed 3 points (+++); if only one of these two is achieved they are given 2 points (++); and if less than three activities have been implemented despite the price being below average they are attributed 1 single point (+).[140] Functional upgrading has been assessed based on the stage of value addition achieved (or planned) by the tannery as of 2016.

As presented in table 6.2, the analysis uses five macro-themes of upgrading that are derived from interviews with the respondents. To explain upgrading patterns,

[138] The analysis of governance and upgrading in chapters five and six have been methodologically assessed as part of the same questionnaire and interview process.
[139] This method is intended to complement the quantitative approach used in chapter four whereby product and process upgrading were defined solely in terms of changes in unit values.
[140] For Ugandan tanneries, due to a lack of data on unit values, only upgrading steps were considered.

respondents referred to aspects of size and market share, standards, procurement strategy, market stability, as well as profit margins and consistency. Except for procurement, whose conceptualisation is purely inductive and grounded in the respondents' interviews, all other themes have been previously adopted and explained in the literature (see column 4 in table 6.2). To complement the outcome of chapter four, where firm size was expressed in terms of firms' average yearly export value, size has been further defined by number of employees and average monthly production.[141]

It is important to note that this chapter addresses the South as a single category – i.e. without singling out China. As stressed in sections 4.9 and 5.4.4, the Chinese market is associated with higher profits compared to the rest of the South. Yet, as will be observed in the following sections, the instability that characterises both these markets has a similar effect on local suppliers.

Drawing on the themes reported in table 6.2, the rest of the chapter examines their relevance across North, South, and regional market trajectories. Sections 6.4 does so with regards to tanners' product and process upgrading, while section 6.5 focuses on functional upgrading. Section 6.6 summarises the results, draws conclusions, and points to some major limitations and suggestions for further research.

[141] Size can be interpreted as a proxy of suppliers' upgrading potential (Hatanaka et al. 2005, p.366; Evers, Opondo, et al. 2014), as well as an indicator of the firm's knowledge base (Gereffi et al. 2005) and ability to guarantee stable quality outputs (Gereffi & Frederick 2011, p.185).

Table 6.1: Measuring product and process upgrading

Factors	Definition	Variables
Process Upgrading	New methods of production and industrial organisation	New tanning standards New equipment/machines Waste treatment plant New managerial techniques New technicians
Product Upgrading	New or modified commodities	Higher quality (unit values) New product lines within the same function Amelioration of current products (e.g. different packaging)
Functional Upgrading	Higher stages of value addition	Wet blue Crust and finished leather Footwear and leather goods' manufacture

Source: Author's elaboration.

Table 6.2: Upgrading themes

	Themes	Question	Literature	Section
UPGRADING	Size	How large should suppliers be to access the respective market (average production / capital)?	(Dallas 2015, pp.11–12; Gebreeyesus & Mohnen 2013; Sheldon 2012; Essaji 2008; Henson & Humphrey 2010; Ouma 2010; Gereffi 2014, p.15; AfDB et al. 2014, pp.51–54; Fu 2012)	6.4.1 & 6.5.1
	Standards	What are the process, product, social and environmental standards? How are they codified and enforced?	(Kaplinsky & Farooki 2010; Fromm 2007; Otieno & Knorringa 2012; Aykut & Goldstein 2006; Palpacuer et al. 2005; Guarín & Knorringa 2013; Barrientos, Knorringa, Evers, Margaaret Visser, et al. 2016; Mainville et al. 2003; Funcke et al. 2014; Lee et al. 2012; Gereffi & Frederick 2011; Horner 2016)	6.4.1
	Procurement	How do companies procure raw material upstream?	Inductively defined – see input sourcing (Staritz & Whitfield 2017b)	6.4.2
	Market Stability	How stable is the relation with the buyer across time?	(Fromm 2007; Dallas 2015, p.19; Roy 2013, pp.117–120; Kaplinsky et al. 2011, p.14; Gereffi et al. 2005; Staritz & Whitfield 2017b)	6.5.2
	Profitability	How profitable is the market overall?	(Bernhardt & Milberg 2011; Ponte & Ewert 2009; Gibbon 2004b; Kaplinsky & Readman 2005; Gereffi 2005, p.171; Schmitz 2006, p.563; Goto 2011)	6.5.3

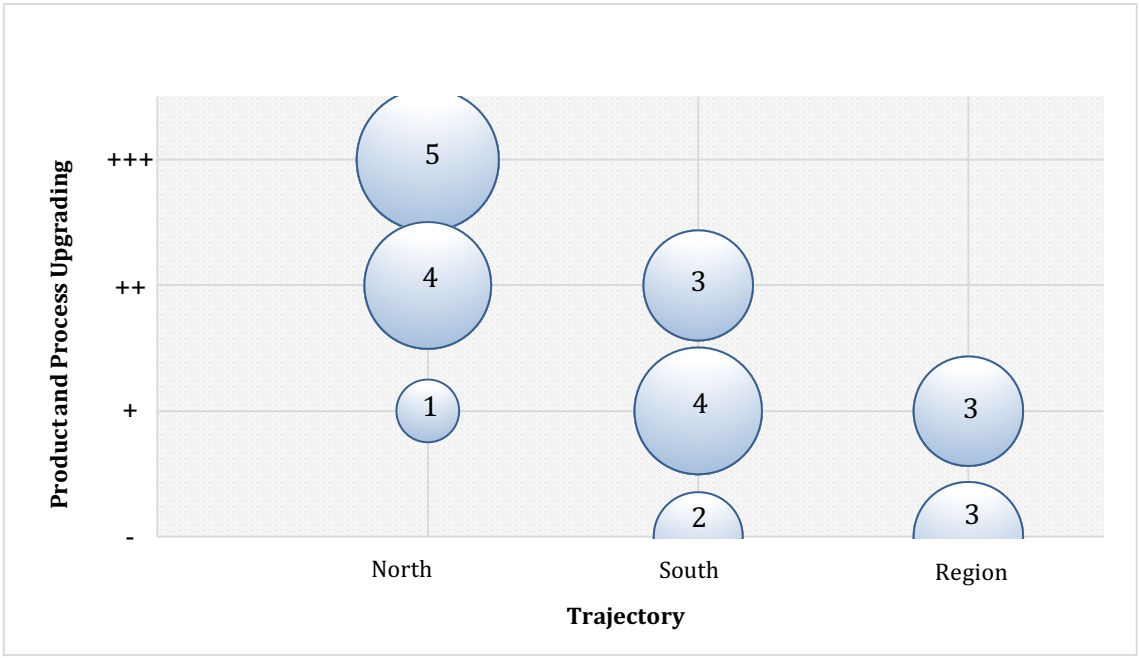
Source: Author's elaboration.

6.4 Product and Process Upgrading

Chapter four pointed to a positive correlation between size and product upgrading. Section 6.4.1 takes a closer look at patterns of product and process upgrading, as qualitatively defined by practitioners themselves and links them to market trajectories and firm size. Drawing on tanners' statements regarding their procurement strategy, section 6.4.2 sheds light on how access to premium markets depends on buyers' capacity to secure stable procurement of high quality raw material.

Figure 6.1 displays the relationship between product and process upgrading and the respective market trajectory - the size of the bubbles and their respective numbers indicate the firms falling within that specific category.[142] The data confirms in part the outcome of chapter four; showing how companies exporting to northern markets display increasing process and product standards. As presented in the next section, product and process upgrading are influenced by tanneries' size and procurement networks.

Figure 6.1: Product and process upgrading by market trajectory



Source: Author's elaboration (survey data).

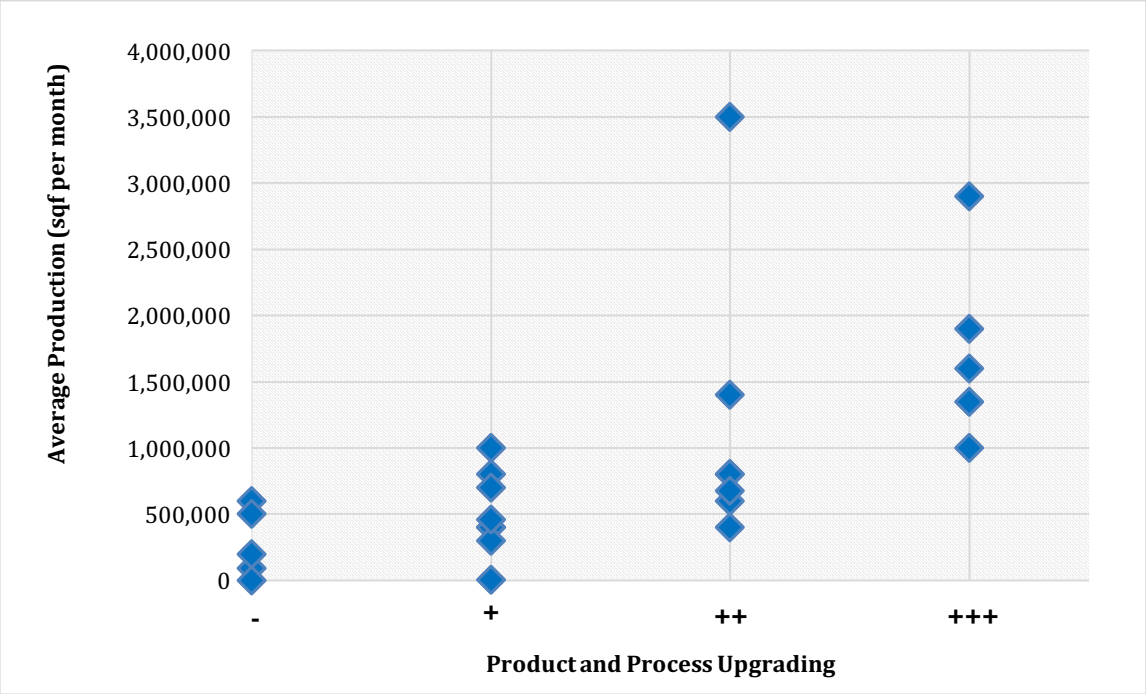
[142] Tables 6.7 and 6.8 in the appendix disaggregate the data by tannery.

6.4.1 Standards and market share

Figure 6.2 points to the link between product and process upgrading and firms' monthly average production. Overall, the figure shows how tanneries with larger market shares experience on average higher degrees of product and process upgrading.

As reported by KLDC, process and product standards are usually low across the industry. Most tanners lament a lack of available expertise and financial means to acquire new machineries. Small tanneries exporting wet blue to the Indian and Chinese markets and finishing for local manufacturers utilise second-hand machineries imported from Asia, Italy or from other local tanneries. As reported by Tan-11, "the company acquired several machineries in 2015, small and used from Tan-5." Equally, Tan-23 in Jinja stressed "I am constrained by machinery… I have no splitting machine, no embossing and shaving machines – so, at the moment, I am contracting Tan-20 for finishing…" Tan-14 uses mainly second-hand Indian technology for tanning and has not changed or acquired any machine for over six years. According to a technician hired to upgrade production processes in Tan-10, "there is only so much quality that you can achieve with these machineries… They used to buy second-hand machineries from India, maintenance was scarce and their chemical feeders were lacking the required knowledge to achieve quality throughout the tanning process… At least the one we require to export to Europe!"

Figure 6.2: Product and process upgraders by firm size



Notes: See table 6.8 in appendix for the data used to create the figures.
Source: Author's elaboration (survey data).

Large tanneries are the exception to this rule. The four largest Kenyan tanners, along with four tanneries in Uganda, are endowed with new machineries, and operate frequent renovations and scheduled maintenance. Tan-1, Tan-18, Tan-2, and Tan-19 all have in-house training programs with international instructors. On a lower scale, so do Tan-4, Tan-6, Tan-17 and Tan-21. Most of these companies possess automatic chain drying systems and modern tanning drums. Some of them have recently started to produce and export *wet white* to the European market.[143] As Tan-1 remarks, "European buyers share specifications on what exactly they want and make suggestions on how the process should take place. For example, with wet white they advised on chemicals and recipes…" Diversifying across markets is a technique used by Tan-4 who points out the following: "Italy is the leading market in terms of innovation and they often make

[143] Wet white is a recent and more expensive tanning technique for chromium-free leather increasingly demanded in the high-end automotive sector. It distinguishes itself from the traditional wet blue as the absence of chromium results in a white- rather than blue-coloured hide.

specific requests about processing… However, often if they do not take something, this can be placed to China or elsewhere…"

In response to the question of whether they ever made a change to their process due to a request/suggestion from a client, Tan-4 replied: "Yes only with Italian tanners. It is about chemicals. In a few occasions, we were asked to change the recipe and use specific chemicals." In a similar way, Tan-21 stated: "Yes we have made some changes to our production process… One (European) buyer advised on longer soaking period to increase plumpness (thickness) and another advised on how to apply slow fleshing method especially on hides with humps to control 'cutting or holes'." Tan-10's manager further pointed to how packaging standards for the European market are often more demanding. Another tanner, Tan-3, identified stricter EU regulations as a trigger for European clients' involvement in defining processing standards: "Europeans, because of EU REACH regulations, are stricter about this (chemicals and processing). Chinese control is more about quantity and quality of the raw material…"

In this context, some mid-sized tanneries interested in entering the European market are trying to upgrade and re-organise their processing, as pinpointed by Tan-10: "we hired 3 Italian technicians because we want to increase our quality to enter the European market, train the workforce and re-organise the production structure." Such upgrading plans however are often constrained by a lack of institutional support, credit, and, more importantly, access to high-quality raw material through a procurement strategy that allows upstream control of sourcing channels.

6.4.2 Procurement Strategy

Large tanners serving northern markets are the main upgraders in terms of product and process. Nevertheless, quality standards are not just the consequence of downstream relations between buyers and suppliers. They depend on firms' sourcing

strategies and upstream integration. Due to the higher specifications set by European markets and the dependency of wet blue quality on the grading of raw material, only those suppliers who manage to procure high quality raw material succeed in accessing these markets. As reported by Mwinyihija (2014a, p.21), "[t]he final quality of hides and skins is dependent on the entire production chain including animal nutrition, control of ecto-parasitic diseases, and adoption of standardized flaying procedures to storage techniques."

Yet, for reasons explained elsewhere (see chapter three), the overall quality of Kenyan hides has decreased considerably in the last 20 years as the liberalisation process put an end to the government subsidised tick-control and artificial insemination programme. In this context, few tanneries had the means to set up collection centres and implement upstream quality-control.[144] Having to compete with illegal trading implies that tanneries pay a higher price to secure supplies of comparatively lower quality material.[145]

Some tanners admit that lack of trust among traders makes prices skyrocket in periods when raw material is scarce. As one large tanner laments, "in 2012 we had to source raw material from Tanzania as most of the Kenyan one was being smuggled to China by traders… The quality available dropped significantly and we survived on low quality scrap-leather…" (*int.* Tan-2) The Veterinary Department echoed this statement, "in 2012 prices surged and quality dropped due to a lack of quality hides in the market…", whilst COMESA-LLIP further stressed that "prices of raw material do not reflect quality but are often dependent on traders' speculation and market volatility."

[144] According to both the World Bank (2015, p.52) and Mwynihija (2014d, p.112), the procurement of raw hides and skins accounts for about 50% of the tannery costs.
[145] KLDC estimates that around 20% of the total production in 2012 may have been smuggled (*int.* KLDC). Having to compete with illegal traders implies that local tanners have to pay higher prices to secure provisions (World Bank 2015, p.53).

KLDC pointed to a market failure generated by lowering prices and decreasing margins that affects the overall quality of raw hides: "due to high competition, traders tend to adopt different techniques to increase margins and reduce costs, such as re-using salt or reducing its amount… They do this as they know they will be able to find a market for the product anyway. Tanners, in turn, negotiate lower prices to make up for decreasing margins brought about by lower quality." In the long term, this process damages the curing procedure, lowers quality, and constrains profits. As a result, continues KLDC, "to prevent this market failure, major tanneries who have the means to do so, provide traders with salt, flaying material and training…" In other words, those with the capital to do so integrate the sourcing procedure to prevent quality deterioration and an inconsistency of supplies. This practice is identified in the literature as *insourcing* and/or *upstream vertical integration* (Stuckey & White 1993; Wei & Rehme 2012; Delpal 2013).

Now, whilst Mwyinihinja (2015, p.6) describes upstream tanner-procurer relations as a network-based system dominated by soft-loans and tight controls on delivery, the situation appears much more diversified. Of 24 tanneries interviewed between Kenya and Uganda, only six large actors admitted providing soft-loans to traders as a form of advanced payment to secure the supply of top-quality material, and only one tannery integrated the slaughtering process. Most tanners, instead, base their sourcing strategy on gate negotiations, trust-ties to traders, and/or third-party provision. As reported by Tan-8, "the raw material is sourced by our main contractor for the subcontracted work. However, the hides that we finish in-house are procured from a trader we know well and trust. This is not ideal as we have to purchase the whole truckload, we cannot select based on quality!" To the question of why he does not use the sourcing channels of his main contractor, the tanner replied: "we cannot afford

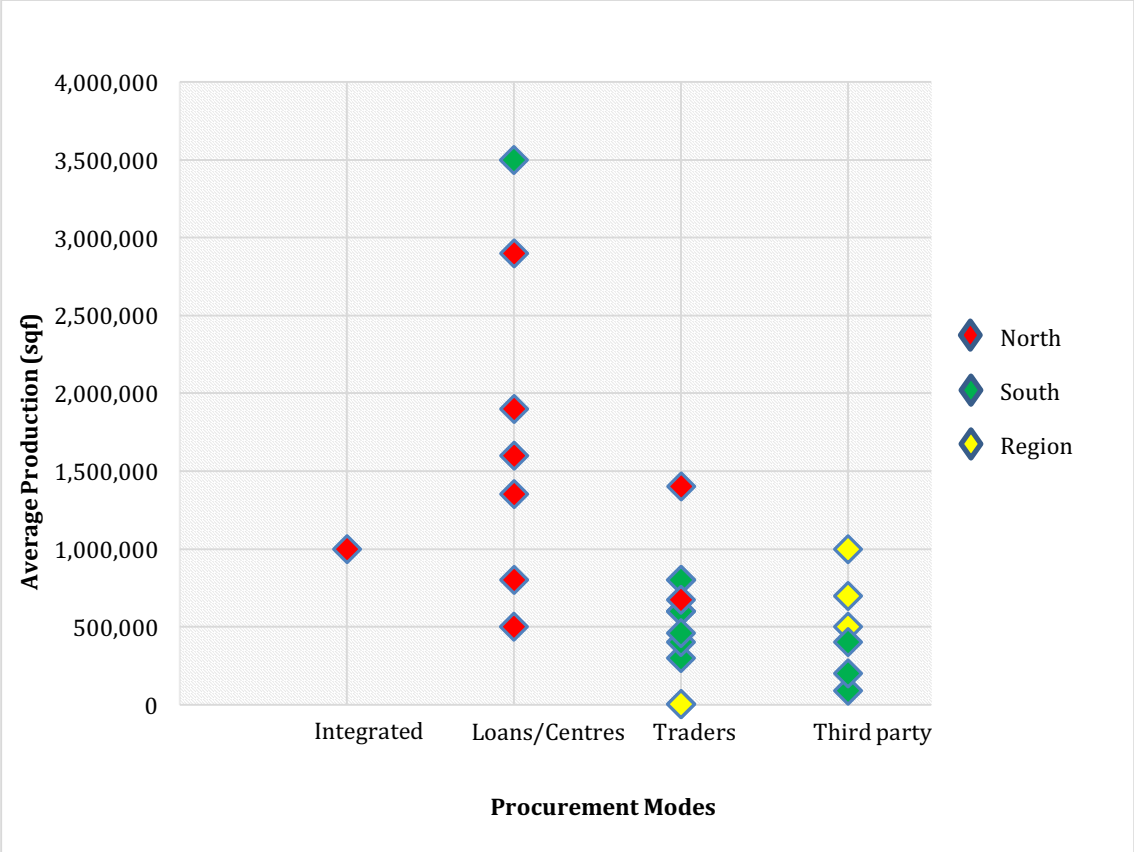
sourcing from this channel as premiums paid on quality are too high…" Similarly, Tan-11 stated that "quality has been going down in the last years and we struggle to secure good material… However, for the markets we serve it is not that bad. There are about 10 traders that supply us when required. We pay based on quality. We cannot afford advanced payments, collection points, or salt provision…" And Tan-4 further stressed: "We buy at 130 KhS, that's the maximum price and the top tanner will pay 150 KhS so everybody goes to him first. […] He does this, which is simple and effective and gets the best material. He also has collection centres and monitors everybody, knowing their capacity…"

Figure 6.3 shows the link between a tannery size, market served, and procurement strategy. Table 6.9 in the appendix displays the strategy applied by each tannery in sourcing raw material. The different forms of procurement have been extrapolated from actors' responses and grouped as a function of integration in terms of upstream control and information sharing (from the most to the least integrated): (i) *integrated* slaughtering premises; (ii) issuing *soft loans* to collectors and setting up *collection centres*; (iii) *traders* showing up at the tannery's door; and (iv) procurement by *third party* contractor.

The trend confirms how large tanners manage the chain through upstream control of collection procedures, while smaller tanners procure what remains. As pinpointed by a leather and wet blue trader, "some tanneries advance money to secure loyalty but this is a risky practice. To do so, you need to know the supply-chain well, being able to track the material and evaluate its quality […] The main tanneries have trained selectors with a lot of knowledge that allow them to track the hide. They take the cream and leave the rest to the supplier who re-sells it to other smaller tanneries by mixing with some green material." (*int.* A.S.)

The result is that size and economic power determine successful product upgrading in a vicious circle that perpetuates the dominant position of larger tanneries and increasingly deteriorates the quality and profits of smaller firms, who cannot afford costly sourcing practices and, consequently, participation in premium northern markets.

Figure 6.3: Procurement strategy by market trajectory and firm size



Source: Author's elaboration (survey data).

6.4.3 Summary

This section has analysed the main factors underpinning process and product upgrading among Kenyan and Ugandan tanners. The link between market trajectories and quality standards presented in chapter four was confirmed and explained. However, the relationship between product/process upgrading and market trajectory emerges as a double-edged sword, where the former is not only the consequence of increasing specifications – and in some cases assistance – from buyers, but also a repercussion of

tanners' capacity to secure the procurement of high-end raw material through upstream chain governance. Larger tanners with a consolidated market-share exploit their market power to control upstream stages and secure the stable procurement of high quality material to achieve the standards demanded by northern premium markets.

6.5 Functional Upgrading

In chapter three, we observed how more downstream functional stages attract higher profit margins. However, a feature that remains unexplained is whether larger firms, by their consolidated upstream position and product upgrading, are also more likely to experience functional upgrading. Section 6.5.1 shows how larger firms are in fact less prone to functionally upgrade. To explain this outcome, elements of stability and profitability are further explored.

6.5.1 Firm size

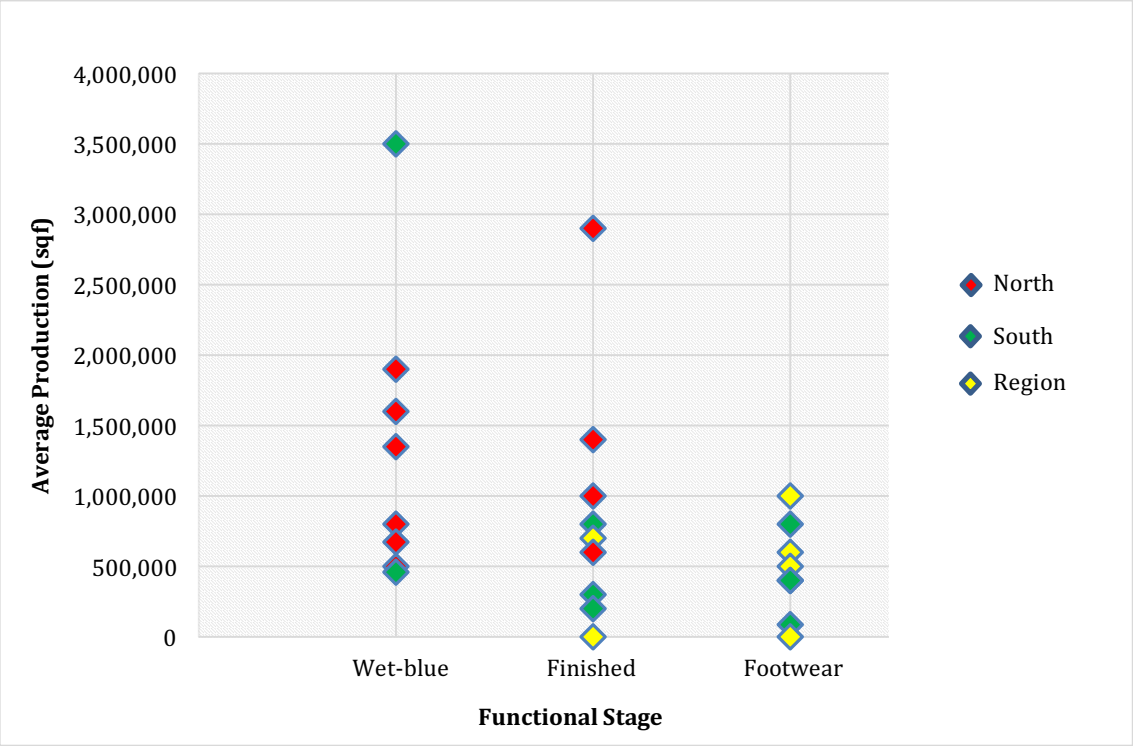
Figure 6.4 plots tanneries' production, functional stage, and market trajectory while figure 6.5 shows tanneries' size in terms of employees by market trajectory. Tables 6.6 and 6.7 in the appendix provide the data as collected during interviews. Companies are identified as *exporting to the North* if at least 10% of their export in 2015 followed this trajectory. The functional stage indicates the highest level of functional upgrading achieved as of 2015 independently of the market trajectory of each specific stage. It is important to note here that each tannery produces wet blue by definition. Therefore, firms displayed in green are still producing wet blue and further upgraded into finished leather, whereas firms displayed in yellow are producing wet blue and finished leather, and further upgraded into footwear manufacturing.

By comparing figures 6.4 and 6.5, it is possible to observe current links between market trajectories, functional upgrading, and size. In general, participation in northern markets

appears to be linked to larger companies as a function of companies' average monthly production. Of the seven top exporters, six are serving the North and this constitutes a significant share of their exports. This confirms the outcome of chapter four, showing a positive correlation between exporters' size and high product standards characteristic of northern markets. Using employees as a proxy for size in figure 6.4 still points towards a prevalence of larger firms within a North-South bound and proves the robustness of the relationship.

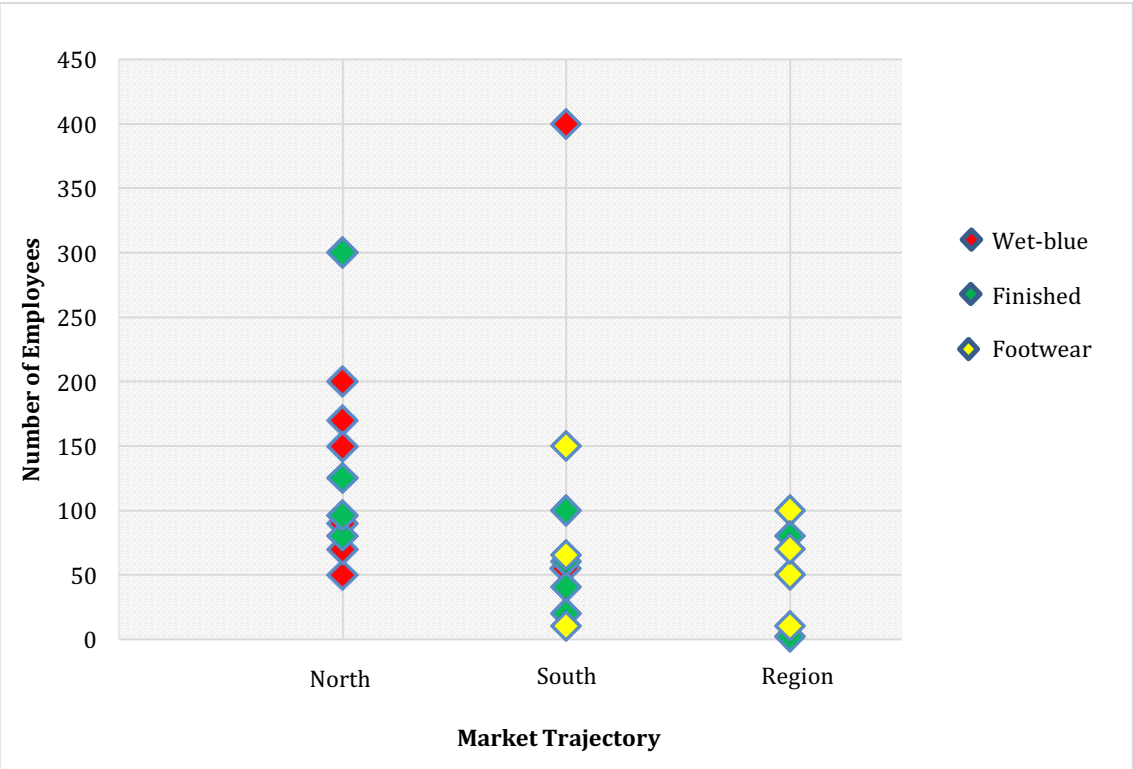
What is striking about figure 6.4 is the overwhelming presence among functional upgraders of small firms serving southern and regional markets. Yet, whilst upgrading into finished leather has been a more diffused practice triggered by increasing local demand and institutional pressure, upgrading into shoemaking and manufacturing has involved mainly small South-South exporters, non-exporters, and subcontractors. This pattern, which is consistent with the results of table 4.6 in chapter four, raises the question of whether (and how) market orientation has influenced tanners' decisions and capacity to functionally upgrade. This aspect is particularly interesting if we consider the inclination of South-South exporters towards lower functional stages put forth in the literature (Kaplinsky et al. 2011; Kaplinsky & Farooki 2010). Moreover, such results challenge the notion that functional upgrading occurs once firms have consolidated their position in lower segments of the value chain (Gereffi 1999; Kaplinsky et al. 2002; Fernandez-Stark et al. 2011, pp.23–24; Jean 2014; Schmitz & Knorringa 2000) and is more likely to involve larger firms with wider access to GVCs (Gereffi & Frederick 2011). In other words, while the main tanners in the country are those serving northern markets and experiencing higher degrees of product and process upgrading, these are not the same actors that functionally upgraded into higher value addition, especially in manufacturing.

Figure 6.4: Functional upgraders by market trajectory and firm size



Source: Author's elaboration (survey data).

Figure 6.5: Firm size by market trajectory (employees' number)



Notes: Subcontractors producing and selling locally are categorised under "Region".
Source: Author's elaboration (survey data).

The literature points to a positive link between process, product, and functional upgrading (Kaplinsky & Morris 2002). Yet among Kenyan tanners we observe a different trend, whereby major product and process upgraders with access to more profitable markets do not venture into functional upgrading to the same extent as smaller producers with no access to such markets. Is this the consequence of hierarchical constraints exerted by northern buyers to preserve core competences and safeguard rents, as suggested by Humphrey and Schmitz (2002; Bazan & Navas-Alemán 2004), or are there other factors at play?

Firstly, the notion that tighter hierarchical control from lead-firms is preventing suppliers from moving into higher value addition does not hold in this case. Functional upgrading is not prevented by the *governance structure* implemented by global buyers. Major tanners dealing with northern premium markets denied undergoing pressures from their major buyers. Only Tan-1, the top Kenyan exporter, declared that exporting finished leather to northern markets would spark competition with tanners buying wet blue to finish abroad. However, they stated: "finished leather is a fashion item and requires a strict relation with manufacturers… European tanners have an advantage over exporters as they can adapt more quickly in response to market changes. I do not see any concern in this sense, as it would be impossible to export finished leather to Italy, except maybe for some low range material like shoe uppers, tongues and glove leather." (*int.* Tan-1) Conversely, a move to crust leather is not only welcome but also encouraged by buyers: "if you produce a basic crust to convert into finished leather it's easier to market it. Crust is close to finished leather and can be re-converted for many usages." In the same way, an Italian tanner working with Kenya stressed how European manufacturers have no specific interest in the East African regional market and would not prevent an upgrading attempt by their suppliers: "if that means that they could improve their quality

and produce good crust, we may even be interested in buying it!" (*int.* V.I.) In recent years, two tanneries have achieved good quality finished leather sold locally and regionally to high-end leather manufacturers exporting their products to Europe and the US, with no consequences on the tannery's global business network.

By looking at the interplay between elements of stability and profitability, subsequent sections put forth a potential explanation for why small tanneries with lower profits functionally upgrade more than larger actors with access to premium markets.

6.5.2 Market stability

Two major mechanisms that explain functional upgrading among Kenyan and Ugandan tanners appear to emerge from the interviews; one impinges on tanners' choices to refrain from (or delay) plans for functional upgrading, whilst the other concerns small tanners' decisions to functionally upgrade. We argue here that while the first is the consequence of *exploitation* practices derived from stable market relations, the second is embedded in the *exploration* of alternative forms of market participation underpinned by a lack of market stability and the pursuit of new and more profitable options.

Large tanneries export a minimum of 12-15 containers of wet blue a month. Profits vary considerably depending on quality (e.g. skins vs. hides; grading…) and international demand. Between 2015 and 2016, when prices of raw material were particularly depressed, average net profits of tanners exporting to the North would average a minimum of 30,000 USD a month.[146] Profit margins are about 10% of the total payment for a container and money is made on the capacity to deliver high quantities consistently across the year. Stability is therefore paramount and northern

[146] This figure is calculated for the smallest tannery among those exporting to the North.

markets offer a guarantee in this sense. Tanners dealing with northern buyers acknowledge that their business is characterised by long-term relationships with few trusted clients (see chapter five).[147]

In our study, of eight tanneries exporting to northern markets, none have integrated footwear production, and four have moved into leather finishing.[148] Moreover, except for two tanneries, most of those who have moved into finishing consider the latter a side business whose importance is secondary to the export of wet blue. Tan-19 reported that they are only slowly working on finished leather, emphasising that "our main market is wet blue and we want to concentrate on it." Tan-4, one of the few large tanneries to venture into leather finishing, likewise pinpointed it as relatively marginal: "since acquiring the present tannery in 2002, we focused on wet blue for export… Only reject is brought to finishing. It is not a demand vs. supply issue, if the grade of wet blue is too low to be sold in the export market, it goes for finishing for the local market […] What happened is that we also got a deal to buying machines for finishing… We found a tannery that was closing in Zambia and bought the machines at a very good price… I do not think we would have done it otherwise."

Confronted with data on market expansion and regional demand for finished leather, tanners acknowledged the potential market opportunities inherent in functional upgrading, but, as a leather expert puts it, "do not have the time and interest to explore it" (*int.* M.M.). Given the stable profits they can make from exporting wet blue to premium northern markets, tanners are not sufficiently incentivised to find an alternative source of income that would trigger functional upgrading. A salesman with experience in different tanneries declared: "you know, if you look at these clients in Italy, they have

[147] See section 5.4.3 in chapter five.
[148] Tan-10 has a sister company producing footwear under the same ownership. Yet, this constitutes an independent investment and not an upgrade from the tannery.

been there for generations. Somebody like LDB buys from January to December. Tanneries do not know if these guys [new local manufacturers and consumers] can sustain it. Tomorrow, if nobody is buying the bags and shoes, they lose out. Europeans when it comes to wet blue are more reliable and long-term…. It's a risk factor and you prioritise people you have known for longer and with whom things are working well" (*int.* A.S.)

As to the question of why large tanneries did not upgrade into finishing, Tan-3 replied: "it is also a matter of motivation to move into higher value addition… They lack it I think… They are comfortable with what they are doing now, profits are good!" Replying to the same question, a representative of COMESA-LLIP stressed: "most of these tanners have contractual obligations to supply wet blue to certain suppliers overseas, which provide in momentariness a 'guaranteed market' irrespective of any upcoming turbulence. Furthermore, finishing for local leather goods and footwear manufacturers appears risky for them, although this is a very elusive reason holding no weight… Because most of the persons seeking the finished leather are from SMEs buying low volumes and at irregular intervals…"

The continuous interaction with northern buyers distracts resources from sections of the firm that are not directly affected by upgrading requests (i.e. *finishing departments*), and prevents tanners from engaging in more *explorative* and riskier practices. Having to describe their current market strategy, Tan-4 acknowledged the emerging local market for footwear and leather, but nevertheless declared that "we have no plans to move into manufacturing and neither to improve our finishing section much… The machines for finishing leather came with the first investment and not much changed… […] Now our goal is to focus on higher grades in the wet blue export market. We know that there is more local demand for shoes and more shoes are being made in

the country, but other tanneries and manufacturers are filling up the gap already…" In the same way, Tan-1 who started finishing leather for the local market in 2013, explained: "our plan is to specialise in wet blue, wet white and crust for premium markets. We have no interest in going into products because we would lose focus on what we do best." When asked about their business plan, Tan-2/Tan-19 stressed: "There is no plan to move into shoes or leather goods… We want to operate on high volumes for exports, the focus is on wet blue, gelatine and splits. For now, we prefer to invest our resources in what we do best and is most profitable". Tan-18, Tan-26, and Tan-27 produce only wet blue with no concrete plans for functional upgrading. As pointed out by COMESA-LLIP, "it's the quick wins they aspire to […] The technology in finishing leather and manufacturing is quite high and most tanners lack the skills to produce good quality finished leather competitively." Here, a lack of skills and technology is often accompanied by a lack of will to acquire them, rather than a lack of financial means. In fact, although the minimum investment to produce decent quality finished leather exceeds 1 million USD, most Kenyan and Ugandan large tanneries would have the financial capacity to sustain such an investment.

Several manufacturers purchasing leather from the few large tanneries that ventured into finishing also lament a lack of attention towards their requests and a disproportionate concentration of resources on wet blue exports. A top tier bag and belt maker commented that the purchased finished leather is "…awful, the colour changes every month, so [does] the thickness …. They export the best leather in wet blue" (*int.* Hnb-34). Hnb-28, a design house and bag manufacturer, stressed something similar: "now, this is where the frustration comes in. Tanners are finishing the worst leather at the most expensive price. If you are so focused in exporting wet blue and picking the very best for this purpose, what you cannot place in this market is what you finish and

sell to me, then there is no way I can compete […] I asked them to give me the good wet blue and finish it but they say it is for export…" On that note, the travelware producer Hnb-25 acknowledged the following: "we have tried to get them to finish better quality… Tan-9 [a small tannery focused on the regional market] seems to be more cooperative in this, but Tan-1 [large tannery] has not been receptive to any form of quality inquiry. We are thinking about importing leather from Ethiopia…" And Hnb-20, an exporter of belts and collars, echoed such concerns: "with Tan-1 [large tannery], I do not have access to choose what I want… What they give us is not TR. We are always in contact with the tanneries about quality… Tan-10 [medium size tannery] takes on board our complaints… With Tan-1 there is not even a beginning about a discussion […] Their business is wet blue and we are small for them, they treat us as small frays."

What emerges from these statements is the prevalence of an *exploitative* behaviour that perpetuates the status-quo, whereby higher profits in a specific area determine a concentration of resources and efforts within said area. In other words, successful tanneries prefer to invest their resources in the activity that has been most profitable for them and continues to be so: export of wet blue. Footwear manufacturing does not come into the picture and *finishing* becomes an option only as a side activity, attracting limited investment and resources.

Understanding whether moving into finishing and manufacturing entails a business case for major tanneries is not the purpose of this study. In fact, it may well be that, in the long run, concentrating on stable, premium wet blue markets is the best solution. Yet, this section highlights how market stability contributed to tanners' decisions to focus their efforts on exploiting their current market, rather than exploring further and potentially more rewarding (see table 3.4 in chapter three) but also riskier and less stable options.

At this stage, it remains puzzling how and why smaller producers, with no comparative advantage over their bigger competitors, would seize the same opportunity to functionally upgrade much faster than their counterparts. Considerations of profitability in the following section provide an answer to this question.

6.5.3 Profitability[149]

Whilst market stability plays a role in preventing functional upgrading among large tanners, it is argued here that the move of smaller firms into value addition is instead the consequence of lower and unstable profits. This situation triggers an *explorative* behaviour towards downstream activities where profits, though higher, are also riskier.

As presented in figure 3.4 of chapter three, in Kenya finished leather and footwear attract a profit margin of 15-20%, with a respective value addition of 200% and 700% on raw material. However, downstream stages of value addition do not attract the same level of stability as wet blue and, with major fixed costs and stiff foreign competition, they present significant long-term risks for entrepreneurs willing to functionally upgrade.

As it emerged from chapter four and was further confirmed in the above sections, functional upgraders venturing into footwear production are small and medium-size tanners dealing mainly with regional and southern markets. As for the question of what prompted their decision to invest in finishing and shoemaking facilities, these tanners pointed to the low quality of raw material and decreasing profit margins, along with unstable and inconsistent market access.

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[149] Profitability is understood in terms of net revenue. See section 3.6.1 in chapter three and footnote 54.

The declining quality of raw hides and skins, together with the lack of machineries and skills required to *correct* and improve the quality of wet blue, has led to an overall increase in the amount of *reject* and low grade wet blue in warehouses. With wet blue being a low margin product where gains are made on quantity and scale production (Mwinyihija 2014d, p.112), low grades have profit margins close to zero and sometimes they can even be sold to a loss. As Tan-8 stressed, "I have to take all skins delivered by traders… And these have been more and more of poor quality! The margins on poor quality material as wet blue are zero and they have to go to India… Now, if you finish it for the local market and you make leather-goods, you find a way to make it profitable…" Similarly, Tan-13 who recently moved into crust leather and footwear pinpointed how "this is allowing for higher profits as the market for wet blue is becoming too competitive and margins are lowering…"

In response to the question of why they preferred to venture into a new sector rather than improve the quality of wet blue, Tan-13 responded with the following: "the main concern of the company is prices of raw material… Traders don't lower the prices even if the quality is lower! This market is too competitive and we cannot procure better quality… The Kenyan demand for shoes is 20 million pairs a year and the local market barely achieves 2. There is enormous room for investment and gains to be made…" Tan-9, who increased its production of finished leather from 1% to 10% of its total in the last three years and who cooperates directly with a sister-company making school-shoes and leather backpacks, stated: "markets for low quality wet blue do not bring much margins and are often a loss… The reason why tanners move into shoemaking is that they need a way to sell finished leather at a higher price. They do not enter the shoemaking market to sell the shoe, but to sell the leather on the shoe for a profitable price". Tan-3, whose tannery sells most of its wet blue to India and China, stressed: "my margin is 5-10% on

wet blue… Sometimes you rather move your stocks even if it is at a loss than just keeping material around here […] If you finish the leather, you can sell it at 1.50, 2 USD up to 2.50 depending on the quality of the finishing. Your margins on finished material is 20% though! So, it is much better than wet blue…"

Tan-5, who moved into footwear in 2015, also underlined the relationship between quality and profits: "profit margins of wet blue for our market were reducing and we needed to move into higher value addition… However the capacity to produce high quality leather for premium markets is not there, so we looked inwards to the local and regional market and we saw a business case for shoemaking…" Tan-11, who ventured into finishing in 2015 and is piloting an attempt to produce sandals for the local and export markets, explained: "shoemaking requires a higher expense in terms of machineries and leather, so I decided to experiment with something low cost to test the market… Finishing for the local market is proving to be a good business and profitable, more than wet blue." Tan-14, who entered the footwear market in 2009 and left it due to stiff competition from the *mitumba* market, is now planning to produce and export sandals directly: "we face a problem with 50% of our wet blue being *reject*… Finishing and manufacturing goods is a way to make it profitable. We aim at moving into finishing and shoemaking for the local market in two years' time…"

In Uganda, the situation is similar to Kenya. Out of 11 tanneries, two have upgraded into footwear, two more have concrete plans do so in the future, and one is considering the option. With the exception of Tan-22, all other tanneries express a rationale similar to that of their Kenyan counterparts: finishing and footwear production are targeted exclusively at the local and regional market as a strategy to add value in an increasingly competitive market. Tan-24, a small leather finisher and shoemaker, entered the market in 2006, increasing its production by five times in the last five years.

Recently, he developed an expansion plan that aims at increasing production from 500 to 2000 sqf per week and employment from 10 to 25 workers: "we looked around and saw that most tanneries in place were tanning wet blue for export. So, we decided to start from wet blue and finish… This reduced trouble with NEMA and put us in a less competitive and growing market where we can acquire low grades at lower costs. We started with shoemaking gradually in 2014 as we saw a business opportunity…" Tan-22 constitutes an exception to the rule; the firm started as a footwear business and integrated upstream into tanning and finishing. They entered the tanning industry with the aim of decreasing costs by acquiring low-end material unsuitable for profitable export: "tanneries usually don't buy reject because they do not have a market for it. Since I am making shoes I can still use the bad part to make stripping etc. We wanted to make leather out of rejects…"

The interviews indicate that small and medium tanners prefer to explore new functional stages rather than exploit their core activity by focusing on wet blue exports. This is prompted not only by low quality and decreasing margins, but also by the inconsistency of profits and the uncertainty of their current markets. According to Tan-9, who contracts wet blue for Chinese and Indian importers regionally, "we sell our wet blue regionally to local traders, but I know that over 90% goes to China […] Yet, the growth of the local market for manufactured goods is a guarantee of more stable and constant orders of finished leather, that we do not have from other markets…"

Prices of locally finished leather and manufactured goods are generally more consistent and less prone to international shocks, as reported by a Kenyan leather expert: "I have never seen tanners re-calculate what price to sell their finished leather, unlike with the export-side of the business where wet blue costings are done every 10 days or whenever market abruptly changes. Selling price for finished leather and shoes seem to

be constant throughout the year… [This is because] people who buy finished leather have no information on raw material prices!" (*int.* A.S.) In the same way, Tan-13 stressed that "[tanners] are losing on one hand [wet blue] and they are making up for it on the other hand [crust and finished leather]… And the small local producers do not know about it [the price of raw material] or even have the capacity to switch supplier outside Kenya." In other words, while wet blue is subject to international price shocks, the same is not true for finished leather and manufactured goods, whose constant price in the regional market allow producers to secure more stable profits.

Willing to find a source of higher and more consistent profits, small tanners' *exploratory* attempts to functionally upgrade found support in KLDC, who (in some cases) managed to provide them with counselling, training, and a source of expertise to venture into manufacturing. In addition, their upgrading strategy has been facilitated by a growing local demand for leather and leather goods. As reported by Tan-3, "all the talks about value addition and the upcoming duty on wet blue from the government have played a role too… We thought about it even before they came to us, but then KLDC came and in fact they gave us indications on how to move forth for machines and so… Also, the exposure that we got through these seminars helped psychologically to make the investment into finishing. We got to know what Ethiopia was doing and how the local and regional market looks like and its potential." Similarly, Tan-14 and Tan-5 upgraded into finished leather by using the facilities provided by KIRDI, before acquiring their own machineries.

What emerges from the interviews is the prevalence of an *explorative* behaviour among small and medium tanners. In this context, low and inconsistent profits in a specific area determine a shift of resources and efforts towards a different market segment. The exact consequences of this strategy will take a number of years to become

clear. Nevertheless, there are elements that suggest some tanners may have overestimated the returns of *exploration*, especially when upgrading into manufacturing. Due to the low quality of the leather, upgraders have no alternative but to enter the low-end footwear market, where margins are constrained and competition stiff. As stressed by Mekonnen et al. (2014, p.21) in their analysis of the Kenyan shoe market, this is a sector dominated by SMEs facing major challenges in terms of credit facilitation, market access, technical support, work space, and consistent supply of leather and other components. In this segment, the major obstacle remains the severe competition from low-cost and second-hand shoes respectively from Asia and Europe, as well as neighbouring Ethiopia: "it is very difficult for local leather footwear producers to compete in the domestic market against the inflow of cheap footwear imports (mainly from China and India) and against the growth of the second-hand *mitumba* market […] Meanwhile, Ethiopia is emerging as a new world-class player in leather footwear […] Ethiopia has made tremendous productivity gains in recent years and now surpasses Kenya in terms of a cost competitiveness advantage." (World Bank 2015, pp.iii–iv)

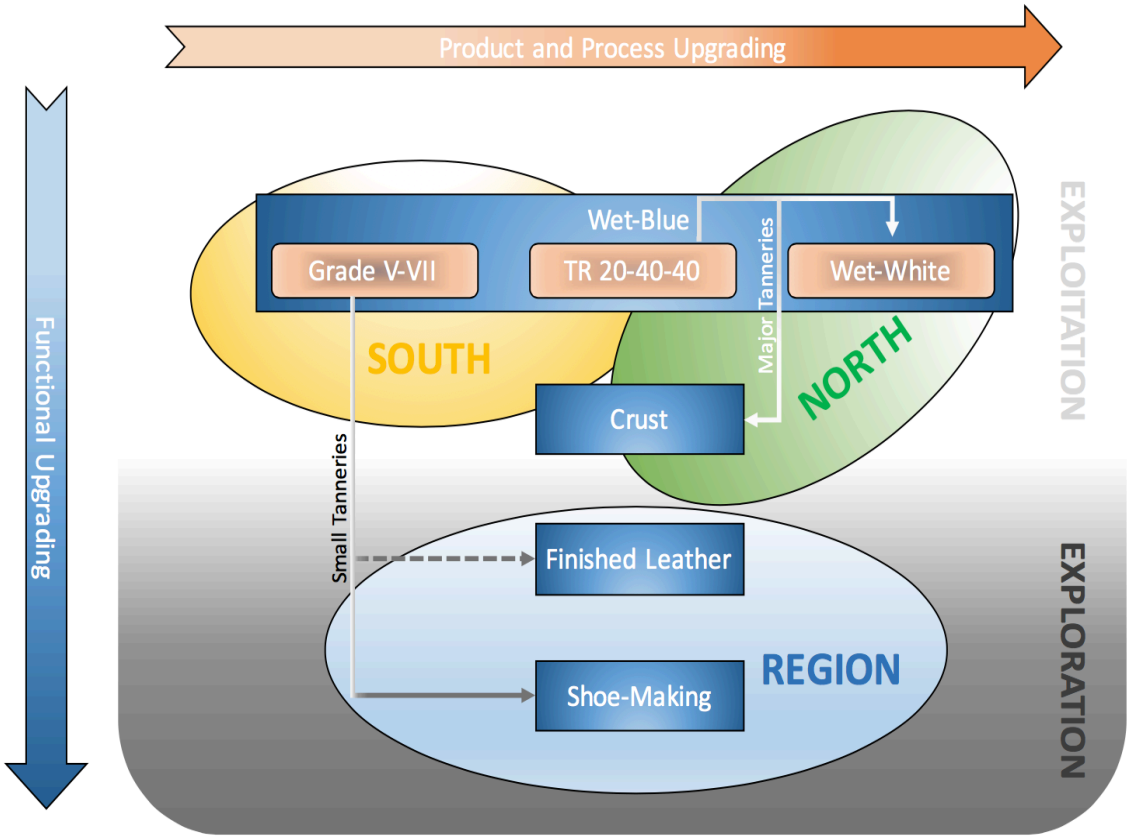
Whilst the strengths and weaknesses which characterise the leather manufacturing subsectors are further addressed in chapter seven, the difficulties plaguing the industry and the recent origins of tanners' functional upgrading do not allow for any firm conclusions as to the economic and social consequences of such upgrading strategies.

6.5.4 Summary

This section has analysed the main factors underpinning functional upgrading among Kenyan and Ugandan tanners. As summarised in figure 6.6, larger companies with access to northern markets have not experienced functional upgrading to the same extent as smaller tanneries operating in less profitable regional and southern markets.

Interviews conducted with practitioners point to a learning pattern that tends towards *exploitation* among the former and *exploration* for the latter. As stressed in the literature review, while *exploitation* focuses on the "ruse" and refinement of existing practices, *exploration* entails the experimentation of new alternatives with uncertain and unpredictable returns (Tamayo-Torres et al. 2011).

Figure 6.6: Exploration, exploitation, and upgrading by market trajectory



Notes: The traced arrow indicates the tanners' intention to achieve that stage as instrumental to shoe-making rather than as an objective by itself.
Source: Author's elaboration.

As stressed by March (1991), excessive *exploration* suffers the cost of experimentation without gaining much of its benefits, whereas excessive *exploitation* traps organisations in suboptimal equilibria. In this respect, the authors refer respectively to a *success*- and *failure trap* (Levinthal & March 1993; Sato 2012). It is, however, too early to assess the consequences of *exploration* and *exploitation* practices among

Kenyan tanneries. On the one hand, larger companies may well be justified in delaying their upgrading efforts. Though a growing local market and the higher profits associated with value addition may suggest the contrary, gains in these platforms appear to be unstable and risky, especially in the absence of any institutional incentive. On the other hand, smaller tanneries' *exploratory* behaviour could prove successful in the long term, especially if they exploit their *first-mover* advantage over their larger competitors and manage to defeat foreign competition. The growth and harmonisation of a regional market in the EAC and COMESA regional blocks will prove crucial, as has been the case for Brazilian producers in the Sinos Valley (Bazan & Navas-Alemán 2004). The successful case of small handbags manufacturers provided in chapter seven is indicative here.

The government's industrial and trade policy is also likely to be highly influential in the years to come, with a set of milestones spelled out in the Vision 2030 and the World Bank's (2015) action plan. Many small tanners have welcomed the support of KLDC in favouring functional upgrading, though there is a lot of scepticism regarding the will to combat smuggling and support tanneries in their upgrading efforts.[150]

In a nutshell, major GVCs governance theories fall short when it comes to explain the functional upgrading characterising small and medium Kenyan tanners and their integration into crust leather and footwear production. As in the case of Indian buyers establishing direct links with Kenyan exporters,[151] low product and process standards, decreasing quality, standardised production, and lowering margins appear to be the driving force pushing tanners towards stages of increasing value addition. In this

[150] The importance of trade and industrial policy in triggering functional upgrading has been stressed in the literature (Curran & Nadvi 2015; Stevens 2001; Brandt & Thun 2016).
[151] See section 5.4 in chapter five.

sense, functional upgrading is better explained as a consequence of profit margins and stable market relations, rather than more (or less) relational forms of governance in the value chain. It occurs through *exploration* of new stages of value addition in an attempt to secure earnings over time and capture gains in regional markets where reachable profits are located (Rangan et al. 1993; Richardson 1996). To the extent that this implies a process of differentiating oneself from powerful competitors, it is the structure of competition which dictates upgrading strategies, rather than the organisation and governance of the chain (Wei & Rehme 2012).

6.6 Conclusion

Through a set of interviews with 24 tanners across Kenya and Uganda as well as several other experts and institutional bodies, this chapter sheds light on some of the causal links underpinning the study's research question – i.e. how does participation in value chains with different market trajectories relate to the upgrading of local suppliers in developing countries? Building on the outcome of chapter four, the previous sections showed how suppliers' incentives to upgrade differ depending on their participation in value chains with different market trajectories. Table 6.3 summarises upgrading characteristics as they emerge from the chapter. It is important to notice that, while this chapter addressed the South as a single category – that is, without singling out China – table 6.3 separates them by virtue of the outcome of chapter five. Accordingly, these two markets are very similar under all categories except for *profitability*. This is because, as explained in chapters four and five, in some instances Chinese traders pay prices similar to those paid by northern buyers while purchasing lower quality. Yet, the instability of this market, both in terms of prices and buyer-supplier interactions, likens it to the rest of the South.

Section 6.4 looks at how product and process upgrading relate to firm size and procurement strategy across market trajectories. Participation in northern premium markets is positively linked to product and process upgrading, as well as market share. This is in line with the literature, according to which northern markets, despite stricter entry barriers, are conducive to higher profits as a result of reduced competitiveness embedded in more complex product and process specifications (Trienekens 2011; Jaffee & Masakure 2005, p.331; Funcke et al. 2014; Essaji 2008). Nevertheless, an analysis of tanners' procurement strategies points to how major actors consolidate access to premium markets by exerting hierarchical control and in-sourcing upstream activities. Here, firm size interacts with participation in northern markets through a process of upstream integration that allows larger firms to increase product quality and lock out smaller competitors from the profits and stability associated with these markets.

Section 6.5 shows how functional upgrading into footwear and leather manufacturing has involved mainly small and medium tanners, non-exporters, and subcontractors. The low degrees of process and product upgrading along with a lack of access to premium markets among smaller tanners challenges the GVCs literature championing a causal link between process/product and functional upgrading (Gereffi 1999; Kaplinsky et al. 2002; Fernandez-Stark et al. 2011, pp.23–24; Jean 2014; Schmitz & Knorringa 2000). Conversely, decreasing quality, standardised production, and lowering profit margins appear to be the driving force pushing tanners towards stages of increased value addition. At the same time, participation in northern markets does not seem to prevent functional upgrading by virtue of more relational governance and top-down control, as purported by some authors (Navas-Alemán 2011; Bazan & Navas-Alemán 2004; Humphrey & Schmitz 2002). Instead, as of today, what prevents tanners trading with the North from functionally upgrading is a propensity towards *exploitation*

of their core business – i.e. wet blue exports. Small and medium tanners dealing with the global South and regional markets may have entered a *failure trap* that is pushing them towards excessive *exploration* of stages that might not yet entail a comparative advantage. However, ascertaining the final impact of *explorative* and *exploitative* practices would be premature at this early stage.[152]

For the most part, this chapter provides a clear picture of the effect that markets have on suppliers' capacity and decisions to upgrade, highlighting causal links where chapter four established only correlations. Nevertheless, the analysis contains several limitations and space for further inquiry.

On the one hand, further research into the relationship between learning, innovation, and participation in GVCs and RVCs is compelling. As stressed by Rabellotti et al. (2007), by focusing on governance, the GVCs literature overshadows the role of the firm in the process of innovation and knowledge acquisition: "[k]nowledge features and firms technological capabilities-building strategies affect the pace and direction of learning and knowledge absorption." For instance, ownership has been identified as crucial in defining companies' upgrading patterns, especially when comparing foreign and locally owned enterprises (Gibbon 2008; Staritz & Morris 2013). Staritz and Withfield (2017a, p.33; 2017b, pp.37–38) have highlighted how skills development among local suppliers is often firm-specific and can depend on value chain relationships as much as on industrial policy and business strategies. The way in which upgrading is achieved requires therefore a within- rather than just cross-firm analytical approach. While this has been done quantitatively in chapter four, there remains room for an in-firm inquiry that identifies causal links in the interactions among firms.

[152] This outcome casts further doubt on Fessehaie's (2012) argument according to which functional upgrading is enabled through more relational forms governance characterising North-South value chains.

On the other hand, concerning the development of *exploitative* and *explorative* learning patterns among local firms, excessive *exploration* may be detrimental in the long term. This notwithstanding, some authors have put forth theoretical frameworks to achieve competitive advantage through collaboration and learning-by-doing (Tsang 2002; Khamseh & Nasiriyar 2014), as well as manufacturing flexibility and external interaction (Tamayo-Torres et al. 2011). Comparing companies' business strategies and analysing institutional constraints would offer a great tool for policymakers interested in developing the industry and facilitating a move towards value addition.

Through an in-firm perspective of Kenyan leather goods' manufacturers, chapter seven aims precisely at making sense of how different market strategies are developed at the micro-level and how these are impacted by ownership, industrial policy, and market access.

Table 6.3: Summary of upgrading characteristics by market trajectory

	UPGRADING				
	Functional	**Product/ Process**	**Market share**	**Procurement (integration)**	**Profitability**
North (42%)[153]	Low 	High 	Large firms	Collection centres, loans 	High 
Region (8%)[154]	High 	Low 	Small firms	Trader and third party 	Low to high  
China (36%)	Low but trigger high[155] 	Mid-low 	Small to large firms	Trader and third party 	High 
South (14%)	Low but trigger high 	Low 	Small / medium firms	Trader and third party 	Low 

Source: Author's elaboration.

[153] Percentage of total exported value aggregated for 2006-2015.
[154] Computing a percentage for this market based on the available data is trivial as local trade is unaccounted and regional trade underestimated (see chapter three).
[155] The South and China attract low levels of functional upgrading; however, they trigger *exploration* into regional functional upgrading among companies that trade with these markets.

7.

Survivors vs. Creators: A comparative analysis of Kenyan footwear and handbag manufacturers

7.1 Introduction

Chapter three depicts a market dominated by semi-processed exports with a growing, though uneven, tendency towards value addition. Different upgrading trajectories were identified across multiple linkages in the value chain. Whilst product and process upgrading have characterised a North-South trajectory, a consistent number of small and medium tanneries exporting to the global South unveiled a tendency towards functional upgrading within local and regional markets. This begs the question of whether and how southern and regional markets trigger knowledge acquisition and favour functional upgrading, notwithstanding lower standards and less relational governance ties. The aim of this chapter is to address this question by focusing on the most-downstream linkage in the leather value chain: footwear and handbag manufacturing.

Despite entailing a competitive disadvantage vis-à-vis dominant wet blue exports, the manufacture of leather products in Kenya has witnessed some slow but steady growth in the last decade (World Bank 2015).[156] Such growth, however, has not been uniform, neither in terms of product variety nor upgrading. The main leather manufacturing subsectors in Kenya – in particular, the handbag and footwear industries – have been driven by local and regional markets with similar types of governance ties. Yet, they display diverging upgrading outcomes, with handbag production featuring higher levels of economic and social upgrading. As a World Bank (2015, p.10) assessment of competitive advantages in the Kenyan leather value chain reports, "[w]hile the footwear subsector has the biggest production volume, leather bags have the highest competitive advantage" attracting higher prices and profit margins.

By comparing the upgrading patterns of footwear and handbag manufacturers in Kenya, this chapter addresses the question of what enables some actors (and not others) to upgrade into higher stages of value addition. Moreover, to the extent that both subsectors expanded within a local and regional market trajectory, the chapter provides new evidence on the conditions that render local and regional markets conducive to economic and social upgrading.

As made evident in the following sections, market trajectories and governance are insufficient in explaining the upgrading patterns of local suppliers. Upgrading in local and regional markets is influenced by the institutional setups that shaped entrepreneurship and firms' upgrading strategies within specific market segments. Where footwear production was generated during a period of import substitution with a

[156] The competitive disadvantage is reflected in the lower market share of finished leather and manufactured goods compared to wet blue. As stressed by the World Bank (2015, p.iv; 58-59), the production semi processed wet blue skins and hides has a comparative cost advantage over that of finished leather and manufacturing, due to a lack of market access and sophisticated marketing capabilities.

focus on technical skills within large subsidised firms, handbag manufacturing developed in an isolated and often hostile institutional environment within foreign-owned small enterprises. According to the export dataset presented in chapter four, between 2006 and 2015, eight companies accounted for 88% of the total leather footwear exports, with one company taking approximately 75% of the share. Comparatively, 31 companies accounted for 79% of handbag and small leather products exports, with the main exporter taking only 18% of the share and no other company above 10%.

The next two sections present the relevant literature and methodological approach. Section 7.4 briefly introduces the handbag and footwear subsectors in Kenya and section 7.5 describes their respective patterns of economic upgrading in terms of product, process, and functional upgrading. Section 7.6 provides an overview of social upgrading within the two subsectors. Most importantly, section 7.7 relates the causes of upgrading to the origins of entrepreneurship in relation to the country's industrial policy. Finally, section 7.8 summarises the argument and concludes.

7.2 Literature Review[157]

This chapter draws on the concepts of economic and social upgrading to address the research question – how do we make sense of different upgrading paths among actors operating within the same local and regional market trajectory, at similar stages of value addition, and embedded in similar governance networks?

As observed in the previous chapters, GVCs and GPNs scholars have pointed to local and regional markets as training grounds for firms to upgrade in isolation from foreign competition and other value-chain constraints (Brandt & Thun 2010; Navas-

[157] This section presumes familiarity with the concepts of *economic*- and *social upgrading* defined in chapter two.

Alemán 2011; Gereffi & Frederick 2011; Butollo 2015a; Fessehaie 2012; Barrientos & Visser 2012; Nadvi 2014). However, these studies do not explain how and why some actors are more successful than others in seizing value addition within regional value chains. As stressed by Lutz (2012), smallholder producers in developing countries often enter immiserising spirals due to a lack of capabilities. Yet, how such capabilities translate into economic and social upgrading is a matter that requires further research.

For this purpose, this chapter advocates a combined understanding of the institutional framework surrounding the value chain along with its relationship to firms' market strategy and entrepreneurial decision-making.

The impact of institutions on firms' upgrading in global markets has not been overlooked by the literature.[158] However, with few notable exceptions (Selwyn 2012; 2013), most of this scholarship concentrates more on state interventionism at a macro level and less on its relationship with entrepreneurship and firms' upgrading strategies. For instance, Milberg and Winkler (2013, p.240) have posited vertical specialised industrialisation as a new paradigm of economic development after import substitution and export-oriented industrialisation. The authors argue that, if developing countries are to benefit from their participation in GVCs, they require "intelligent industrial policy" to identify industries with the largest potential. Furthermore, Milberg et al. (2014) stressed the importance of liberalising imports of intermediate goods to achieve the global standards demanded by GVCs. This perspective is shared by Thun and Brandt (2010; 2016), according to whom local firms benefit the most from non-restrictive policies enabling, rather than restricting, competition between domestic and foreign firms.

Conversely, Chang et al. (2016) argue that creating linkages with local firms to

[158] GPNs scholars have focused on localised assets such as institutions, labour, and capital flows in relation to national industrial policies (Parrilli et al. 2013; Hess & Yeung 2006).

support learning and knowledge transfer is crucial in achieving upgrading. In a similar way, recent research in Ethiopia by Staritz and Whitfield (2017a), Grbreeyesus (2011; Gebreeyesus & Mohnen 2013), Oqubay (2015), and UNECA (2015, chap.4) shows how protectionist industrial policies from national governments enable firms' participation both in global as well as regional value chains. But what do these macro policies imply for small producers embedded in local and regional value chains? How do they trigger/prevent upgrading strategy decisions by the firms' management?

Entrepreneurship and managerial organisation have been indicated as crucial links between state policies and the development of firms' capabilities by the Resource-based view (RBV) (Teece et al. 1997; Adner & Helfat 2003; Amit & Schoemaker 1993). According to Penrose (1959), some entrepreneurs are more versatile than others and there may be times when choosing a strategy consistent with the resources a firm controls becomes almost a "creative act" (Barney & Arikan 2006). Rangone (1999) identifies entrepreneurship as an engine that leads firms' upgrading through product, process and market strategies to shape firms' competitiveness. Moreover, Amsden (2001) defines "knowledge-based assets" as sets of *capabilities* allowing their owners to produce and distribute a product above prevailing market prices. In this context, given imperfect knowledge, performance tends to vary sharply across firms in the same industry. However, the way such variation is generated and plays out at different linkages of the value chain remains unclear.

In this context, some studies in the GVCs tradition have analysed firms' upgrading differences in terms of entrepreneurship and its impact on governance and market trajectories. Yet, when it comes to evaluating the link between entrepreneurship and firms' upgrading, value chain studies tend to analyse it in isolation from institutional settings and policies. Gibbon (2008) and Staritz and Morris (2013) have stressed the

importance of entrepreneurs' market linkages in defining their upgrading strategies, while Schrank (2008) has shown how local entrepreneurs are in general more resilient to competition due to their local knowledge and lack of exit options. In this context, Sanchez-Anchocea (2013) points to how new domestic suppliers entering GPNs are more inclined to demand and support productivity-enhancing social spending than foreign investors and traditional elites. This notwithstanding, the relationship between entrepreneurship, upgrading, and state policies, as well as the latter's impact on the upgrading of local suppliers in RVCs and GVCs, remains vastly overlooked.

As Giuliani et al. (2005) point out, firms' upgrading depends on both firm-specific actions and the environment in which firms operate. Similarly, Rabellotti et al. (2007) stress how technology and knowledge transmission are not exogenous to local firms, and that in-firm efforts to absorb knowledge and technology are also crucial. According to Palpacuer (2000), a firm's competitive advantage is derived as much from internal management practices in exploiting competences, as from value chain and cooperative linkages. Moreover, Staritz and Whitfield (2017b) reveal the need "to understand and explain what drives capability building and hence why some firms decide to and are more successful in building certain capabilities and others not."

In order to explain how firms operating within the same regional context, with shared suppliers, and equivalent institutional support display different upgrading outcomes, this study advocates a complementary use of the GVCs analytical framework and the literature on industrial policy and entrepreneurship.[159]

[159] An overview of the GVCs and GPNs literature, as well as a conceptualisation of upgrading, has been already provided in chapter two. This section concentrates only on the scholarship linking the concepts of value chains, entrepreneurship, and industrial policy.

7.3 Methodology

The chapter draws on a comparative analysis of footwear and handbag producers in both the formal and informal markets.

Manufacturers were identified from official lists provided by the Kenya Footwear Manufacturer Association (KFMA), the Leather Articles Entrepreneurs Association (LAEA), the Kenya Manufacturers Association (KAM), a list of taxpayers from the Kenya Revenue Authority (KRA), and other exporters taken from the dataset presented in chapter four.

The total number of interviewed firms is 20 in the formal footwear subsector and 33 in the formal handbag subsector. These figures amount to almost the entire population operating in the Kenyan formal market. To the author knowledge, only two handbag producers and one footwear firm declined the interview.

On top of this, 10 footwear and two handbag informal manufacturers operating in Kariokor Market (Nairobi) and Jamhuri Market (Thika) were interviewed. While there is no exhaustive list for the informal market, the number of manufacturers in Kariokor alone well exceeds 250-300 (see chapter three) – interviewees in the informal market were selected based on a partial list provided by KLDC and KFMA. These represent a small sample of producers occupying leading positions in their respective markets and liaising with other formal businesses through direct representation in KLDC and KFMA. These producers were included due to their extensive background on the history of the market and to account for the crucial role informal production plays within the footwear subsector. Interestingly enough, leather handbags and

travelware are rarely produced in the informal market. For this reason, only two informal producers dealing with handbags were interviewed.[160]

Manufacturers were presented with semi-structured interviews focusing on five main themes: (i) *General information*: business history, products, gender, age and education of the owner, productivity and premises; (ii) *Market and sourcing information*: main markets, branding, marketing strategy, selling and sourcing methods, sources of credit, profit margins and competition; (iii) *Upgrading path*: machineries, certifications, design strategy, recent improvements in process/product/function, future market plans and major challenges; (iv) *Employment information*: permanent employees, gender, wages, working hours, in-house training and retaining of expertise; (v) *Networking*: associations and their usefulness, relationships to other producers/competitors and information shared. Finally, producers were asked their opinion on specific topics through targeted questions: Why do you think that handbag manufacturers are being more successful compared to footwear producers? What are the main challenges you currently face in your business? Do you have trust in the government and what do you expect from it? Do you think that leather is too expensive and/or not up to quality standards? A copy of the questionnaire is included in the appendix to this chapter.

Drawing on the conceptualisation provided in chapter two, the first part of the chapter analyses firms' economic upgrading and its realisation in terms of product, process, and functional upgrading.[161]

Concerning the indicators of *product and process upgrading*, the analysis focuses on innovation through design and technology usage. Following Giuliani et al.

[160] Except for low-price Kiondo baskets, these goods are not produced in large informal markets.
[161] Economic upgrading has been defined in chapter two in terms of unit values and market share as a consequence of improvements in product, process, and functions. Here, due to a lack of disaggregated comparative data for other countries, we refer to the total exported value across years.

(2005, p.567), this study understands product and process innovation as a story of marginal evolutionary improvements that are new to the firm, involving a shift of activities that leads to increasing value addition. Drawing on the specificities of the leather manufacturing industry, respondents' replies, previous work by COMESA-LLIP (Mwinyihija & Quisenberry 2014; Mekonnen et al. 2014), as well as studies of leather SMEs in Ethiopia and India (Gebreeyesus & Mohnen 2013; Roy 2013), the study defines product upgrading in terms of (i) design, and (ii) product development. Following the same logic, *process upgrading* is defined in terms of (i) ICT usage, and (ii) sourcing strategy.

Furthermore, building on previous GVCs studies on market channels, branding, and functional upgrading in regional value chains (Gereffi & Frederick 2011; Knorringa 1999; Roy 2013, p.48), section 7.5 defines two sub-categories for *functional upgrading*: (i) marketing and branding, and (ii) market segment. These indicators are consequential to the fact that functional upgrading among manufacturers remains almost exclusively a matter of entering new market segments and/or embracing new marketing strategies.[162] This is different from functional upgrading of tanners, which entailed a radical move into new stages of the value chain (see chapter six). A summary of product, process, and functional upgrading indictors is provided in table 7.1.[163]

Concerning social upgrading, the definition provided in chapter two cannot be utilised here due to the lack of time series data on employment. Labour quality is instead assessed as a function of wages at the time when interviews were carried out.

[162] See Humphrey (2004, p.8) and Gereffi (1999) for a description of upgrading trajectories in light manufacturing industries.

[163] The use of inductive indicators to assess economic performance is not new to the empirical value chain literature (Schmitz & Knorringa 2000; Bazan & Navas-Alemán 2004; Fromm 2007; Staritz & Whitfield 2017b; Van Wijk & Kwakkenbos 2012). Moreover, several case studies have applied similar categories to assess the relationship between firms' capabilities and performance in the RBV scholarship (Grant 1991; Henderson & Cockburn 1994; Huselid et al. 1997; Bogner et al. 1998; Ray et al. 2004; Sirmon & Hitt 2009; Rangone 1999).

Employment is an indicator of overall social wellbeing as it gives more workers the opportunity of earning an income (Bernhardt & Milberg 2011, p.7). In this respect, the GVCs literature has shown that women encounter higher obstacles in accessing better working conditions (Barrientos et al. 2011, p.332). Accordingly, this study further considers employment rates of women in the workforce and among firm management as an indicator of social upgrading.

Finally, in order to make sense of divergent upgrading patterns, the chapter presents a narrative on firms' evolution within different time frames and policy environments. This is achieved in section 7.6 through a combined use of descriptive statistics, policy reviews, historical accounts, and direct references to practitioners' statements and opinions.

Across the different sections of the chapter, producers' answers are coded using quantitative as well as qualitative data analysis. Comparison across subsectors is achieved by means of descriptive statistics. Qualitative explanations are presented through direct and indirect quotes of respondents' statements.

Table 7.1: Indicators of product, process, and functional upgrading

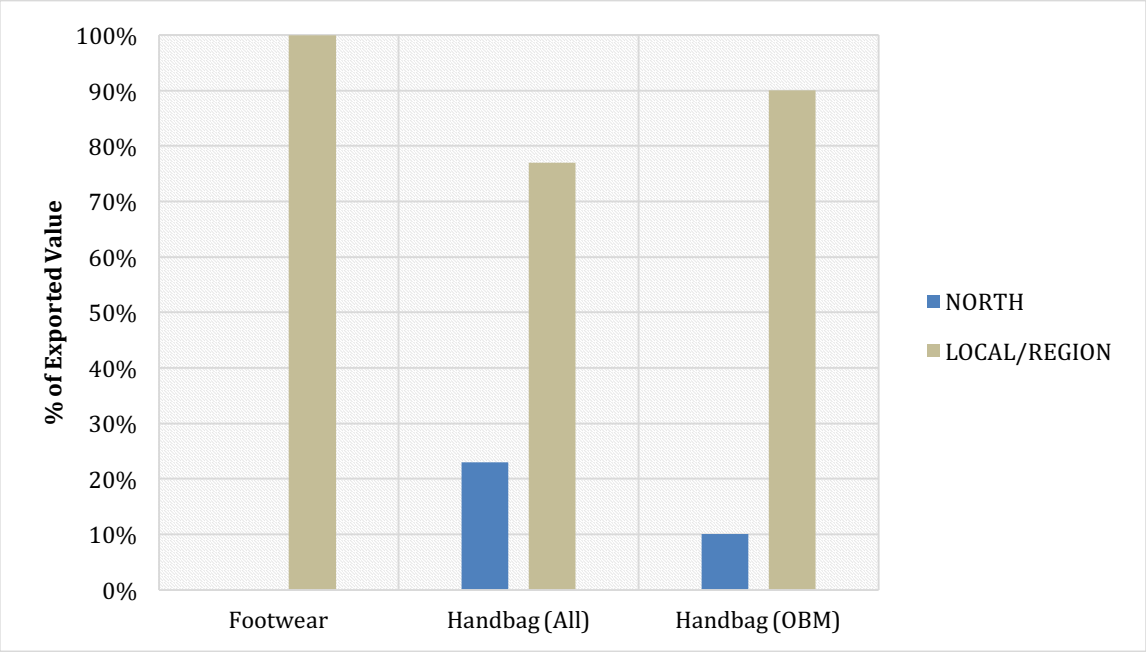
	Categories	**Indicators**
Product upgrading	Design and product development	Own design; Designs per year; Fashion vs. imitation-driven design; Custom production; Issues with copycatting
Process upgrading	ICT usage	Internet access; E-commerce; Online marketing
	Sourcing strategy	Direct vs. indirect sourcing; Quality vs. price focus
Functional upgrading	Marketing and branding	Branding: OBM production; Promotion of *Made in Kenya* Marketing: Use of traditional salesman; Presence at local fairs
	Market segment (competition)	Market tier; Local vs. import competition

Source: Inductively defined drawing on similar methodologies implemented by Navas-Aleman and Bazan (2004) Fromm (2007), and Schmitz and Knorringa (2000).

7.4 The Footwear and Handbag Subsectors in Kenya

The main leather manufacturing subsectors in Kenya are footwear and handbags.[164] As observed in chapter three, the first is characterised by low value-added and standardised production allocated mainly to the local and regional market, whereas the second displays higher unit values and quality standards across both a regional and North-South trajectory. This notwithstanding, as reported in figure 7.1, the evidence collected during interviews shows that only 23% of the handbag output (10% when it comes to original brand manufacturing (OBM) products) is exported to the North, while 77% (90% of OBM products) is sold locally or regionally. In line with chapter four, where regional markets emerge as the most conducive to functional upgrading, here too the local market is identified as the main platform where Kenyan firms define both their *high-* and *low-roads* to market participation.

Figure 7.1: Exported value by product and market trajectory



Source: Author's elaboration (survey data).

[164] According to Mwinyihija (2014c; 2014d), these two sectors differ in terms of ownership, experience, gender balance and productivity.

Despite a similar market trajectory, the handbag subsector (which includes the manufacturing of travelware, wallets, and other small leather items) entails a competitive advantage over footwear with more prospects for sustainable growth. According to the World Bank (2015, p.10), this is the consequence of the lower competition it faces regionally – i.e. quadruple exports compared to the regional leather champion, Ethiopia – and the higher prices and profits it attracts.[165]

In this context, Kenya has recently built a reputation for quality leather bags improving standards and promoting some of its brands regionally and globally. While inferior to footwear exports in terms of total value,[166] the handbag industry has witnessed an overall upward trend since 2007, increasing from 383,000 USD to 2.3 million in 2013. Together with sandals, it presents unit values and profit margins higher than any other leather manufacturing subsector.

This represents a surprising outcome considering the overall composition of the value chain. In fact, not only Kenyan exports are concentrated on a mid-low level of value addition (i.e. wet blue), but functional upgrading has been often driven by price rather than quality concerns, standardisation rather than flexibility, and low-end commodities rather than luxury goods. In this sense, the World Bank (2015, pp.ii–iv) report on the Kenyan leather sector points to the high cost of finished leather, labour and electricity, along with cheap imports as a major obstacle to an industry whose outputs remain "standardised undifferentiated goods of little quality or design differentiation".

Within this framework, the growth of the handbag sector is remarkable to the

[165] The evaluation of competitive advantage carried out by the World Bank (2015, p.10) rests on a survey in which industry experts were asked to evaluate the competitiveness of each domestic leather subsector in comparison to other subsectors.

[166] Between 2006 and 2015, manufacturing exports represented 7% of total exports, with the handbag sector accounting for about 15% of this share (in 2006 it was 10% and in 2015 it was 26%). As explained in chapter two, official statistics underestimate the value of manufacturing production as (i) they depict only exports, whereas most manufacture is consumed locally; (ii) they fail to account for most regional exports within EAC and COMESA.

extent that it reverts on a *high-road* approach where competition is defined by quality and flexibility rather than lower standards and labour costs: "[c]ontrary to the varied differences among leather footwear's competitive advantages, many leather bags produced in Kenya are considered high quality and high-end, and they naturally receive higher prices in the market." (World Bank 2015, p.10).

In the context presented by this study, shoemakers are mostly cobblers who learnt either through informal apprenticeship or as former employees in large companies during the 70s and 80s. Conversely, handbag producers are fashion designers and marketing experts who entered manufacturing more recently.

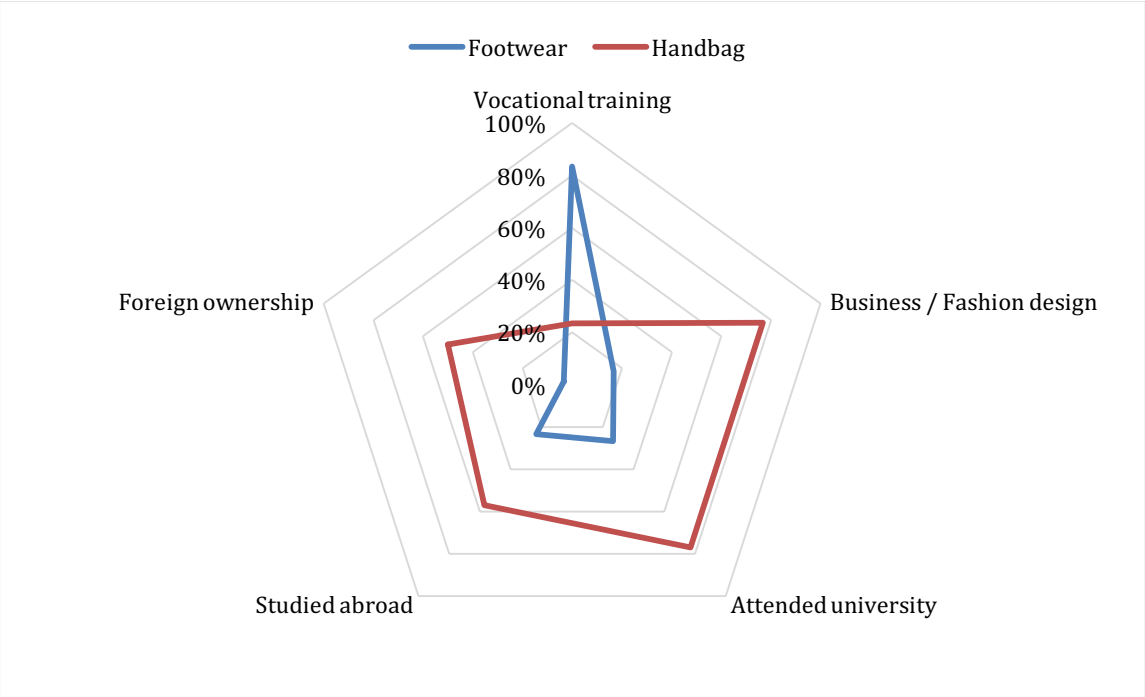
Figures 7.2 points to some major differences when it comes to ownership across the two groups. Handbag manufacturers are on average seven years' younger compared to footwear entrepreneurs.[167] Their origins range across Kenyan, Expatriates, and Asian, and their education is geared more towards marketing, design, and fashion compared to the more vocational training dominating the footwear sector. Moreover, handbag entrepreneurs are more likely to possess university degrees and to have studied abroad in European or American institutions.

The overall picture points to a handbag entrepreneurial class that is younger, better educated, more international and gender representative, and whose business and market success occurred more recently. According to the president of LAEA and owner of the handbag brand Hnb-28, the difference between the two subsectors is a matter of skills, knowledge, and business model: "people entering the bag market are totally different. They are people who studied and graduated from university, they understand business and they have a flavour for design. They bring in a set of skills and knowledge that did not exist among shoemakers […] Shoemakers tend to follow the path of the

[167] The average age of footwear entrepreneurs is 50, compared to 43 for handbag manufacturers.

masters… From apprenticeship, they just replicate the old approach, the old-school guy who went from being a cobbler to running a factory…"

Figure 7.2: Education and origins of entrepreneurship



Source: Author's elaboration (survey data).

7.5 Economic Upgrading

Drawing on the definition of economic upgrading presented in chapter two, figure 7.3 compares the upgrading patterns of handbag and footwear producers between 2006 and 2015 with respect to official export figures. 2006 and 2015 were selected as they represent respectively the first and last year of the export dataset presented in chapter four and used to compute the figure.

Whilst small in terms of absolute export value, the handbag industry experienced economic upgrading as a combination of increased total exports and unit values. This was not the case for the footwear industry, which reduced its total exports despite an

increase in average unit values.[168]

To the extent that unit values have been criticised as a proxy for upgrading (Curran & Nadvi 2015, p.10), figure 7.4 further accounts for profit margins along with total exported value. Figure 7.4 is computed using the entire export dataset, including all exports between 2006 and 2015. The diameter of the bubbles reflects the average profit acquired by manufacturers as a percentage of final prices.[169] The colour of the bubbles further indicates the group of producers: firms producing handbags are often the same that engage in the production of apparel, belts, wallets and, mostly, fashion sandals, while shoemakers specialise in footwear and, in some cases, sandals.[170]

Confirming the outcome of figure 7.3, figure 7.4 shows how leather shoes are the most exported items, while handbags and other leather goods command the highest profit margin. Furthermore, producers appear to be clustered around high- vs. low-profit products, with comparative advantage shifted towards the *blue group* – i.e. handbag producers.

Both figures 7.3 and 7.4 include under *handbag* other leather products manufactured by the same firms that engage in handbag production – i.e. travelware, belts, wallets, and other small items. Fashion sandals for exports are mostly produced by handbag manufacturers, while only a small percentage is exported by footwear producers at lower margins. Yet, since the exact share for each group could not be calculated, this category is presented independently in figure 7.4, while it is excluded from the computation of figure 7.3.

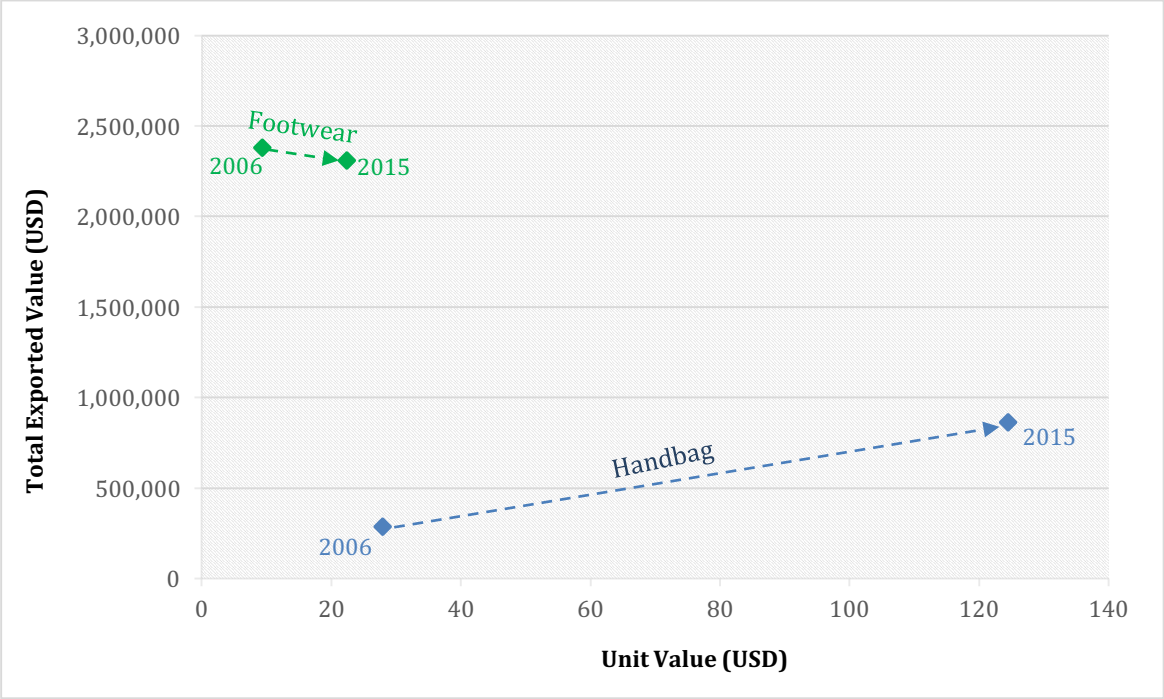
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[168] Using the market share in the COMESA region instead of total exported value, as suggested by Milberg and Bernhardt (2011), points to similar negative results due to the recent growth of Ethiopian exports (ITC aggregated data).

[169] The relationship between upgrading and profit margins is widely acknowledged in the GVCs and GPNs literature (Barrientos et al. 2011, p.323; Schmitz 2006, p.567)

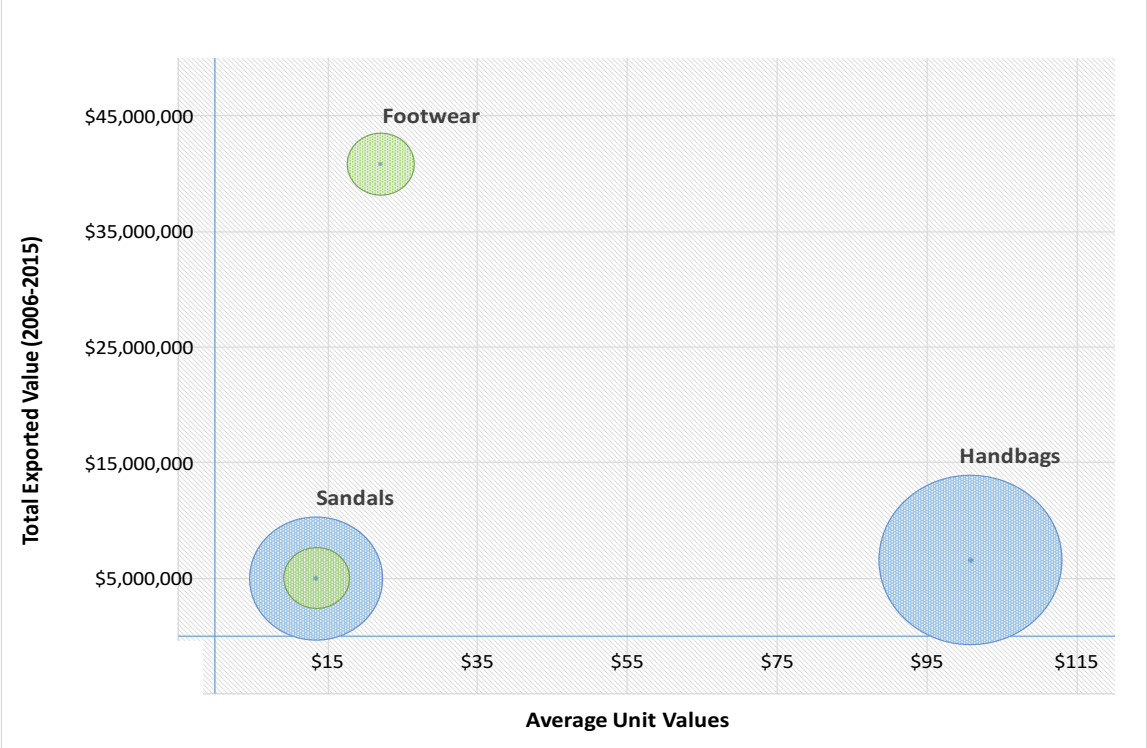
[170] Notice that figures 7.3 and 7.4 refer to the formal market. In the informal economy, most footwear producers engage in sandal production too. However, to the extent that the export data used to generate the figures is limited to the formal market, it makes sense to incorporate the handbag and sandals category as part of the same group of manufacturers. This is why the two spheres are reported in blue in figure 7.4.

Figure 7.3: Economic upgrading



Source: Author's elaboration based on official export figures.

Figure 7.4: Competitive advantages by product group



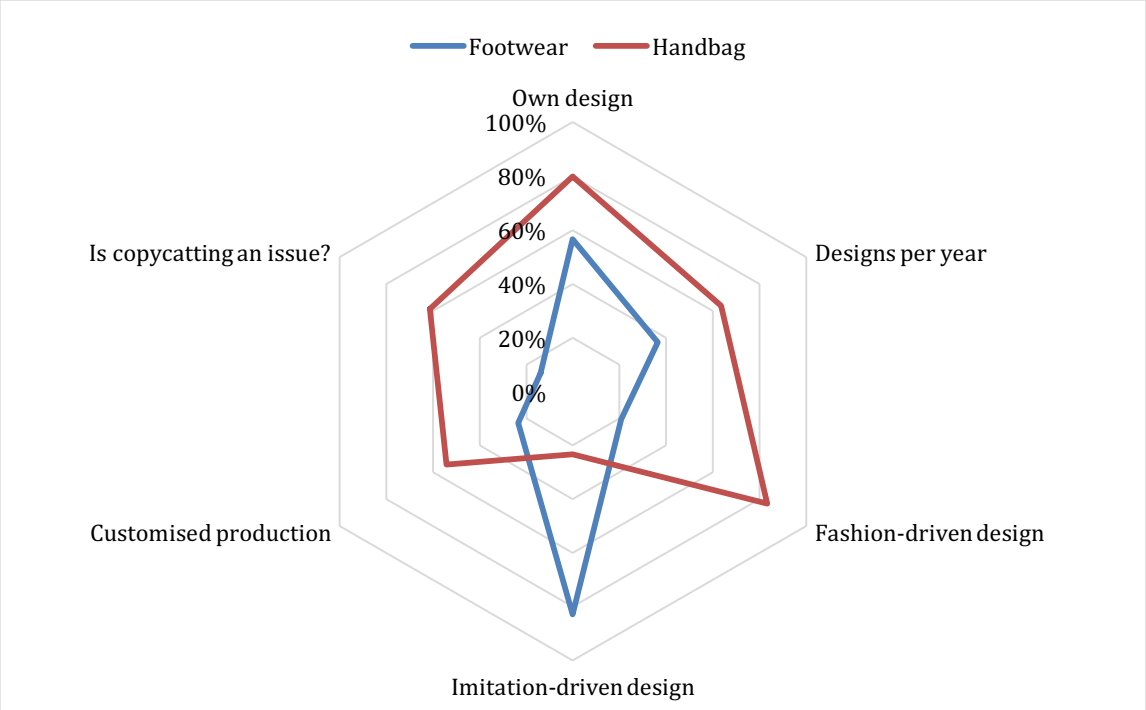
Notes: The double sphere in the category *sandal* is the consequence of this product being exported both by footwear and handbag manufacturers. Data is expressed in real values.
Source: total exported value (Y-axis) and the average unit values (X-axis) are sourced from official KRA export statistics (see chapter three). Profit margins (bubbles' diameter) are based on the author's survey data. The double sphere in the category *sandal* is the consequence of this product being exported both by footwear and handbag manufacturers.

In chapter two, product, process, and functions have been defined as the attributes that enable a firm to exploit its resources and achieve economic upgrading through higher profits. The following subsections explore how footwear and handbag manufacturers undertook different upgrading strategies that led them to experience divergent economic upgrading.

7.5.1 Product Upgrading

According to figure 7.5, handbag producers are more likely to define their own-design in-house, introduce designs more frequently, define their products based on fashion trends rather than imitation, provide customisation services to their clients, and evidence more concern with issues relating to copycatting and product imitation.

Figure 7.5: Design and product development



Note: "Designs per year" indicates how many times on average producers introduce a new design or collection within a year time. To allow for a comparative approach, the frequency has been expressed as a percentage of the total – i.e. footwear producers introduce a new design on average 1.88 times per year, while handbag producers do so 3.29 times.
Source: Author's elaboration (survey data).

Footwear producers in Kenya tend to specialise in non-fashion items such as school shoes and security boots. While production of women shoes is close to zero, most gents-shoes manufactures struggle to introduce new designs. Lack of skills and information along with stiff competition and high costs are the main issues put forth. Some formal established producers make use of TPCSI – a government infrastructure providing design and production assistance at a fee (see chapter three). Smaller and informal producers tend to share and replicate designs they acquire from imported footwear. As reported by Ftw-17, "I rely on two or three fixed designs. I never changed design… I change a bit by decorating but I use the same pattern and last. Now to design the shoe that can match with that last is the problem… I do not have the skills…" Similarly, Ftw-14 stressed, "we currently do the design in TPCSI and we mainly modify old designs by adding small things... It is hard as the designer I used moved to a different company…."

The lack of design capabilities and financial power to hire a designer is a major constraint. As Ftw-7 reports, "I have a designer in Kayole… I realised that this person is making the design for many other shoemakers and the problem is there." When it comes to inspiration, Ftw-1, who designs his own shoes in-house, said: "I usually stand in the street and look at people and what they are wearing, and change my design based on the most common ones." Ftw-6, like many small artisans, does repairs too: "I do repairs… So, if you bring a shoe, I look at the design and get inspiration there." Informal manufacturers in Kariokor Market inevitably share lasts and designs. As Ftw-22 argued, "you can see it from other people designs in here or outside here, then we come and do the same… If I make a design right now, in the evening other people will have it."

Handbag producers, by contrast, appear to pay more attention to design and product development. Entrepreneurs, as observed in section 7.4, have often a

background in design. The exclusivity of the design is a key aspect in differentiating products not just from cheaper Chinese and second-hand imports, but also from other local competitors. It is in this respect that the fear of copycatting, customization policies, and continuous design modifications should be interpreted. Time and resources are invested to ensure new and unique products, as reported by Hnb-1: "it takes quite a while from the research, the drawing, the prototype, the rejection, the next prototype… It takes three months. […] Our top-selling bag goes for 40,000 KhS. One of my former tailor copied it and sells it for a fraction of the price but they are awful…" Hnb-34, a collars, belts and handbags producer, said: "I was the first to introduce this kind of stitching and many people copied it. I decided to work on functionality… We change all the time, really. I'm always experimenting with new things." For Hnb-28, new products are driven by demand and competition: "we make inquiries at exhibitions and collect clients' requests… We do our own investigation and we determine whether the modern man in Kenya is demanding these items… However, every time we come up with new ideas, they get copied. As soon as we notice this has happened, we move on and we quickly innovate…"

When it comes to the specificity of their product and design, most handbag producers agree that uniqueness is fundamental to distinguish themselves from less expensive imports. This often includes an attempt at *Kenyanisation* of the product through the use of traditional patterns, Maasai beadings, and Safari lines. Hnb-23 highlighted that "I worked on my style to making it ethnically Kenyan…" Hnb-30, an emerging brand popular among Nairobi's upper-middle class, also pointed to the unicity of its product design: "we try to make sure that people understand that the bags come from here. It is a unique proposition that we try to present… If we were trying to make bags that Italians are making, what's the point? Buy the Italian." Comparing her

experience as a handbag designer to that of Kenyan shoemakers, Hnb-31 stressed: "I used to wear Kenyan school shoes when I was a kid... But if I look at shoe manufacturers now I can tell that the design and the comfort is not there. They have failed at keeping up with trends and fashion…"

7.5.2 Process Upgrading

Adoption of ICT was inductively assessed and associated with three main activities: internet access in the firm, the adoption of an e-commerce platform (own or third-party), and the implementation of online marketing activities. As presented in figure 7.6, handbag producers make more intensive use of ICT in all categories.

Figure 7.6: ICT usage

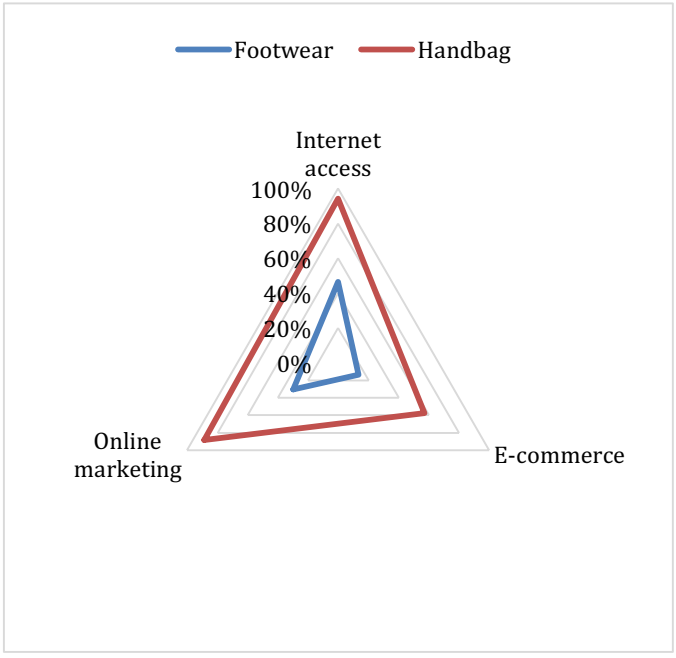
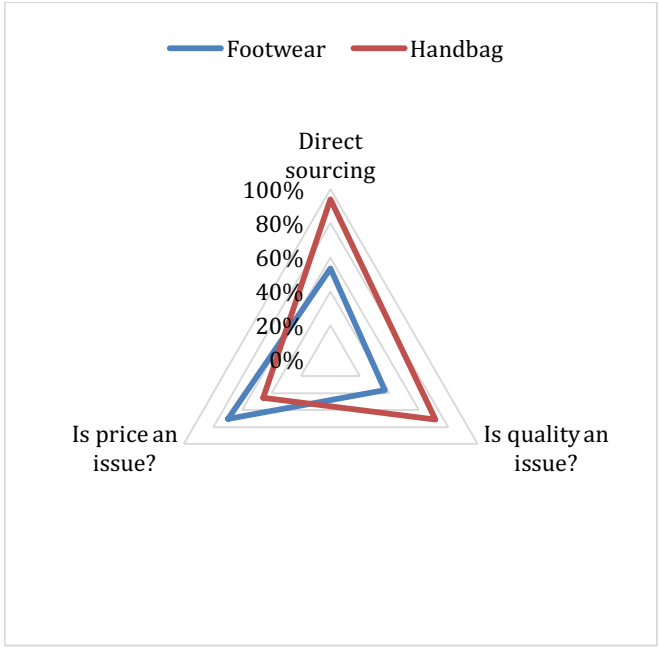


Figure 7.7: Sourcing strategy



Source: Author's elaboration (survey data).

The importance of ICT is particularly stressed by handbag producers. Given the high costs of opening a store in high income neighbourhoods, online adverts and e-commerce are often an expedient way to approach the growing local market and reach out to potential export clients. According to Hnb-32, whose mixed of leather, denim, and

kitenge bags are becoming popular in Nairobi, "locally we do not sell through stores yet. We just do everything through our website… You pay online and we deliver. […] 90% of our sales here are through internet…" Hnb-31, a small bag designer stressed something similar: "opening a store is a long-term plan, not now as it is too expensive. I'd like to increase social media activities […] I have Facebook, Twitter, Instagram and I'm active on Pinterest. We have an e-commerce platform. I will make sure that the e-commerce works for people outside Kenya…" Hnb-29, the most popular brand in the region with 10 flagship stores, recognised the importance of online media and is in the process of finalising an e-commerce platform for export sales only: "we want to build our string e-commerce system […]. We are planning to retail oversea directly through e-commerce[171] […] We paid for an Instagram campaign that will be running in the next months, once the website is ready. An incubator developed the campaign idea and we executed it by working with a number of Instagram influencers…"

Footwear producers, with few notable exceptions,[172] do not attribute much value to ICT. Most manufacturers privilege a traditional approach based on salesmen and traders advertising the product directly to store-keepers. According to Ftw-15, a producer of security boots who is among the very few to have an online presence, "my son tried to promote the business online but the response is low… We got some few inquiries…" When questioned why he does not market his product online, Ftw-9 (who owns a shoe workshop in Nairobi City Centre) points out the following: "[hand]bag makers have managed to use the internet and marketing in a smarter way, I think. They are younger, they are smarter, they have better ideas… If you want me to change my way, it will not be easy!"

[171] The platform is now online.
[172] Ftw-30 makes a more extensive and often successful use of ICT technology. Ftw-3 and Ftw-10 have a plan to implement an e-commerce platform in the next future.

A second aspect of process upgrading emerges from firms' procuring strategies. As shown in figure 7.7, handbag producers privilege direct sourcing of leather in 33 out of 35 cases because of the high standards and design originality required by each manufacturer. In this respect, the bag manufacturer Hnb-3 explains: "our work is based on colours! We change and introduce new colours all the time, so with a local supplier we can get exactly what we want […] We need to work in close relation with the supplier." Hnb-18 also pointed out: "I cannot buy 18 sqf and only 2 are good for the item […] I did ask for better quality and sometimes I refuse to take. The point is, I never order leather from the tannery for delivery. I always go there." On the same note, Hnb-8 stated, "I buy directly […] I can define pattern, colour and quality... I go there and get to know them and we work together to achieve what I want."

Footwear producers, conversely, justify the use of traders as tanneries require a minimum of 500 sqf order to personalise colours and patterns. In fact, most footwear producers' decision to buy directly from the tannery is a function of the quantity of leather they need rather than its specificities. According to Ftw-18, "I locally sourced leather from Tan-9 and Tan-10. When I do not need too much though, I just buy from merchants in town…" While complaints on quality are present, these are often overridden by price concerns.

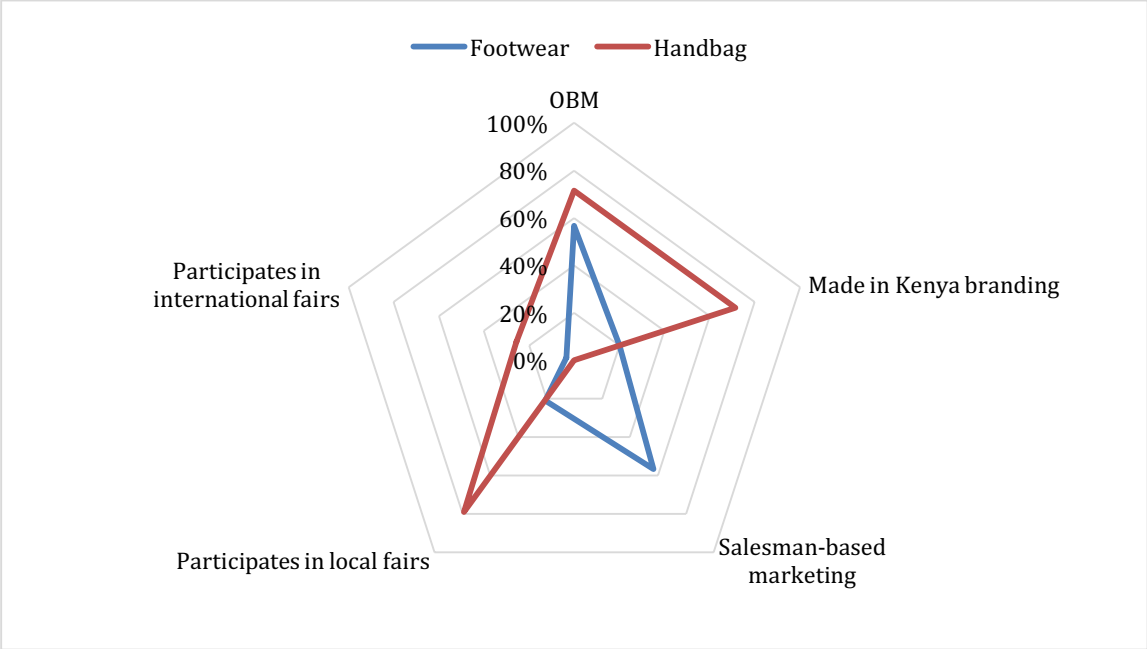
Figure 7.7 further unveils a tendency among handbag manufacturers to complain about leather quality, while price is more of a concern among footwear producers. The reason is twofold and rests on the different capabilities defining the two groups. Firstly, handbags tend to attract higher prices and profit margins, making the cost of leather less of an issue. Secondly, due to fierce import competition, a small increase in the price of leather can have major consequences on profits and market share for footwear producers. Hnb-21, who manufactures high quality leather goods in Thika, pointed out,

"the price of leather is not a big deal for us… In Europe it is more expensive, though the quality is higher… I am ready to pay more for better quality but they do not give it to me!" Conversely, Ftw-13, a boots manufacturer in Mombasa stated, "the price is high! The quality is ok for our products. There's inconsistency but you can't complain that much. This is what is available."

7.5.3 Functional Upgrading

Handbag producers are mainly OBM with only two to three major actors doing original equipment manufacturing (OEM) for both local and international brands. OBM companies tend to operate locally and regionally, while OEM producers compete more on a North-South trajectory with commands from major European and American fashion brands. Most OBM producers retail directly through their own stores, pop up shops, expos, and e-commerce. Hnb-24, a newly formed apparel and leather goods' designer, stressed the importance of building a brand image before entering the market: "Nairobi is a very culturally dynamic place that is going through a metamorphosis… We want the energy of this to appear in our brand too… […] We want to develop our brand before we create our digital home, because it is so important to get it right." In this context, Hnb-33, a producer of dog collars and harnesses, pointed to branding as a guarantee of originality and tradition: "we are rebranding the name from [Hnb-33] to Naramat, a Maasai name for *taking care*. The story will be that my accessories will take care of your pet and of the people making it at the same time […]"

Figure 7.8: Branding and marketing



Source: Author's elaboration (survey data).

Although figure 7.8 shows that about half of footwear producers likewise adopt an OBM strategy, branding has no original market function.[173] As highlighted by Ftw-8, "I have a label in some shoes… We keep changing names. This one was put about 1 month ago. We try to avoid monotony. I think that if you keep changing your name, you get more customers." Ftw-12 and Ftw-9 try to convey an ideal of "foreign" in their products in striking contrast to the value attributed by handbag producers to the *Made in Kenya*. According to Ftw-12, "*PS* is the brand on all shoes. For my fashion shoes, I put Italian Model and real leather." In the same way, Ftw-9 stressed, "our brand is [Ftw-9] – Italian Fashion – Genuine Leather. I started with this logo and did not make any change. I put "Italian" because Italians are the pioneers in shoe fashion. You copy the fashion from Italy…"

Most footwear manufacturers adopt a traditional marketing approach based on salesmen showing up at retailers' doors with samples and collecting orders. Compared

[173] With one major exception.

to handbag producers, shoemakers not only lack online marketing, but their participation in local expos and trade fairs is also considerably lower. As stressed by Ftw-19, "people know me because I go to their shops with the products and show them…" Likewise Ftw-12 declared, "I have a salesman going to the clients… We do not have a website or anything… People get to know me mostly through word of mouth." Whereas participation in international fairs is low in both groups, only one footwear producer reported attending international fairs, while nine handbag manufacturers have attended at least once in the last two years.

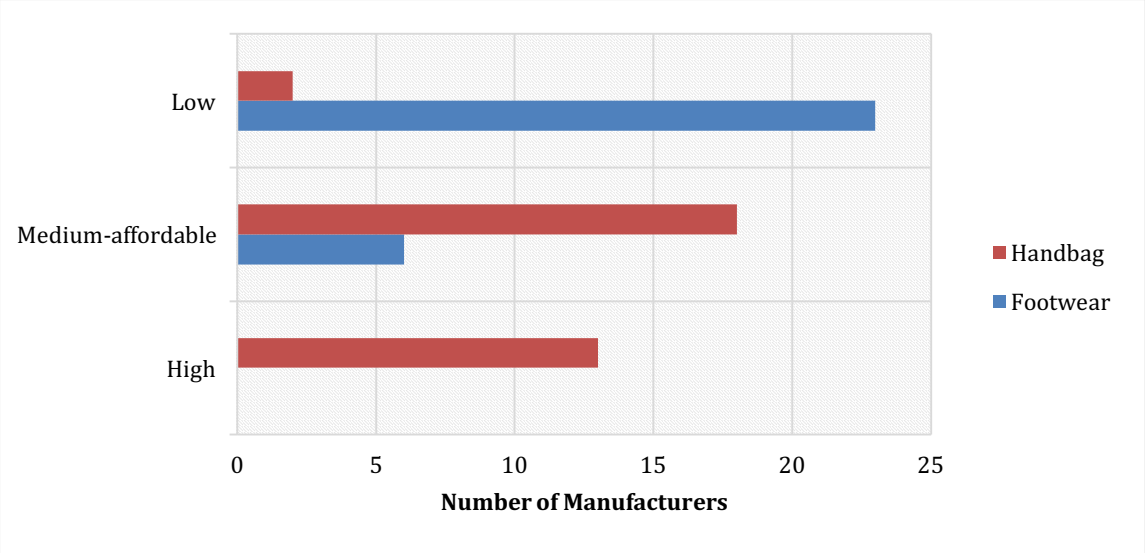
When it comes to informal producers, marketing is practically non-existent. Manufacturers co-exist in clusters where traders buy in bulk. It is the customer who goes to the producer rather than vice-versa. Participation in fairs is not a viable option due to the informal status of the business, while most of the production is unbranded or utilises *fake* brands inspired by Italian and Ethiopian footwear. As stressed by Ftw-25, "I put a label on fashion shoes yes… It says Italian Shoe Design… Many people do not know the quality of the leather, but they know that Italian shoes are of high quality…" Ftw-23 pinpointed, "I have something like this: Ethioplan… I'm just trying to imitate. Because most of our customers like this name Ethiopia… Ethiopian product."

Contrary to footwear manufacturers, handbag producers tend to supply their product in a niche market drawing on concepts such as originality and ethnic characteristics. For instance, the use of the *Made in Kenya* branding is pivotal. Hnb-4 recently introduced a Kenyan flag as part of her brand: "I go to many fairs and see what is coming out of China, India and Turkey and other areas where manufacturing is high. We have a great product and our items are really handmade with an attention to details that is not there in many cases […] So I want to express that I'm selling the fact that is made in Kenya, I want to boost that is made in Kenya and I'm proud that I made it in

Kenya…"[174] Similarly, Hnb-8' statement echoes that of many other producers in the industry: "my mission and message is that bags are handmade in Kenya".

Finally, concerning the market-tier, handbag producers have targeted the growing urban middle- and upper-middle class. As presented in figure 7.9, most handbag manufacturers are situated in the top and medium market segments, while footwear producers cater to lower-end customers. A manager at KIRDI said in this respect, "most handbag manufacturers' products are targeted either to the middle-class or the upper-class […] One of the challenges in the shoe industry is that manufacturers are making sub-standard footwear and that has really killed the industry generating a cut-throat competition that lowered quality and profits…". Comparing its handbag business to shoemakers, Hnb-11 stressed, "handbag producers have high standards […] Shoemakers are mainly *Jua Kali*, the leather is low quality […] I guess there is a major quality-based competition [in handbag] and that is working on our side […] People are competing on quality rather than price."

Figure 7.9: Market segment



Source: Author's elaboration (survey data).

[174] Footwear producers who adopted the *Made in Kenya* brand, such as Ftw-14, Ftw-2, Ftw-1, and Ftw-4, did so following recommendations from KLDC and KFMA rather than as part of a marketing strategy.

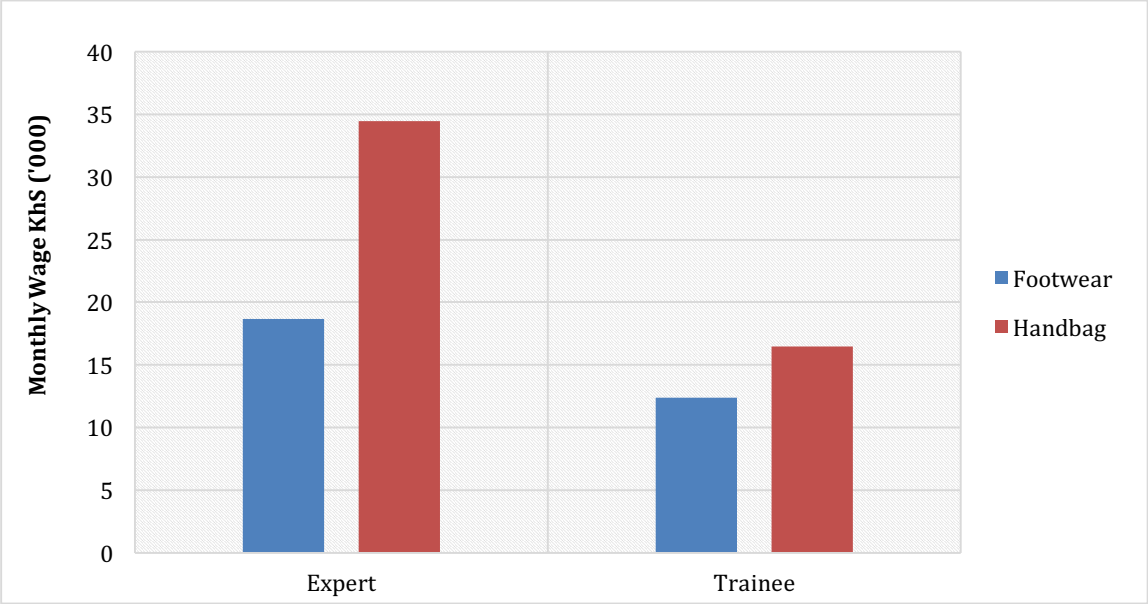
7.6 Social Upgrading

The definition of social upgrading in chapter two requires a comparison between employement, wages, and overall labour conditions across time. Unfortunately, there are no sub-sectorial data to allow for a comparative approach as the one presented in figure 7.3 for economic upgrading.

Figures 7.10 and 7.11 compare wages, job security, and gender participation across the footwear and handbag subsectors as of 2016 when interviews were carried out. Figure 7.10 points to the higher employment quality among handbag producers, which reflects in higher average wages paid to both expert and training employees. Handbag producers are quite jealous of their workforce and lament "labour poaching" as a common practice by competitors. As will be observed in section 7.6.3, this often generates a positive spiral that increases wages and labour conditions.

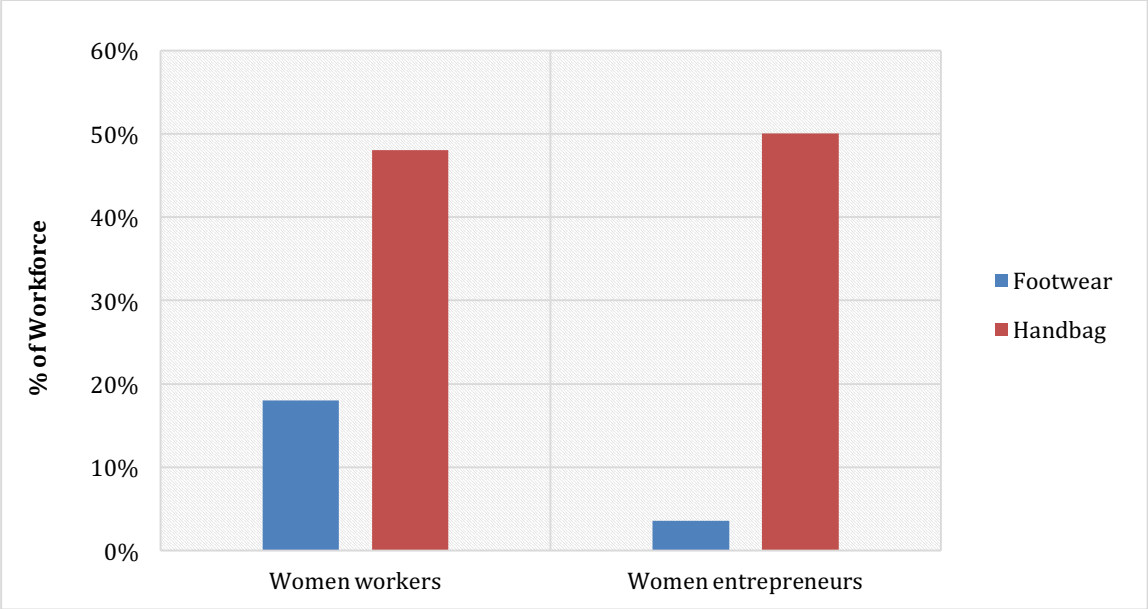
Concerning gender dynamics, figure 7.11 shows how the handbag subsector not only employs a larger number of permanent female workers compared to the footwear industry, but is also more likely to attract female entrepreneurs. As stressed by the shoemaker Ftw-21, "ladies are not interested in this work, they consider it as a work for men." When employed in shoemaking, women are principally assigned to the stitching department or sandal beading - activities that are often casual and piece-based. As reported by the sandals producer Ftw-26, "women are doing the beadings… The ladies are paid per piece depending on the beadworks…" By contrast, in the handbag subsector female workers are often tailors, designers, and managers – all permanent and qualified positions. As it emerges from the interviews, female entrepreneurs are also more likely to have a background in fashion design rather than technical training in handcrafting.

Figure 7.10: Average salary by product



Source: Author's elaboration (survey data).

Figure 7.11: Gender participation in the workforce



Source: Author's elaboration (survey data).

Having acknowledged the economic and social upgrading distinguishing handbag and footwear manufacturers, the next section compares the origins of the two subsectors in order to shed light on the roots of their divergent upgrading pathways.

7.7 Origins of entrepreneurship and industrial policy

Sections 6.4 and 6.5 outlined the *high-road* approach undertaken by handbag producers compared to footwear manufacturers. This translated into both economic and social upgrading where higher profit margins and unit values are accompanied by improved working conditions. It is nevertheless still unclear what triggered the upgrade. The scope of this section is to take a step back and make sense of how institutional constraints and policies have shaped manufacturers' access to different upgrading opportunities and strategies.

Whilst footwear manufacturing originated in a period of Import Substitution (IS) within a context dominated by a few large companies, handbag producers emerged in a post-liberalisation scenario underpinned by a lack of government intervention and dominated by small and micro enterprises. Moreover, the international input of foreign entrepreneurs with an interest in the Kenyan handcraft industry played a crucial role in the development and acquisition of the tacit knowledge embedded in production, innovation, and market management capabilities of handbag manufacturers. The next two subsections analyse the *origins* of these two groups and the resources that enabled their respective upgrading trajectories.

7.7.1 Footwear Manufacturing: the IS period

The footwear industry emerged in the early colonial days in Kenya with the opening of the Bata production unit in 1938. At this point in time, Kenya already possessed a small tanning industry producing leather locally for the colonial regime. The first legislation regulating the sector was promulgated in 1947, although it was not until 1958 that the colonial administration introduced tariffs to favour British concerns in the country. Upon independence, the newly formed Kenyan government embraced a policy

of IS aimed at harnessing indigenous entrepreneurship, easing balance of payments pressures, and increasing productivity through targeted measures – such as the Industrial Commercial and Development Corporation and the Kenya Industrial Estate Programme (KIE) in 1967 (Chege et al. 2015).

However, it is only with the Export Compensation Manufacturing Act in 1974 and the following ban on export of raw skins and hides that the footwear manufacturing industry took off. As presented in chapter three, this policy entailed a 100% duty on imports of leather, a ban on the export of intermediate inputs, and a 22% export compensation-scheme for local manufacturers (Mwinyihija 2014b; Mwinyihija 2014a). Within this context, major actors such as Tiger Shoes (1974), United Footwear (1978), C&P Shoes (1981), and MacQuin Shoes (1982) were born and reached the apex of their business. The presence of a thriving tanning industry worked as a booster for the industry. As reported by Kinyanjui (2013), the successful growth of large-scale manufacturing was the consequence of government subsidised finance through foreign capital. Leather tanning and footwear were among the leading sectors that expanded into industries offering a large variety of products and employment opportunities (Coughlin 1988).

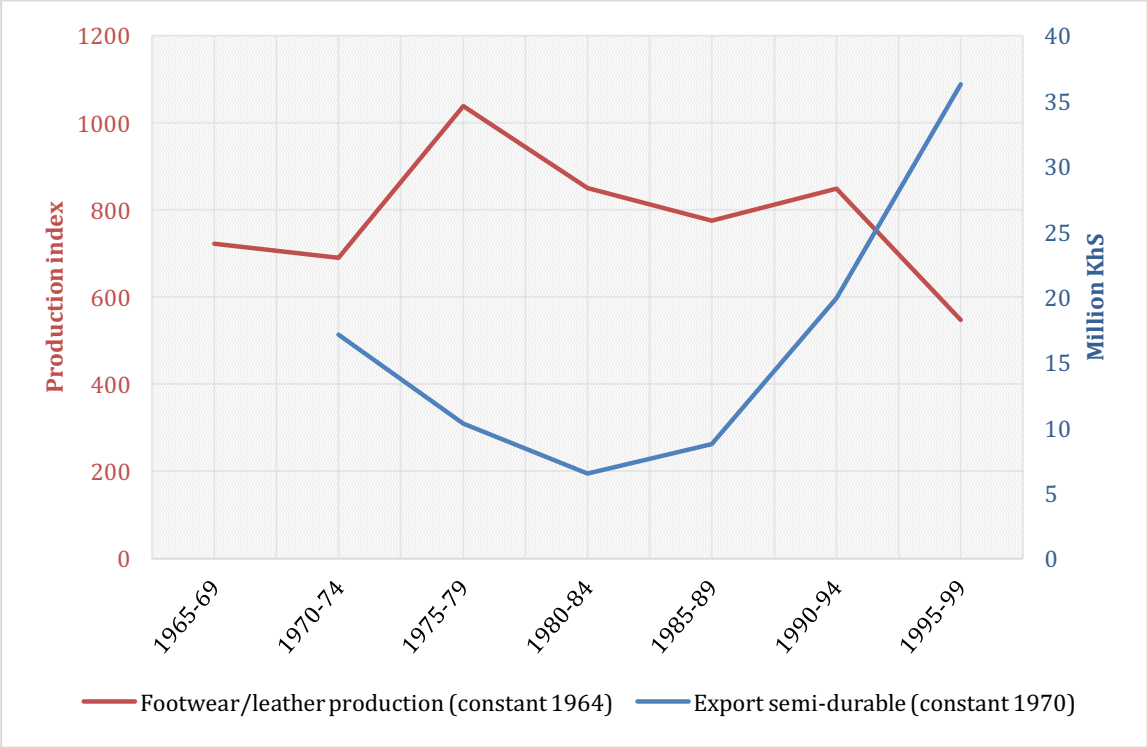
While boosting the local leather industry, IS generated overall inefficiencies as industries found it more convenient to reap the benefits of a highly protected internal market while operating at low capacity utilisation and high prices (Chege et al. 2015). This was particularly the case from the mid-70's, when the collapse of EAC (the major market for Kenyan manufactured goods) and the deterioration of the country's external terms of trade following the 1977 oil shock further reduced the competitiveness of Kenyan exports (World Bank 1983, p.xi; Gitonga 2015, p.123). As reported by Nyongo (1988, p.39), highly protected Kenyan industries were reaping high profits locally in

conditions of market monopoly and production inefficiency, which further discouraged industrial expansion.

Manufacturing grew across the 70's and 80's, however such growth was disproportionally driven by the internal protected market. According to the World Bank (1983, p.xii), the proportion of output exported declined sharply while the share of locally produced consumption goods increased. It is estimated that between 1976 and 1983, 64% of Kenya's industrial growth was the consequence of increasing import substitution, 41% of increasing domestic demand, and *negative* 5% of decreasing exports (World Bank 1987).[175] Figure 7.12 makes use of KNBS official statistics to show the trend of footwear and leather production compared to the overall export of semi-durable goods between 1965 and the 90's, when liberalisation was fully implemented.[176] The outcome shows how increasing production was accompanied by decreasing exports across the 70's. As depicted in figures 7.12 and 7.13, liberalisation in the 90's brought about an increase in overall export shares, which was however accompanied by a dramatic drop in local manufacturing as inefficient companies struggled to sustain foreign competition (Gitonga 2015).

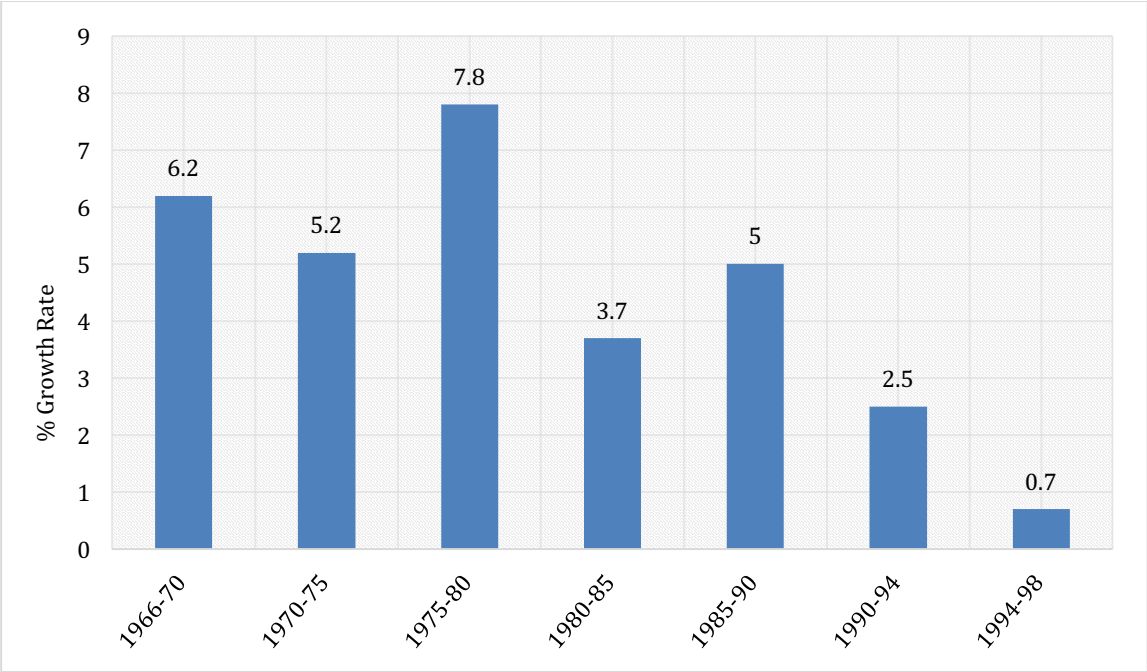
[175] Reported by Coughlin (1988, p.287).
[176] No data is available on the export of footwear and leather for this period. The category *semi-durable goods* is therefore adopted as an indicator which should include such products.

Figure 7.12: Footwear and leather internal production vs. exports



Notes: Due to scarce data availability and inconsistency in measurements across years, figure 7.12 reports (in red) an index of total production of footwear and leather as reported throughout KNBS Economic Surveys between 1968 and 2000. The index is composed by the sum of percentage changes computed using 1964 as base year. In blue, the figure reports the trend in exports of semi-durable goods in million KhS, adjusted for inflation.
Source: Author's elaboration based on KNBS Economic Surveys for the years 1967 to 2000.

Figure 7.13: Growth rate of the manufacturing sector in Kenya



Notes: Using 1965 as the base year.
Source: Gitonga (2015, p.122).

While increasing local productivity, the structure of IS subsidies and protection measures was biased towards large companies, often subsidiaries of MNCs (Gachuki & Coughlin 1988). In the footwear sector, "[t]he monopoly given to such companies as Bata has led to the destruction of small-scale artisans all over the country using leather inputs from local tanneries. […] The employment generated from such artisan workshops was much higher […]. The prices of the artisans' shoes were much lower. Shoe-making by artisans also had many more linkages within the domestic economy" (Nyongo 1988, p.40). According to the same author, IS industries were limited in their employment creation as they expanded little and slowly, serving a small market, with limited upstream local linkages (Nyongo 1988, p.44).[177] Overall, the literature dealing with the impact of IS on Kenyan light manufacturing points towards a trend of increasing productivity for the local market and decreasing exports brought about by large subsidised companies.

7.7.2 Footwear Manufacturing: post-liberalisation

In the early 90's, the Kenyan government embarked on a set of structural reforms, including the removal of price controls, import and foreign exchange licensing, and tariffs. Kenya joined the WTO in 1994, fully liberalising capital and current transactions and abolishing the export compensation scheme (Chege et al. 2015; WTO 2000). Market liberalisation coupled with low purchasing power allowed the second-hand market of footwear coming from Europe, the US, and Asia to prosper and, in many cases, to outperform Kenyan producers. According to KFMA, between 1995 and 2000 over 100 formal shoemakers and leather good producers closed down, with many among

[177] Coughlin (1988, pp.277–284) provides several examples of how IS regulations and "artificial standards" prevented small local suppliers from participating in the market, favouring large conglomerates.

these, incapable of facing low-cost competition, turning themselves into retailers or cobblers and entering the second-hand value chain. According to the president of KFMA: "liberalisation turned shoemakers into cobblers. By 2000, the entire industry was on its knees and entrepreneurs had lost hope […] Between the 70's and 90's Kenya was able to supply 90% of the country requirement! Now more than 90% is import". Similarly, Okello (2016) writes: "[e]ven though Kenya served as a leather footwear hub for East Africa two decades ago, it is currently a very minor exporter […] Its competitive position has been eroded by global imports of new low-cost footwear […] and second-hand imported footwear invading domestic markets."

As evidenced in the interviews and further confirmed by Okello (2016), the know-how within the footwear manufacturing sector emerged as a spill-over of Bata-trained personnel in the 60's and, later on, Tiger Shoes, C&P, and other large companies. Whereas entrepreneurs such as Ftw-14, Ftw-2, Ftw-1, and Ftw-7 were formally educated within the Bata academy, many smaller producers learnt as employees in Bata and Tiger, or from people who were formally trained there. In some cases, technical apprenticeship was provided also by public institutions such as TPCSI (from the early 90s onwards) and the Kenya Industrial Training Institute (KITI).[178] As reported by Ftw-19, "I learnt from my brother. He was trained here in Bata and then started his own business in 1993." Ftw-11 stressed, "I went to polytechnic school for shoe making and then I worked for Charles (Ftw-2). When I started my company, I had more than 20 years' experience", and Ftw-12 in Thika, "I was employed by Sana Shoes and trained by UNIDO through TPCSI." Ftw-6, a small manufacturing unit managed by a young man named David, declared: "my father had a long experience making shoes at Tiger. He started as a stitcher and then became a supervisor. Myself, I grew up here

[178] See chapter three for a better explanation of the role of these institutions within the value chain.

since I was a kid and stepped in…" Ftw-17, whose workshop in Limuru is next-door to Bata, explained: "I learned at Bata where I worked for 10 years before setting up my own business. Most of the shoe makers around Limuru are former Bata employees who started their own business."

The history of informal footwear hubs such as Kariokor Market in Nairobi and Jamhuri Market in Thika is indicative of this phenomenon. According to Ftw-25,[179] who worked in Kariokor since 1986 and is currently an established presence in the market, the tradition of Kariokor has only recently become associated with footwear:

"In Kariokor during the 80s and 90s we were not doing (leather) shoes. We were doing belts, wallets and baskets… Shoes not so much because Bata was producing a lot and there was Tiger too and other big companies like [Ftw-2] producing shoes. Around 10 years ago (other sources say from 2000) Kariokor started producing shoes. What happened is that many people employed in [Ftw-2] and Tiger and other companies and employment had ceased… When they lost their jobs they looked for a way to keep making what they knew and moved here: that is how Kariokor started producing shoes… People came in with the expertise."

The *informalisation* of the footwear sector in Kenya – today accounting for approximately 75% to 85% of the total national production (Mudungwe 2012, p.4; World Bank 2015)[180] – coincided with the retreat of the formal sector. In this context, capacity building within informal markets such as Kariokor has taken place through apprenticeships from those who were previously employed at companies that either closed down or significantly restructured their businesses upon liberalisation. As

[179] Member of the Cobblers Association of Kenya (CAK) and the Kariokor Traders Association (KTA).
[180] According to our estimation, this may be around 70-75%. The World Bank (2015) brings it to about 81%, estimating a total production of 3.3 million per year, of which 2.7 in the informal market. Our data shows a production of about 2.7 million per year only in the formal market.

reported in Okello's (2016) survey of the Kariokor Market, "[m]ost of the producers are historically workers from Bata Shoe Company who resigned to start up their own production firms."

Whilst the resilience of the informal market in face of competition from low-cost imports deserves further attention, this study is concerned with the link between the footwear entrepreneurial class and its origins within the pre-liberalisation IS context.

As stressed by UNIDO (1997), liberalisation diminished the involvement of the government in the economy, resulting in budgetary cuts for training, testing, R&D, and extension services. In an attempt to deal with this decline in funding, institutions tried to commercialize their services. However, their efforts were constrained by the limited readiness of the industry to pay for such services, preventing institutions from sustaining their previous role.[181]

The lack of institutional support that followed the post-liberalisation era and the crisis experienced by most institutional bodies generated a sense of helplessness among footwear entrepreneurs and workers. When it comes to identifying their major challenges, figure 7.14 shows how footwear producers are much more prone to frame cheap imports as an obstacle requiring government intervention. Most footwear manufacturers do not envision any long-term future for the industry unless the government intervenes to stop or limit importation. As Ftw-1 articulates, "with imported shoes we cannot grow. But if they stop the importation, then we manufacture more and can grow. There is no future for the industry unless they do that. We are squeezing ourselves very much to maintain manufacturing […] The future is not bright if we continue like this." Ftw-10 makes a similar point: "they should stop importation…

[181] The drop in the quality of skins and hides that followed the end of the subsidized tick-control and insemination programme is indicative in this sense (see chapter six).

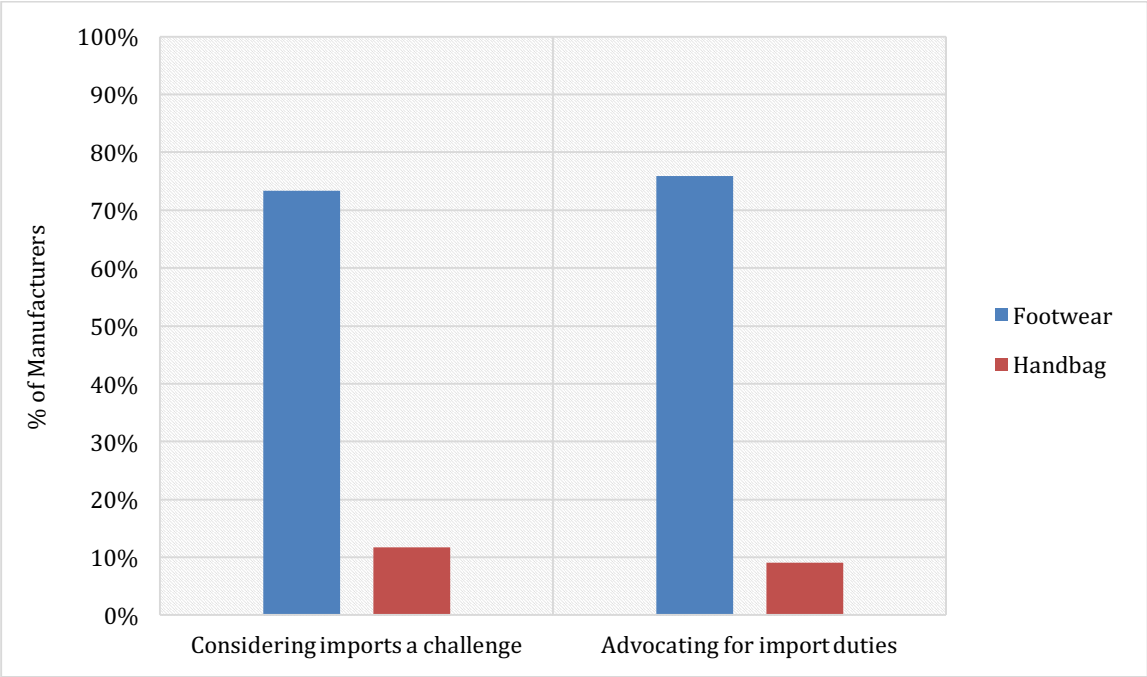
Unless they stop importation, there is no future for the industry. We talked to the government several times, they even used to come here before… They should stop sub-standard products, mainly from China…" And Ftw-8 further echoes these concerns: "the future is there only if the government intervenes to protect the leather industry. All we need is support from the government. Let the government support us, because there is a lot of talents among young boys in Kenya… But the government has to intervene. Let them protect us the way the Ethiopian government does!"

Functional upgrading among handbag producers reasons with their strategy of differentiating while eschewing foreign competition. As reported in in figure 7.14, handbag manufacturers are on average less concerned with imports than footwear producers. In this subsector, competition tends to be driven by quality rather than price concerns. According to Hnb-3, "we created our name and we have our niche and stores […] The *mitumba* (second-hand market) and cheap imports […] do not affect the bag market as much." Hnb-31 likewise stressed, "for me when you say competition you mean people consistently competing with each other… But people have different production timelines, collections are presented at different points during the year […] *Mitumba* and Chinese imports would be a big deal if I was in competition with them, but I am not and therefore I do not see them as a threat." Similarly, Hnb-20 pinpointed, "*Mitumba* and liberalisation does not seem to have affected our business. This is because we produce quality. If you have a good quality product, you will always have a market. As long as we keep it up, we can differentiate ourselves from cheap competition."

Footwear producers identify foreign Chinese and Ethiopian imports as a major obstacle to upgrading and a challenge to their survival. Here, competition is driven by price concerns, although quality issues are often put forth to justify the unfairness of sub-standard imports. Ftw-14, who chairs KFMA, highlighted how foreign competition

is increasingly an issue: "a lot of shoes today come from Ethiopia through porous borders to Nairobi at a retail cost that is inferior to my production cost! We need to impose quality standards on imports so that bad quality does not get in. Don't bring garbage. Instead of coming from outside, let's make our own garbage with Kenyan standards."

Figure 7.14: Challenges and expectations on imports



Source: Author's elaboration (survey data).

Ftw-18 is one of the few footwear entrepreneurs that entered the market as an investor in 2007, well after the end of the IS regime. He joined KFMA with the hope of playing a role in shaping the industry agenda and gaining knowledge from major experts:

"Shoemakers are living in the past. I was inducted (to KFMA) as I started the business, but I never saw the need of even attending. The leadership was made by old men like me, people who are disillusioned with life. They were in big business before! Business that was challenging Bata at the time and they had all come from Bata

themselves… They left there and started their own business… When the mitumba came in, they had to close. So, they have been bitter with the government for allowing the mitumba at that time. To those days, even if somebody comes here you will read the bitterness, you will identify the bitterness when they talk about shoes and shoe-trade. They'll say: 'you know when I was with Tiger Shoes, the government, the government… blabla' To me it is a moaning association, crying sour grapes. We go there and have to spend a lot of time to discuss how unfair was the government for allowing mitumba to kill those industries… But why does Bata still exist? They pre-dated mitumba and they are still in business…"

Not surprisingly, as most footwear manufacturers were directly or indirectly formed through knowledge spillovers from established formal companies, the attitude described by Ftw-18 emerges also among younger entrepreneurs in the post-liberalisation era. Ftw-6, who has recently taken over the business form his father, declared: "the best years for the business were the first years in the 90s! My father tells me that moccasins (fashion items) used to sell a lot… There were no *mitumba* in those days, so it was only local shoes. Now there is a lot of competition!" And Ftw-11, who entered the shoe business in 2008, stated: "trade liberalisation is a challenge because we cannot compete… A duty on the import of cheap shoes is necessary. Until they don't do that there is a big problem. The government has to do something. They need to support those who already have the knowledge and are in shoe manufacturing…"

Footwear manufacturers did not acquire the resources to facilitate upgrading, neither during the period of IS nor in the post-liberalisation era. Rather, once protectionist schemes were removed, most of them continued their previous activities in a context of cut-throat competition that, with few exceptions, triggered a race to the bottom. *Immiserising growth*, a situation where increasing output and employment is

accompanied by falling economic returns and standards of living (Kaplinsky 1998), emerged through *informalisation* and multiplication of small businesses that replicated previous knowledge on a smaller scale. A manager at TPCSI stated in this respect: "one of the challenge in the shoe making industry is that manufacturers are making sub-standard footwear and that has really killed the industry generating competition that lowered quality and profits…"

Under such conditions, producers and their associations have looked to the government to re-establish the climate that characterised the IS period and provide them with the machineries, skills, and capital required to out-compete imported goods. Section 7.5.3 showed how footwear manufacturers have chosen to compete on price instead of quality, reproducing imported products rather than developing original designs. As stressed by Ftw-25, "instead of being competitive in the market, we are competing among each other. The client is not relying on my quality or name but is buying the cheapest available: we are making all the same products! The same design, the same quality… It then depends on the price. The price will drive the customer." Hnb-32, a producer of leather bags whose family has a tradition in the footwear industry, observed: "the shoe industry failed to cater to the market. The market keeps changing but they did not adjust […] Previously they had support from *saccos* [cooperative credit institutions], but these old departments are dead and do not provide support to producers as they used to…"

Figure 7.14 shows that about 25% of footwear producers are not direct advocates of import duties and do not consider imports as a major challenge. These are mainly producers of security boots and school shoes who have found a niche market based on seasonal and corporate orders. Due to time constraints, low quantities and ad-hoc designs, many security companies prefer to source locally rather than undertake the

hassle of importing their boots. As stressed by Tan-13, "*Mitumba* is not a challenge for me and neither cheap Chinese imports, as I am not doing fashion shoes at the moment. I know that security companies do not source boots from China…" However, as evidenced in section 7.5, even in this case the business behaviour of footwear manufacturers is price-driven, characterised by the reproduction of old designs and a passive approach whereby the market is expected to come to the producer – or be brought to him by the government – rather than vice-versa.

7.7.3 Handbag manufacturing

The handbag industry in Kenya has very different origins from the footwear sector and its emergence is barely discussed in the literature. The recent World Bank (2015) report on the leather industry limits itself to an analysis of the sector growth in the last decade.

Drawing on fieldwork interviews from this study, it seems that before 2005 the industry was rather dormant, with four to five formal actors and no identifiable growing trend. The pioneer in the sector was Hnb-18. Currently employing around 40 workers in Nairobi's industrial area, the company was founded in 1984 by Idris R., a Kenyan of Indian origin who took advantage of a loan from KIE to encourage local entrepreneurship under the IS regime. Around the same time, Jacques V. started Hnb-19 in Thika,[182] a few miles north of Nairobi, near his father's tannery. Of British descendent, Jacques trained in London and worked across the world before setting up his workshop which, during the pre-liberalisation period, hired over 200 workers (now 12-15) making a large variety of leather goods from upholstery to bags, saddlery, apparel, and belts. Both Jacques and Idris focused on OEM for northern buyers and, since

[182] In Kiambu since 1998.

liberalisation, corporative items for the local and regional market. In both cases, their business followed the destiny of the footwear industry, considerably shrinking with the emergence of the Chinese market, to which most brands found it more convenient to outsource production. As stressed by Jacques, "the development of the Chinese market was the cause of the shrinking… They were coming to exhibition with amazing machines and they could make the same basket with a machine. They could land it in the US for 3-4 USD with very cheap leather and machine made. They could replace the products at much cheaper prices and now they are impossible to compete with." Contrary to the footwear industry, however, these OEM handbag companies were deeply integrated into GVCs before liberalisation with an export-dominated market structure.

Pioneering producers who did not suffer from foreign competition were OBM Linda C. and Anna T. Linda C., another Kenyan of British origin trained in London by Bill Amberg, started producing leather bed covers and waistcoats in 1986, moving later into bags and beaded belts and collars. Her business has been fairly stable over the years, employing about 10 to 15 workers. Anna T., a British Kenyan like Linda, travelled extensively, learning her skills in London, Paris, Rome, and New York, before setting up her workshop and retail shop in Nairobi. With approximately 15 permanent workers and 30 casual artisans, she has trained several *fundis* most of whom are now working around a multitude of workshops in Nairobi. In contrast to Idris and Jacques, Linda C. and Anna T. have developed their own brand working predominantly with local and regional high-end markets, but increasingly exporting some products as well.

Between 2005 and 2015, through a combination of design knowledge and handcrafting skills stemming from existent workshops and new fashion institutes, several new actors entered the industry. Currently, between Nairobi and Mombasa alone

there are at least 35-40 formal bags' and leather goods' (excluding footwear) manufacturers. While most of these are small workshops with five to 10 workers, there are also some regionally established brands such as Hnb-29, Hnb-25, and Hnb-34, employing 85, 45 and 80 workers respectively. The recent boom of the leather bag sector is rooted in the growth of a new entrepreneurial and highly skilled class: "[t]he reason for the growth in the leather handbag sector can be traced to the rise in the number of talented designers and producers participating in the sector […] Hnb-29 and Hnb-25, for example, have carved out places in this market niche with its distinctive brand." In this context, "[d]espite decreases in the number of tourists visiting Kenya due to the rising insecurity, the reputation of its products [handbags] allows Kenya to continue to outperform Ethiopia" (World Bank 2015, p.59).

Building on the data collected within the scope of this research, upgrading in the handbag sector appears to rest on three intertwined aspects: (i) access to foreign knowledge; (ii) presence of new institutes and faculties for design and fashion studies in the country; and (iii) a diffuse sense of distrust towards the government and the idea that "standing on your own legs" is better than waiting for institutional support.[183]

Concerning access to foreign knowledge, the first four workshops were all managed by Kenyans of British or Indian origins with international expertise. The same is true for major producers like Hnb-29, Hnb-25, Hnb-34 (British), and Hnb-3 (Italian). As presented in table 7.2, more than half of formal workshops and all major brands are owned by either expatriates or British and Indian Kenyans. Out of 35 interviewed businesses, the 16 Kenyan owned workshops were created on average nine years after their foreign counterparts (column 1). Moreover, column 2 of table 7.2 shows that most foreign entrepreneurs were educated abroad, carrying with them a knowledge baggage

[183] Interview with apparel manufacturer Hnb-26.

that was not yet present in the country. As stressed by the president of LAEA, the knowledge input from foreigners was crucial in kick-starting the sector:

"In the late 90's, early 2000's foreigners coming into the country started some small leather stores. Most of these people were European doing small production out of their garage with basic tools and some trained workers. This is when some outstanding items appeared in the market… Some of these people moved into shops and workshops and increased production. Kenyan designers got inspired by this work and started following this trend".

It is not uncommon to meet *fundis* that were trained in these first workshops. For instance, Hnb-11, who started his own unit in 2013, worked three years for Hnb-4 and another three for Hnb-25. In most cases however, *fundis* do not have access to the capital required to formalise a business. Consequently, they are usually employed by wealthier entrepreneurs who have the means and the capacity to manage a firm.

Table 7.2: Year of foundation and entrepreneur's education by provenance (handbag only)

	(1) Age (as of 2016)	**(2) Abroad degree**	
	Mean	**YES**	**NO**
Foreign	15.32	18	1
Kenyan	6.75	2	14

Source: Author's elaboration (survey data).

The number of Kenyan faculties and institutions providing a diploma in fashion design has grown in the last 15 years – e.g. Kenyatta University and the University of Nairobi offer courses in this subject, as does the Buruburu Institute of Fine Arts, Mcensal School of Fashion and Design and Evelyn College of Design in Lavington. As shown in section 7.4, most entrepreneurs in this sector have an academic degree in marketing, fashion, or design-related subjects. Yet, according to LAEA, most of these

local programmes still fail to provide the technical formation required by the sector: "at the moment, the problem is that these institutions lack the infrastructures/tools to offer technical training along with the theoretical preparation. Some teachers bring students to their workshop to train… In order to give them a state of the art sense of how things are practically done." Students are often employed for short-term apprenticeships at major workshops. As stressed by Hnb-18, "we play a major role in encouraging and helping young entrepreneurs. Last year three [students] from the Technical University stayed for two and half month. Their lecturers came. This year another group of three students came. KIE invites me to give a lecture to youths who want to start their business and they bring students here sometimes to see what it means to make leather goods…"

The low level of technical knowledge provided by training schools and the absence of large scale manufacturers and state institutions generating skills during the IS era implies that knowledge has to be created in-house, favouring investment in skills creation and boosting higher salaries to retain expertise. In fact, more attractive remuneration and working conditions are often the only way to prevent "labour poaching" – see section 7.6. As stressed by Hnb-2, "I always managed to retain my employees because I look after them and pay them well…" In the same way, Hnb-28 expressed its increasing concern over the lack of expertise and the consequences of this: "we struggle to retain expertise… There are few good workers in the manufacturing line. What happens is that there are many new people entering the market hunting for experts! Sometimes they poach the entire team… […] I try to pay them more, but that is an endless game, so I try to give them job security, pay for the medical and the pension…"

Designers such as Hnb-8, Hnb-4, and Hnb-30 who produce high-end handbags with considerable profit margins, seem to be less concerned with skills retention. This is mostly the consequence of the higher wages they can afford. Table 7.3 further classifies

producers based on their main audience, showing how manufacturers targeting high and medium-end markets tend to pay higher wages to retain expertise. While this is true also when it comes to newcomers' wages, the result is not significant. This can be explained by the fact that trainees are subjected to the market price as their skills are yet to be developed and there is therefore no particular concern in retaining them.

Table 7.3: Average wages for low- and mid-/high-end handbag manufacturers

	Salary (experts)	**Salary (new-comers)**
	Mean	**Mean**
High and Mid-end	38.3	17.27
Low- and Affordable-end	24.6	14
T-test	-2.162 (0.039) **	-1.63 (0.115)

Notes: In the case of the t-tests, the hypothesis to be tested is based a one tailed p.
P-values in parentheses (***, **, * indicate significance at 1%, 5% and 10% levels).
Source: Author's elaboration (survey data).

The third aspect defining the origins of the handbag sector is a general sense of distrust towards the government. Industrial policy for handbag manufacturers has been either absent (post-liberalisation period) or counterproductive (post 2006). Particularly, by concentrating on upstream export tariffs rather than downstream access to cheaper inputs, industrial policy increasingly favoured large tanneries over small-scale manufacturing. The introduction of a 20% export tax on the value of raw exports in 2007, increased to 40% in 2007 and 80% in 2012, was driven by the government's decision to encourage local processing in consultation with tanners. The consequent increase in export of wet blue that enabled production among large tanners did not translate into any direct benefits for handbag manufacturers. As shown in chapter six, only a few tanneries moved into crust and finished leather, mostly of low quality and inconsistent supply, which hardly fits the high standards of handbag producers. Whereas the government's strategy is to eventually tax the export of wet blue to favour further

value addition (Huaxia 2017), this still appears unrealistic given the dependency of the industry on wet blue exports and the lack of skills and market demand to convert the current production into finished leather.

At present, the main losers are mid- and high-end manufacturers experiencing high prices and difficulties in sourcing leather locally, while importing is further complicated by the *speed-to-market* that characterises the fashion industry and a 25% import tax. As stressed by Hnb-25, "we went up to Ethiopia to a tannery and the leather looked good and cheaper. We are thinking about importing leather from Ethiopia, [but] the tariffs are high…" Hnb-29, the largest leather goods company, is also struggling with leather sourcing: "we are considering importing leather from Ethiopia… The problem though is distance and timing… If we source from them, it's cash on hold and takes 30 days to process and ship... 60 days to turn it back into running… If we work with local tanneries it is 30-60 days from delivery so…" The problem of sourcing leather for manufacturers is well explained by LAEA's president: "if Ethiopia can give me leather at 1.6 USD/sqf, even if I have an import duty of 25%, I'm still better off both in terms of price and quality! Maybe when we start doing that, they will have a wakeup call that they need to do something about the local manufacturers. Unfortunately, for SMEs it is hard to be listened to […] We may have many orders for different kind of colours or design… It is difficult for me to satisfy the market needs under these conditions […]"

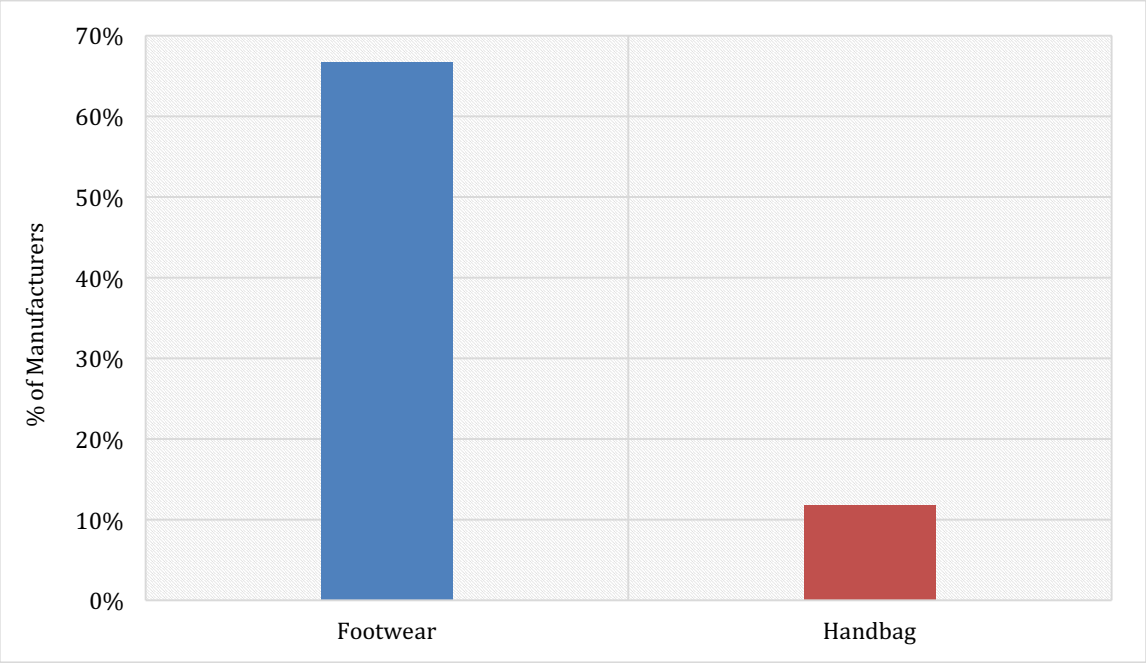
Handbag manufacturers have developed their independent sourcing practices along *domestic quality conventions*.[184] Most producers use different tactics to escape the red-tape and extra costs set in place by bureaucracy when it comes to input sourcing and product export. The general perception is that the government is not interested in

[184] For a definition of *domestic quality convention* see chapter five.

supporting SMEs, and SMEs, in turn, have no power to influence industrial policy. As stressed by Hnb-34, "they [the government] do not support anything on a small scale, they expect you to build massive companies […] They think we are a little bit of a joke really. They do not understand that something like this could be viable… For where I am right now I would give zero credit to the government! Or negative numbers, because they have actually impeded us by coming with all kind of red-tape."

Figure 7.15 reports the difference between footwear and handbag manufacturers when it comes to trust in government support. This is considerably lower among the latter. According to the handbag producer Hnb-21, "the government does not take manufacturing seriously […] Institutions here are 'talk' and I think they are not serious so I decided to move on at my own steam and forget about the government." Not having experienced IS, what handbag manufacturers expect from the government is to do less rather than more. As Hnb-16, a Kenyan bag and fashion designer in Karen, stated: "I'm disillusioned… What has the government done for me? […] The government has a lot of bureaucracy, a lot of talk, but the action is very slow. I'm not sure I want to wait for the government, I want the government to catch up with me." Similarly, Hnb-30 pointed out, "I am not interested in their (government's) stories […] I go to their forums and see people who do not even have workshops sitting and telling people how to run production, this is what is wrong. Those people are just busy talking and talking…" Hnb-26's words are indicative of many entrepreneurs' sentiments: "I walked alone on my own legs, no credit to the government whatsoever… I do not expect anything from them as I never received any support. To be honest, they have been an obstacle to my business…"

Figure 7.15: Trust in public institutions



Source: Author's elaboration (survey data).

7.7.4 Summary

Table 7.4 summarises the outcome of section 7.7. Footwear and handbag manufacturing originated in very different periods characterised respectively by a policy of IS in the 70s and 80s and EOI in the post-liberalisation era. While the footwear sector developed in a context of protectionism and government subsidies to large companies, handbag manufacturing emerged as a result of knowledge spillovers from few foreign-owned SMEs. The foundation of fashion institutes and university departments further created a backbone of expertise for the handbag-sector, which also offered attractive salaries to newly educated workers.

Contrary to footwear manufacturers who grew within a government-led industrialization model, handbag producers emerged in a more hostile environment dominated by foreign competition, lack of access to inputs, low skills availability, and no export support policy. This evolved into a sense of distrust towards government policies and the expectation that market survival depends exclusively on one's own

business skills – i.e. “standing on your own legs”. Whilst footwear producers advocate increasing government intervention through import duties and other protective measures, handbag manufacturers perceive state institutions as counterproductive red-tape.

The strategy of differentiation characterising handbag manufacturers favoured upgrading within new and more remunerative stages of the value chain. Conversely, the attempt by footwear producers to compete with prices of imported goods led to a reduction of production costs, quality, and labour conditions.

Following their origins within a regime of IS and the technical nature of apprenticeship in subsidised firms, footwear manufacturers paid less attention to extra-production aspects they did not master i.e. design, marketing, and branding. By contrast, handbag manufacturers’ upgrading has been enabled by knowledge availability, foreign capital, and low reliance on governance intervention in a post-liberalisation environment characterised by mounting competition. This has translated into innovation across all stages of the value chain, from design to procurement, branding, marketing, competition, and better working conditions to retain scarce capabilities.

According to Barney (1991, p.110), more complex physical technology is not a source of sustained competitive advantage since it is typically imitable. What is not imitable is the tacit knowledge underpinning its usage. In this respect, footwear producers exhibit a lack of capacity to adapt to rapid fashion changes, continuous design modifications, and innovative marketing platforms – all required to access high-end local and export markets. As specified by Goto (2011), unless firms are able to secure the economic rents embedded in these more complex functions, competitive pressures in the market may compel firms to compete by cutting production costs, leading to social downgrading.

Table 7.4: Summary of footwear and handbag manufacturers' characteristics

	Footwear	Handbag
Skills and knowledge origins	Apprenticeship within large firms and technical informal learning	Foreign labour / fashion-design institutions and faculties
Origin of capital	Large investors / state-driven	Small investors / foreign
Industrial policy	Import substitution	Export oriented
Stance towards government	Dependency and support-seeking	Distrust / lack of expectations / red-tape

Source: Author's elaboration (survey data).

7.8 Conclusion

Market access is a necessary but not sufficient condition for upgrading. It is necessary because handbag manufacturers could never have emerged if it were not for a new middle-upper class sharing a taste for African bags, design, and the financial capacity to afford premium products. Such a market allowed handbag producers the room to functionally upgrade and, in some successful cases, export to the global North. It is, however, insufficient to the extent that the same *high-road* approach did not emerge among footwear producers. Other variables influenced manufacturers' social and economic upgrading path.

Figure 7.16 graphically summarises the relationship between industrial policy and upgrading in the two subsectors. Footwear producers, whose success during the 80s and 90s was underpinned by a regime of IS, have failed to innovate in the aftermath of liberalisation. During this period, firms focused on technical production skills while aspects of product differentiation, design, marketing, and sales were overlooked as foreign competition was limited by IS measures. The transition to a policy of EOI in the 90's sparked a crisis among large subsidised companies, triggering an informalisation of the footwear market. Defied by the inflow of low-cost imports, trained workforces either clustered within tax-free informal hubs or re-trenched into the production of seasonal and corporate items to cut costs and avoid competition. Having experienced the benefits

of IS, several producers and institutions such as KFMA invested their resources in lobbying the government for the (re)introduction of import duties, leather subsides, and machineries provision.

By contrast, handbag manufacturing developed more recently via spillover from small foreign investments. Having emerged in a post-liberalisation scenario where state intervention was perceived more as red-tape than as incentive to compete, handbag manufacturers became disillusioned with government intervention. In order to define their market place under intense foreign competition and lack of state support, handbag producers channelled their knowledge and capital into an effort to differentiate production and increase market share. This effort triggered innovation in the form of product, process, and functional upgrading through the adoption of original branding and design; online marketing; e-commerce platforms; and customised sourcing practices. In this respect, handbag manufacturers did not "move up the ladder" from cut-make-and-trim (CMT) to OEM, to own-design manufacture (ODM), and OBM, as suggested in the GVCs literature (Gereffi 1999; Humphrey 2004; Goto 2007). By contrast, most of them entered the market as OBM and still operate within this segment with the required resources and capabilities.

A scarce skilled workforce – no large handbag companies existed beforehand in the country – has meant that handbag entrepreneurs have had to form their labour force in-house and/or through cooperation with recently established fashion and design institutes. In this respect, to retain skills and expertise, companies resorted to social upgrading through higher salaries and better working conditions. As reported in figure 7.16, the exact origins of foreign entrepreneurship in the handbag sectors remain historically contingent and in need of further research.

A sector's ability to target market segments characterised by more stringent standards and quality-oriented consumers has been previously associated with higher profitability and upgrading (Knorringa 1999, p.1593; Schmitz & Knorringa 2000, p.196; Staritz & Morris 2013). Yet, the upgrading trajectory experienced by handbag producers is subject to several limitations. Firstly, the size of the local and regional premium market is still very small and its development will depend on political stability and the government's capacity to generate sustainable long-term growth in the country. Secondly, whilst several studies point to *clustering* as an effective strategy for SMEs to compensate for low economies of scale in GVCs (Schmitz & Nadvi 1999; Giuliani et al. 2005; Nadvi & Halder 2005), this phenomenon has not emerged among handbag manufacturers. The recent efforts of the government and KLDC to promote the construction of *The Leather City* may provide new incentives. However, at present, the lack of coordination among producers and the fear of "copycatting" in a growing but still narrow local market threatens stagnation and, as more skilled actors enter the industry, *immiserising growth*.

This chapter pointed to an epistemological limitation within the current GVCs and GPNs literature in explaining divergent upgrading patterns at the firm-level. The development of in-firm capabilities could be framed within the GVCs 'up- versus downgrading' debate. However, the way in which the latter is rooted in the concept of entrepreneurship, individual learning, and institutional policy framework is yet to be explored. For example, how are we to make sense of divergent upgrading patterns within similar market conditions, institutional arrangements, and governance linkages? Although cross-dialogue efforts between the GVCs and industrial policy literature are evident (Milberg et al. 2014; Chang et al. 2016; Brandt & Thun 2016), this has

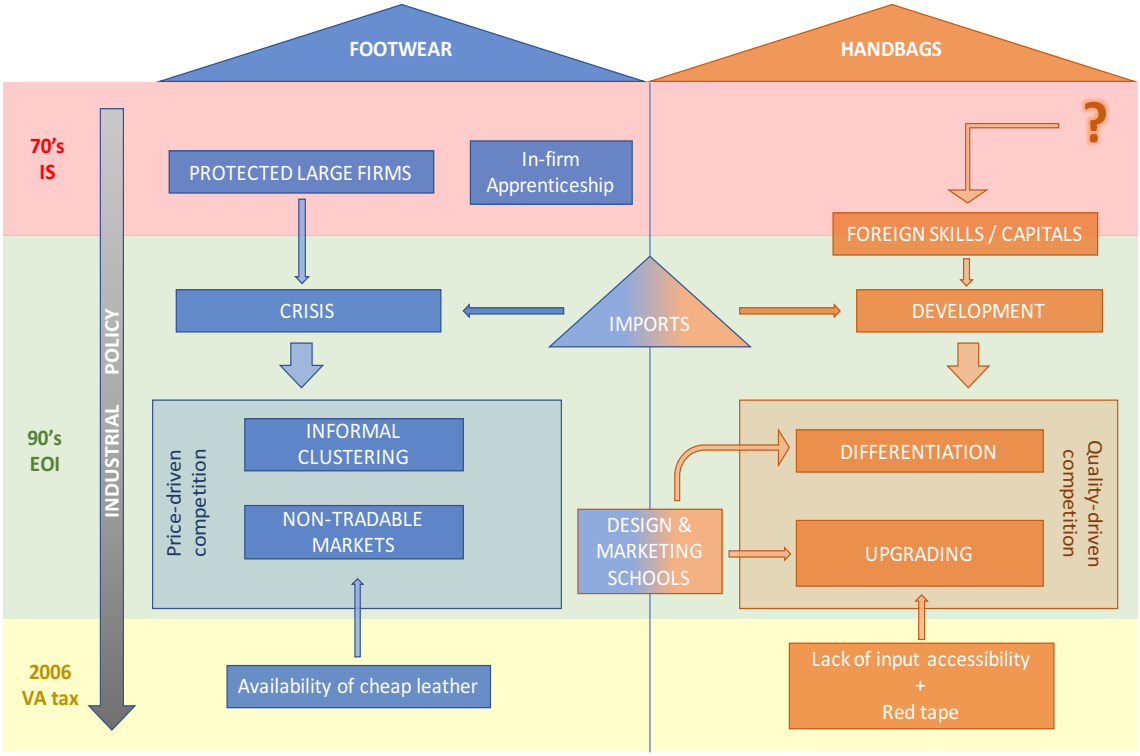
nevertheless developed with scarce attention to the in-firm dynamics where learning takes place and capabilities are shaped (Staritz & Whitfield 2017b; Butollo 2015a).

By combining the GVCs perspective with the literature on industrial policy, this chapter provides an innovative methodological angle to understand how inclusion of producers in value chains can lead to economic and social upgrading. As stressed by Lutz (2012, pp.473–474): "[i]nclusion of producers in value chains will not lead to poverty reduction if they are unable to develop a strong strategic position. Without strategic resources and capabilities, value created [by local producers] will be appropriated by other actors or transferred to final consumers. […] If requirements of GVCs […] do not allow smallholders to create strategic resources, local, regional or emerging markets value chain may provide better alternative options." However, the extent to which local firms seize alternative markets has been shown to vary considerably. Understanding how access to resources shapes firms' capabilities remains crucial to make sense of firms' upgrading.

Furthermore, this chapter has challenged the notion that local producers' upgrading is a necessary consequence of participation in low-end markets while learning from foreign investments in premium markets (Brandt & Thun 2010; 2016). Firstly, with some few exceptions, Kenya's internal market is not large enough to attract the localisation of foreign production. Secondly, Kenya does not currently share China's advantage of low production costs. By contrast, the low-end segment of the market is occupied by Chinese imports whose competition has proven unsustainable for Kenyan producers in the post-liberalisation era. In this context, the initial success of handbag producers seems to rest more on unique, high-quality handcraft and design rather than on lowering production costs and economies of scale. The extent to which a model based on SMEs can generate sustainable sectorial growth is highly disputed (Amsden

2001, pp.287–288).[185] However, much will depend on the government's capacity to provide the required incentives to initiate a clustering phenomenon while securing access to larger regional and global markets.

Figure 7.16: Summary of footwear and handbag manufacturers' historical upgrading



Notes: Figure 7.16 graphically summarises the relation between industrial policy, firms' resources, capabilities development, and upgrading in the two subsectors. The footwear industry emerged during IS within protected large firms, entering a spiral of informalisation upon liberalisation in the 90s. This was further enabled by the local availability of cheap leather that allowed a price-based competition with imported goods. Conversely, handbag production rests on an initial knowledge spill-over from some foreign investments whose origins are mostly contingent. Developing within a post-liberalisation period, handbag SMEs could quickly adapt their product and diversify in order to compete in local markets with cheaper imported products. Whilst representing a major obstacle for the subsector, the government's counterproductive policy and the difficulty in accessing quality inputs have generated a sense of distrust towards institutions that further fuelled functional upgrading into increasing stages of value addition such as branding, marketing, and retailing.
Source: Author's elaboration (survey data).

[185] The extensive literature on industrial districts in Italy and Latin America provides several examples in this sense (Giuliani et al. 2005; Rabellotti 1997; Guerrieri & Pietrobelli 2004; Guerrieri et al. 2001; Pietrobelli & Olarte 2002)

8.

Conclusion

This dissertation has provided a twofold contribution to the literature on GVCs and GPNs. Firstly, combining quantitative and qualitative tools of data analysis, it developed a mixed-methods framework to operationalise the concepts of governance and upgrading. This is particularly innovative as most of the literature has been dominated by qualitative case studies, limiting the potential for descriptive and causal inference of firm-level analysis. For this purpose, chapter four combined the use of PCS and FE linear and logistic regressions to estimate the correlation between market trajectories, governance, and upgrading. Furthermore, through a *difference-in-differences* model, the impact of government policy on value addition was evaluated. In chapters five and six, semi-structured interviews with Kenyan and Ugandan tanners were used to unveil the causal mechanisms underpinning the outcome of chapter four on governance and upgrading respectively. Drawing on a survey covering most Kenyan footwear and leather goods' manufacturers, chapter seven further combined qualitative accounts and descriptive statistics to evaluate the relationship between entrepreneurship, industrial policy, and upgrading.

Secondly, most of the scholarship on the topic has concentrated on North-South value chains and less on South-South and regional networks. In this respect, using the Kenyan leather value chain as a case study, this dissertation compared the relationship between local suppliers and buyers across developed and developing countries, paying

particular attention to the difference between the global South (i.e. China and India) and regional markets. Furthermore, through a comparison of the footwear and handbag subsectors, the study evaluated aspects of industrial policy, entrepreneurship, and regulatory governance in relation to firms' economic and social upgrading.[186]

Overall, the study pointed to how different market trajectories have different implications for local suppliers. While participation in North-South value chains is associated with higher product and process standards and more stable market relationships, it does not encourage value addition neither through outsourcing nor through *learning-by-exporting*. Conversely, southern buyers tend to interact with local suppliers more sporadically, pay lower prices, and implement inferior product standards. This outcome however is not consistent across the South, with India and Pakistan maintaining more direct and stable relations than China, and China paying higher prices than the former. Participation in South-South value chains is further observed to indirectly trigger firms' *exploration* into higher stages of value addition locally and regionally.

Despite being associated with lower product and process upgrading, regional markets represent the main alternative for small suppliers willing to explore new products and functions. Particularly, local and regional markets constitute an upgrading platform for innovative firms whose low capital endowments prevent them from accessing premium North-South value chains. In this case, industrial policy and entrepreneurship play a crucial role in enabling smallholders to innovate and upgrade in a competitive environment.

This final chapter is organised as follows: section 8.1 briefly summarises the outcomes of chapters four to seven. Section 8.2 further points to some policy

[186] See the definition of *external governance* in section 2.1.3 of chapter two.

recommendations that are specific to the Kenyan leather value chain. Finally, section 8.3 presents some major limitations and an agenda for future research.

8.1 Summary

Throughout chapters four to seven, this dissertation combined the analysis of firm-level export data and semi-structured interviews to evaluate the relationship between market trajectories, governance, and upgrading in the Kenyan leather value chain. In this respect, two interconnected stories emerge across the study: one about governance and the other about upgrading.

Concerning governance, this thesis analysed both aspects of *internal governance* between lead-firms and suppliers in GVCs as well as *external governance* in the form of regulations and policies. By comparing global buyers across a South-South and North-South divide, it further evaluated aspects of regulatory governance characterising developed and developing markets – e.g. process and product standards, social and environmental regulations.

The results show how lead-firms across the South and the North adopt similar hierarchical forms of interaction in governing their relationships with local suppliers. This casts doubts on the GVCs literature insofar as a certain degree of integration cannot be explained by suppliers' skills and product complexity alone. Qualitative analysis comparing sourcing practices, regulations, stability, trust, and quality conventions across different market trajectories allowed for a better understanding of how similar forms of buyer-supplier integration characterise both price-driven South-South value chains and quality-driven northern markets: whilst governance is defined by product and process standards in North-South value chains, trust considerations linked to costs and uncertainty lead integration on a South-South trajectory. The

analysis further contradicted the notion that more relational forms of governance prevent functional upgrading, showing how tanners and manufacturers embedded in South-South and regional value chains are more likely to venture into higher stages of value addition.

Concerning upgrading, chapter four presented a first attempt at quantifying this concept both *between-* and *within-firm* using HS-codes and unit values. Accordingly, while northern markets are characterised by high process and product upgrading, regional markets appear to favour functional upgrading into manufacturing. This is particularly the case for smaller firms engaging in South-South and regional trade. Conversely, larger actors embedded in North-South value chains are typically clustered in more upstream stages of value addition. Drawing on a subset of Kenyan and Ugandan tanners, chapter six points to decreasing quality, standardised production, and lowering profits as the driving force of functional upgrading. Here, instability and low profit margins, rather than governance-ties and trade agreements, appear to be the real driving force behind value addition as they boost the *exploration* of new strategies and markets over the *exploitation* of old tasks.

Finally, building on the relationship between upgrading and *external governance*, chapter seven compared up- and downgraders across the value chain, shedding light on the impact that state regulations have on entrepreneurship and firms' social and economic upgrading. Footwear manufacturers who emerged during the IS period struggled to compete in the post-liberalisation market and, in many cases, entered the informal economy, competing on price and quantity. By contrast, growing within a post-liberalisation period, handbag SMEs quickly adapted their product to compete in local markets. In this context, the government's counterproductive policy and the difficulty in accessing quality inputs generated a sense of distrust among entrepreneurs

in the handbag industry, which evolved into the idea that "standing on your own legs" is better than waiting for institutional support. This process further fuelled functional upgrading into designing, branding, marketing, and retailing. The long-term consequences of this phenomenon remain nevertheless unclear.

8.2 Policy recommendations

Functional upgrading among Kenyan and Ugandan tanneries was not based on firms' up- or downstream linkages, but resulted from a quest for stability and profits that was preeminent among smaller actors. Tanners did not upgrade with technology transfers from their buyers, but rather through a learning process that was directly influenced by the market trajectories of their respective value chains. Moreover, while the introduction of duties arguably fostered an increase in the export of semi-processed wet blue, government policies have so far prevented rather than favoured further value addition into crust leather and manufacturing.

Even though Kenya and Uganda may not present a comparative advantage in the production and export of leather and leather goods, the gradual move of China towards the import of crust leather could represent a favourable situation. Chapters four and six further showed how the Chinese market attracts prices higher than the rest of the South and comparable to those of northern premium markets. While the role of China in South-South trade with regional and global partners has been vastly explored (Kaplinsky et al. 2011; Dallas 2015; Gallagher 2012; Song & Li 2011; Altenburg et al. 2008), the impact that this has at firm-level in the governance of GVCs warrants further attention. This is particularly the case in light of the growing importance of environmental and social standards, as well as increasing labour costs that are

characterising this economy (Butollo 2015b; Chan & Nadvi 2014; Afsharipour & Rana 2014).

In addition, the attempt of small and medium tanneries to explore regional manufacturing markets despite stiff Ethiopian and Chinese competition requires more research to understand the potential for successful market expansion and industrial policy measures. Given the results of chapters four to seven and considering the value chain overview presented in chapter three, some policy considerations can be advanced.

Firstly, regional markets are not sub-standard platforms as suggested by some authors (Goger et al. 2014, p.5; Gereffi & Frederick 2011; Schmitz 2006, p.568; Evers, Opondo, et al. 2014). On the contrary, they constitute suitable markets for local producers willing to upgrade into new functions. Suppliers' market knowledge and accessibility to locally sourced inputs invest them with an advantage over foreign firms, notwithstanding stiff foreign competition and deficient industrial policy. Furthermore, as the case of handbag manufacturing reveals, low product standards do not necessarily equate to low entry barriers and *immiserising growth*. Innovation is still possible and skills are often rewarded. Trying to link local producers to GVCs should be further complemented by the development of RVCs, for which Kenya is in a privileged position due to its availability of raw material, growing internal market, and well-established local entrepreneurial class. As stressed by several authors, supporting local actors is pivotal to prevent the formation of *enclave economies* with very limited benefits for the local population and the regional economy (Taglioni & Winkler 2016, p.26; Fessehaie & Morris 2013; Gallagher & Zarsky 2007).

Secondly, chapter seven pointed to how protectionist policies did not trigger suppliers' upgrading, which was instead enabled through the dynamism of an emergent entrepreneurial class. Moreover, as per chapter four, the government's strengthening of

export duties had a very marginal role in favouring value addition. For this reason, the Kenyan government should consider playing a *husbandry* role which pays attention to aspects such as training and access to locally-produced and imported inputs, rather than the implementation of *custodial policies* favouring large, yet less efficient companies.[187]

In this respect, industrial policy experts have pointed to Ethiopia as a successful model and one that should be imitated in the continent (Chang et al. 2016; Mbate 2016). Although certain measures undertaken by Ethiopia should be considered (e.g. credit issue with low interest rates from local banks and horizontal activities aimed at strengthening education, transport and energy access), Kenya has almost double the GDP per capita of Ethiopia and its growing local market has recently attracted foreign investors to gain shares locally (e.g. Danone acquiring 40% of Brookside Dairy in 2014, Carrefour and Woolworth entering the local retail market…) In these circumstances, while attracting foreign investments, it is nevertheless important to support those actors that have managed to functionally upgrade but are struggling to secure market share. Examples in this sense are: the promotion of curing premises to ensure that the quality of skins and hides is preserved; a reduction of duties on intermediate goods not just for exporters but also for producers operating in the local market; and a markdown of fixed costs such as energy-provision and logistics through targeted infrastructures.[188] The government should consider the upgrading of local institutional bodies such as KLDC, KIRDI, and TPCSI, whose roles have been crucial in supporting the upgrading of SMEs, but whose resources and mandate is often plagued by a lack of coordination and resources.[189]

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[187] See section 3.4 in chapter three.
[188] The most recent government decision to finance the construction of a leather park in Athi River near Nairobi and the 2016 acquisition of machineries for the Kariokor Market goes in this direction.
[189] The Ethiopia Leather Industries Development Institutes may serve as a model (World Bank 2015).

Finally, the Kenyan government should make sure that virtuous SMEs are included and prioritised in the country's economic strategy. Anchoring foreign and local investors' as well as large and small players' interests is more likely to result in technology transfer with a positive impact on the local economy (World Bank 2015, p.73). The Leather Industrial Park promoted under the Vision 2030 can become an excellent platform for knowledge exchange and access to product and process upgrading. Its creation would allow smaller actors to benefit from knowledge sharing and spill-overs from major producers, while profiting from shared infrastructures. However, the risk is a co-option of the first as subcontractors for the latter – a situation that would perpetuate and cement the current gap rather than promote value addition and *exploration* into new and more profitable functional stages.

8.3 Limitations and scope for future research

Both the theoretical and methodological structure of this study present several limitations. Most of these have been already discussed and referenced in the concluding part of each chapter. This section recalls some of the most preeminent weaknesses of the research while making recommendations for further research.

From an epistemic perspective, the study would have benefitted from a comparative approach across multiple value chains and countries. Contrasting the results for the leather value chain with other agro-based industries in Kenya is a feasible task given the methodology presented in the previous chapters. However, it would be more complex to do so with other countries in the region to the extent that data is not always available or easy to acquire.

The use of the Ugandan case study in chapters five and six showed that countries with characteristics similar to Kenya, both in terms of availability of raw

material and industrial policy, are likely to share similar dynamics as those described above. Moreover, given the overall status of the leather sector in the region and the harmonised COMESA policy framework (UNECA 2015, p.105; Mwinyihija & Quisenberry 2013b), other countries are likely to present very similar dynamics to those observed in Kenya and Uganda.

To what extent these conclusions can be extended to other value chains with very different characteristics is probably one of the most pressing questions emerging from this research. Kenya's share of horticultural and tea exports to the South and the Region has been increasing, while a growing number of firms are producing apparel in Nairobi and Mombasa's EPZs. Whilst most of these import their garments from Asia and re-export apparel to Europe and the US, some actors are trying to operate regionally while developing their local value chain. For instance, a Kenyan entrepreneur in Nakuru has recently integrated apparel- with garment and cotton production from Uganda at a cost highly competitive with his competitors in EPZs. Hiring over 1500 workers and producing for some among the most renowned European and American brands, he further diversified his market with a 30% regional share. As to the question of why he does not follow the EPZs model, he replied: "they are not Kenyan like us. I have to live and survive in this country. Those guys came here on a mission. They have rented premises and they will simply close down and go to another country… Their paradigm is that they are not putting serious cash… In a garment factory 2 million USD is enough…. But it is a textile mill that costs 30-40 million USD."[190] His model of locally integrated value chains could shed further light on the relationship between entrepreneurship, market trajectory, and upgrading. In particular, a comparison between

[190] In 2016, he was the first African to be elected president of the International Textile Manufacturers Federation.

the market strategy of local entrepreneurs and that of foreign firms operating from EPZs would be enlightening in this respect.

The growth of regional supermarkets and horticulture value chains has been researched and compared to traditional North-South channels (Evers, Opondo, et al. 2014; Barrientos, Knorringa, Evers, Margaaret Visser, et al. 2016). Most of these studies seem to confirm Reardon's *transnationalisation* argument, according to which regional networks are reproducing the market structure of northern economies with high entry barriers and constrained profits for smaller actors (Henson & Reardon 2005, p.251; Funcke et al. 2014). Yet, a more comprehensive analysis extending to South-South trade and including quantitative models as those presented in chapter four would increase the inferential power of these studies and allow for more generalizable claims to be made.

The implications of this research for non-agro-based sectors, such as electronics, automotive, and services, remains to be tested. These value chains display very distinct dynamics in terms of labour and technology-intensity and, except for services, they are mostly absent in the region. While no claim can be extended from this study to cover such sectors, the methodology provided here can still be applied to the extent that the data is available. Further work should aim at widening the analysis to these sectors and comparing results with those obtained here.

Furthermore, future research should consider the complementary use of import data to illuminate on the level of backward integration among suppliers. Lacking reliable input-output figures disaggregated by firm, only a cross import-export analysis at firm-level would help answer this question. Such an analysis could strengthen the argument that northern buyers are more likely to entertain close governance relations with their suppliers through direct control over their inputs.

Another aspect that requires further research is the impact of formal and informal institutions on buyers' governance strategies. This study has benefitted exclusively from fieldwork conducted in Kenya and Uganda with local suppliers. Buyers were only marginally consulted. Yet, for instance, chapter five pointed to how Chinese laws have allowed direct exporting (i.e. without traders' mediation) only since 2004. This and other constraints are likely to play a role in defining firms' relationship with their suppliers, with implications for the latter's upgrading. For this purpose, more research should be conducted to understand the conventions shaping buyers' behaviour in their country of origin.

Most of the present scholarship on GVCs and GPNs is increasingly concerned with new forms of governance in emerging value chains, such as online services and digital platforms. To a certain extent, a tacit understanding exists that traditional value chains have been sufficiently explored and studied, and that it is now time to quantify this work at a sectorial level (Taglioni & Winkler 2016). As stressed by Mayer and Milberg (2013), "[w]ith the collection of case studies available, it is difficult to attribute causality and to generalize […] What is needed, therefore, are carefully and systematically conducted studies of a representative sample of cases." This is certainly true, but what this dissertation has emphasised is that such work is required also at the micro firm-level. For those who have attempted it, summarising and drawing lessons from case studies that use very diverse and unclear methodologies is often a tedious task. In order to achieve coherent aggregated results, assuming that these are desirable and useful at all, a valid, reliable, and generalizable approach should be applied at all

levels of aggregation in the value chain and not just the sectorial and national macro-levels.[191] This study constitutes a first attempt to do.

[191] For a definition of multiple levels of aggregation in the value chain refer to Ponte and Sturgeon (2013).

Appendix to chapter 4

Table 4.8: Upgrading, governance, and firm size by market trajectory

Value Chain	Functional Upgrading	Product Upgrading	Governance (internal)	Supplier Firm Size
North-South	High - due to high production costs and financialisation in the North; knowledge transfer and learning	High – due to high product and process standards in the North and learning-by-exporting	More relational and integrated (long-term stable relationships)	Large size due to high entry costs
	Low – due to tighter downstream control			
South-South	High – due to innovation transfer and "learning-by-importing"	High – due to similar factor endowments and innovation transfer	Less relational and market based (short-term unstable relationships)	Smaller size due to low entry costs (but higher competition)
	Low – due to lower labour and environmental costs and the reproduction of North-South unbalanced trade relations	Low – due to lack of product and process standards		
Region	High – due to less intense control and market knowledge	Low – downgraded platform for suppliers who cannot compete in global markets	Less relational and market based (short-term unstable relationships)	Smaller size due to low entry costs (but higher competition)
	Low – due to lower production costs of other Sothern countries, reproduction of S-N unbalanced dynamics, high competition and industrial policy			

Source: Author's elaboration, based on literature review in chapters two and four.

Table 4.9: Product groups and categories

Product	Functional stage
Raw cow hides	Raw material
Raw sheep skins	
Raw goat skins	
Raw camel hides	
Raw reptile skins and others	
Wet blue cow hides	Wet blue
Wet blue sheep skins	
Wet blue goat skins	
Wet blue camel hides	
Tanned reptile skins	
Tanned fur	
Wet blue fish skins and others	
Crust cow hides	Crust and finished leather
Crust sheep skins	
Crust goat skins	
Crust fish skins	
General finished leather	
Offcuts	
Apparel	Manufacturing
Handbags and travelware	
Belts	
Saddlery	
Wallets	
Gloves	
Gut articles	
Leather sandals	
Leather footwear	
Shoe components (uppers, soles…)	
Other leather articles	

Source: Author's elaboration.

Table 4.10: Importers and exporters coding

Code	Definition
C	Tanneries
CM	Tanneries with integrated manufacturing
D	Trader of final goods (intermediary to retail)
D+	Trader of final goods likely to be trading imported goods
F	Holding financial company
L	Logistics company (freight and forwarding)
M	Footwear or leather goods manufacturer
N	Company with no involvement in the leather value chain[192]
P	Private citizen[193]
S	Retail store likely to be selling locally produced goods
S+	Retail store likely to be selling imported goods
SM	Retail store with integrated branding and production
SM+	Retail store with integrated branding, but outsourced production
T	Traders of intermediate goods (intermediary to manufacturing)[194]

Source: Author's elaboration.

The classification of suppliers and buyers provided in table 4.10 is significant to assess the mediated impact of governance on upgrading. Given the current dataset, the best way to establish the level of integration in the relationship between buyer and supplier is through an assessment of the nature of the buyer and the supplier in accordance with Palpacuer's (2005) definition of *mediated* and *direct trade*. Based on an initial qualitative assessment of buyers involved in the chain and their respective modus operandi, governance relationships have been defined following a twofold structure.

[192] For instance, a construction company buying leather gloves.
[193] People can be storeowners, traders, or private buyers as well as specific people within each of the other categories. However, "person" represents only 1.6% of the total export value between 2006 and 2015. 85% of their purchases are in manufacturing and 80% are directed to the regional market. This shows that "person" buyers are mainly purchasers of finished products for either own consumption or, most likely, informal retail purposes in neighbouring countries. From a buyer perspective, "person" exports represent only 0,23% of the total value with 48% concentrated on footwear and leather goods and 18% on excluded goods.
[194] Traders indicates both: (i) companies that buy merchandise on their own account, owning stocks that they then re-sell to manufacturers in the country of export; as well as (ii) "converters" who finance purchasing on behalf of retailers on a commission basis (Palpacuer et al. 2005).

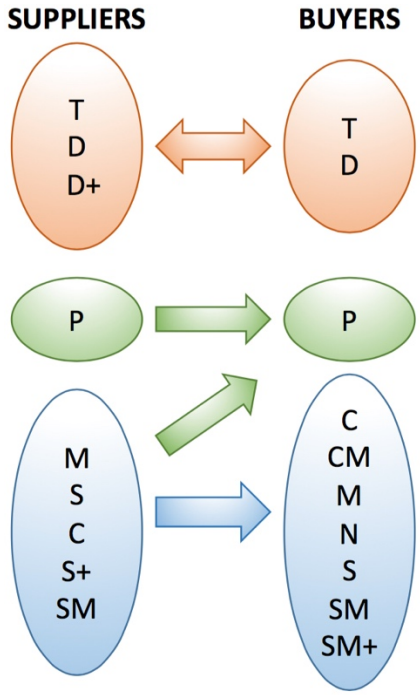
On the one hand, direct governance implies a direct relationship between the local supplier and foreign finisher, manufacturer, or retailer. Interviews with Kenyan suppliers confirm the link between direct sourcing and higher process and product standards. Some buyers want direct control over the chain to select material and control quality in the processing phase. According to a tanner: "Many process changes within the tannery are dictated by requests from finishers buying directly and sharing specifications and standards. Now more than before the client comes and tells you what exactly they want and suggests on how the process should take place..." (Tan-1)

On the other hand, indirect governance implies that the relationship between local suppliers and foreign buyers is mediated by a trader purchasing the material on his own behalf. There is no direct contact between the finisher overseas and the Kenyan supplier and material is provided based on generic specifications. In general, the implementation of quality standards is usually less stringent when the relationship is with a trader.[195] Most traders stock the material upon arrival and re-sell it to finishers based on specific orders. The chain is therefore characterised by an extra-segment constituted by the trader. According to some Kenyan tanners, despite prices may be higher in some cases, there is less trust involved in these relationships and more instability both in terms of contract and stability. A major tanner pointed to the fact that both traders and direct buyers tend to visit the premises and engage in direct communication with the supplier: "However, they do it for different reasons. [The first] are more interested in quality and specifications, whereas [the latter] come mainly for commercial reasons and lack of trust..." (Tan-2) In this context, tanners ignore who the trader is selling the semi-processed wet blue or crust to, generating in this way a gap in

[195] The typical standard here is the TR 20-40-40: a product standard that is usually applied by buyers to indicate the quality of wet blue.

the information flow across the chain: "They buy straight from factory, so we don't know which tanner will get the material…" [196] (Tan-4). In this respect, indirect relationships resemble to a market-based structure based on arm-length relations between buyers and suppliers (see table 2.1).

Figure 4.3: Direct, indirect, and personal sourcing practices



Notes: Direct sourcing practices are indicated in blue, indirect sourcing practices in red, and personal sourcing practices in green. The double arrow implies that the presence of a trader either among the suppliers or the buyers is enough to consider the relationship "indirect", whereas the one-way arrow implies that in order to be considered "direct" the relationship requires the presence of an element from both the buyer and supplier subsets.

Drawing on the classification presented in table 4.10, direct sourcing is operationalised as the relation between a tannery, manufacturing unit, or retailer with any other tannery, manufacturer, store,[197] or end-buyer. Conversely, indirect sourcing

[196] In some cases, to decrease export-related risks (e.g. non-payment, lack of credential, missing cargo…) suppliers may refer to an external agent that oversees the export procedures; such agents however are not traders in Palpacuer's (et al. 2005) definition of entities that "buy merchandise on their own account […], who own stocks at their expense and re-sell products". They are rather "converters" whose specifications originate directly from the finisher/manufacturer or retailer. This aspect is further considered in chapter five.

[197] In table 4.10 retailer and store refer to S, S+, SM and SM+

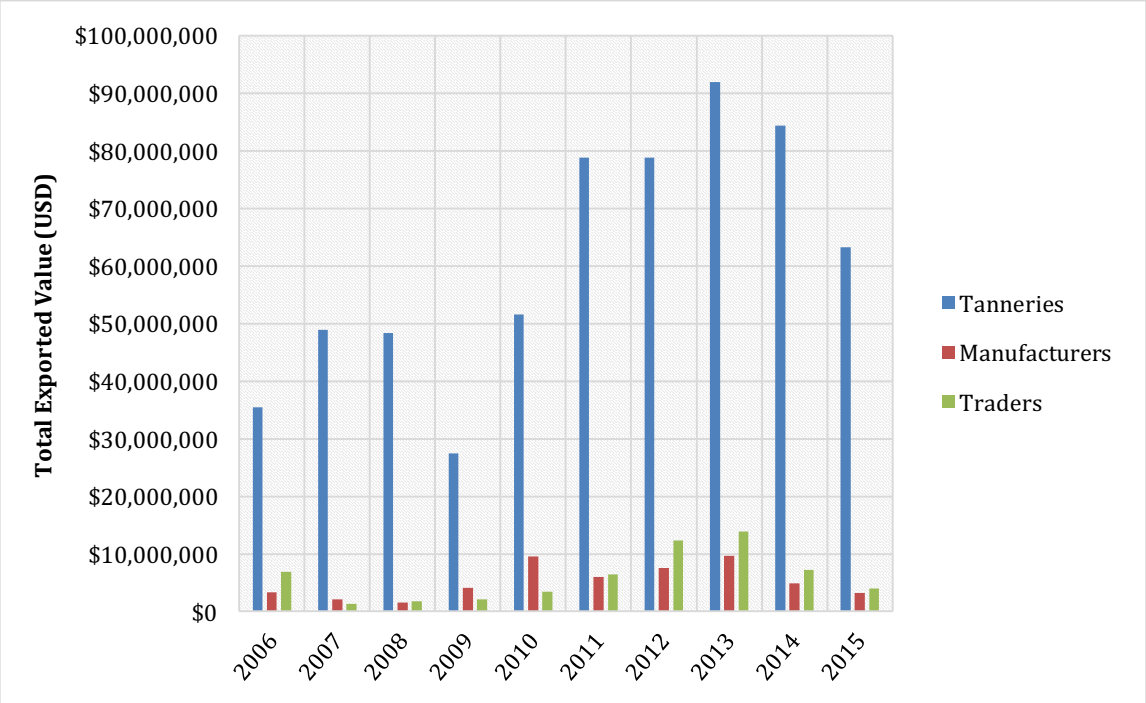
indicates a relation where either the supplier or the buyer (or both) are traders.[198] The logic is graphically presented in figure 4.3.

It is important to notice here that the relation between sourcing and value chain governance cannot be ultimately assessed on the base of the two categories described above. While elements of trust, quality evaluation, standardisation and their respective impact on governance are explored in chapter five, there are several cases where the buyer-supplier link is personal – i.e. characterised by the mediation of private citizens (identified by the green colour in figure 4.3). This is often the case in regional exports of manufacturing where it is particularly hard to understand whether the buyer is a trader, a retailer, or both. While their identification is facilitated by the way their license numbers is coded in the data,[199] the informal nature of this links make it particularly hard to draw significant conclusion on their function within the value chain from the data alone. While this is arguably the case, in the analysis in chapter four, personal linkages are coded as indirect.

Figures 4.4 and 4.5 provide further data on total exported value by kind of buyers and suppliers across years.

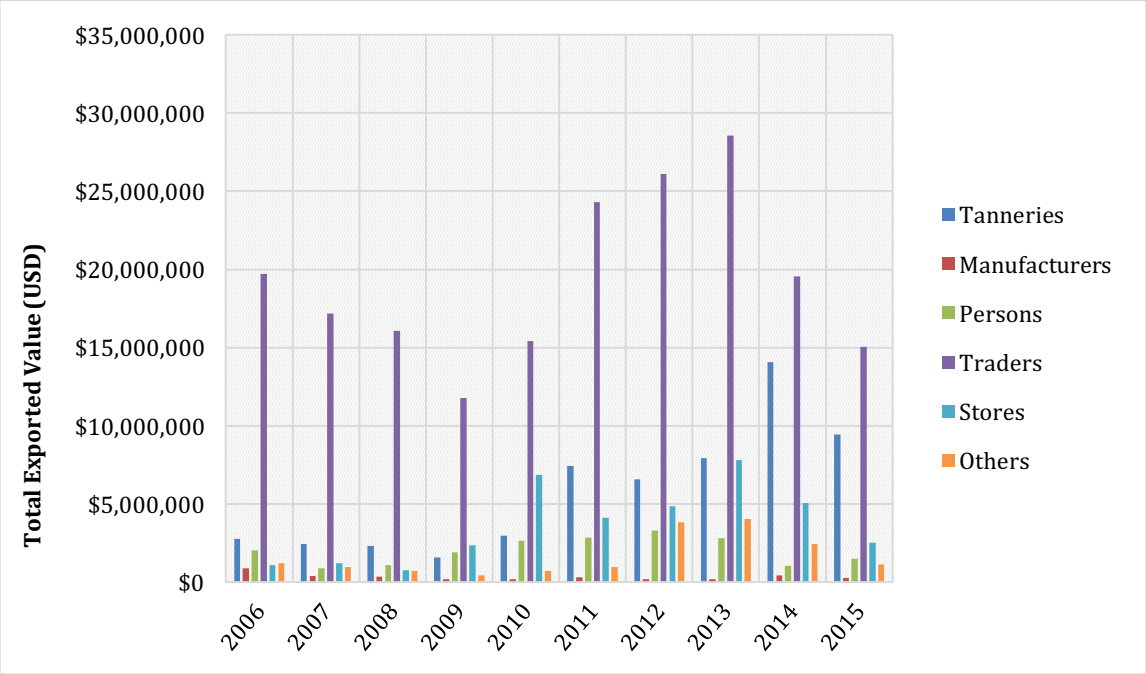
[198] In table 4.10 traders refers to both T and D, D+.
[199] KRA adopts different codes for private citizens and registered businesses.

Figure 4.4: Yearly exports by kind of supplier



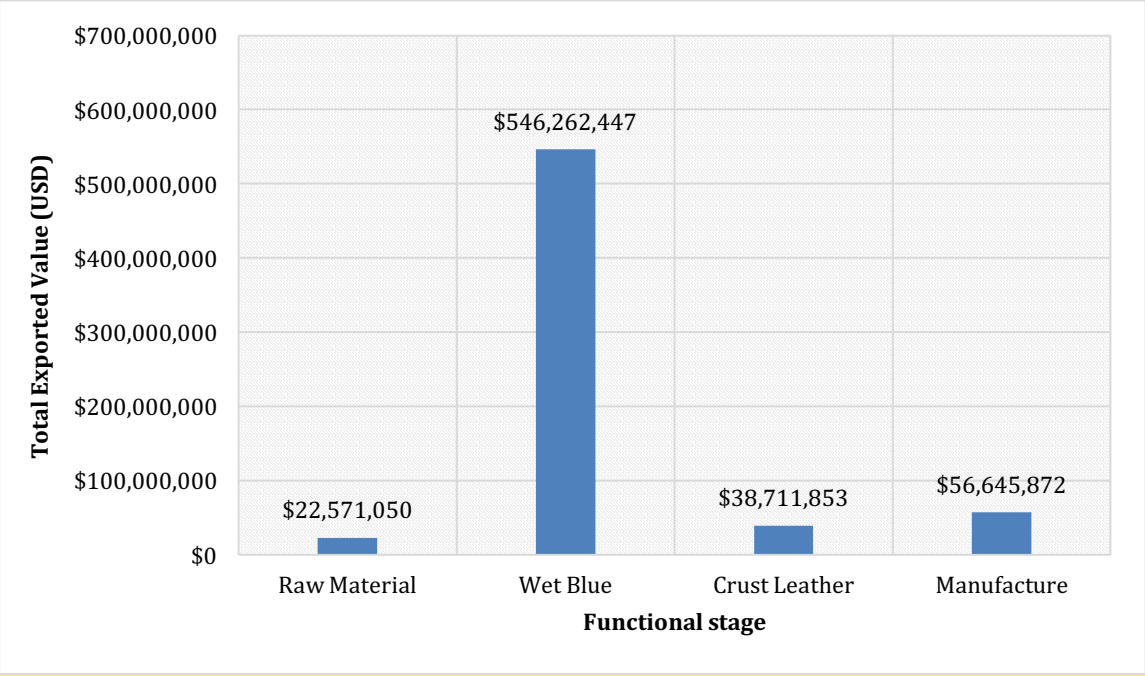
Source: Author's elaboration based on official export figures.

Figure 4.5: Yearly exports by kind of buyer



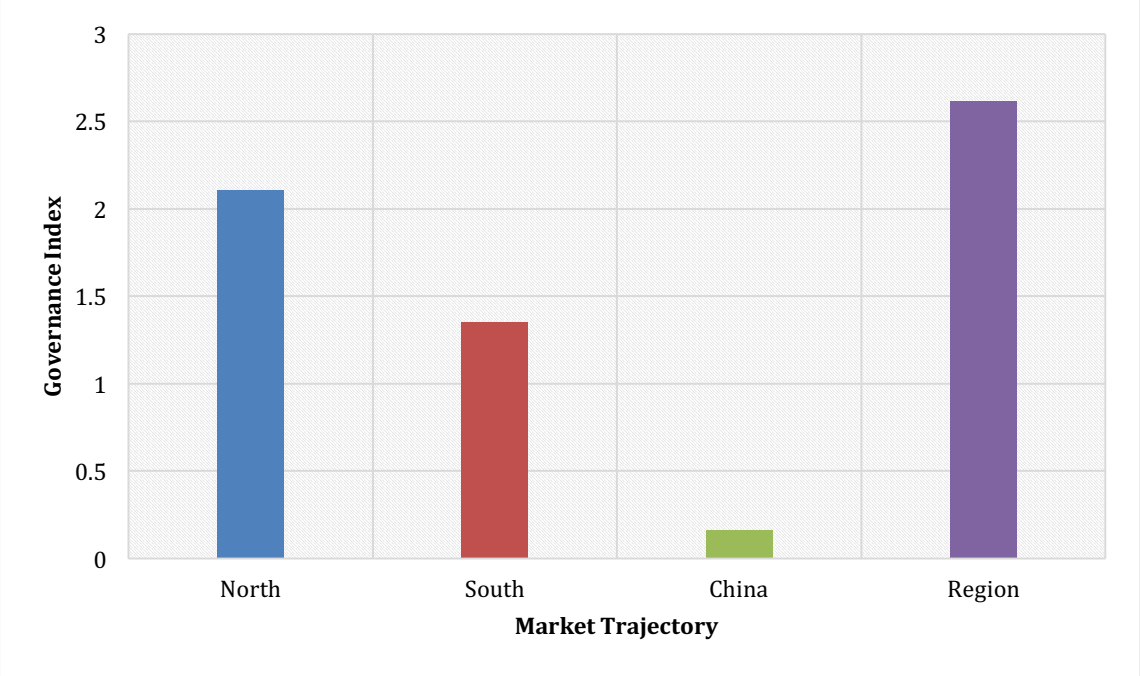
Notes: Whereas the number of traders acquiring Kenyan production has been unstable, but with no consistent growth since 2006, that of tanners has displayed a staggering trend (increasing by 5.2 times since 2006) – missing about 50% of data in terms of total exported value.
Source: Author's elaboration based on official export figures.

Figure 4.6: Exports by functional stage, aggregated data (2006-2015)



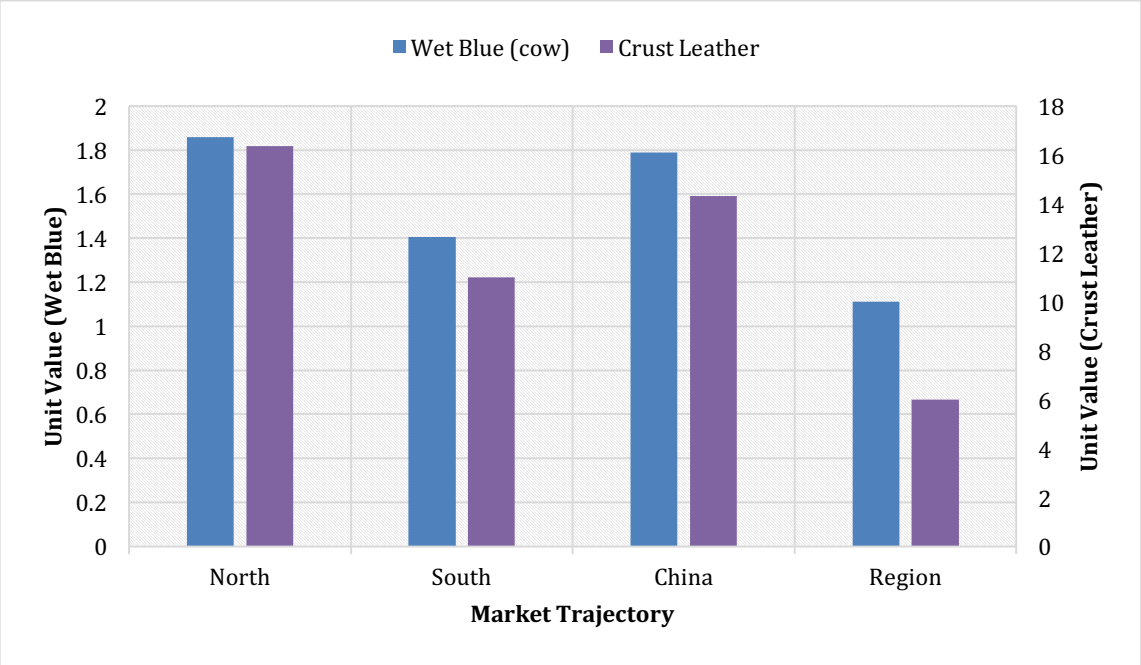
Notes: Refer to chapter two for panel data on the distribution of each functional stage by year.
Source: Author's elaboration based on official export figures.

Figure 4.7: Percentage of exported value by market trajectory and form of governance



Notes: Missing about 50% of the data in terms of exported value.
Source: Disaggregated export data.

Figure 4.8: Unit values by market trajectory (USD per Kg)



Source: Disaggregated export data.

Table 4.11: Exports by functional stage in absolute values, disaggregated by market trajectory

	Raw Material	Wet Blue	Crust Leather	Manufacture
North	$424,211	$246,293,486	$23,999,974	$8,747,464
South	$3,818,262	$124,981,262	$2,667,853	$1,026,444
China	$18,259,821	$170,633,697	$9,753,180	$48,138
Region	$68,756	$4,354,003	$2,290,846	$46,823,825

Notes: Most regional data for the category finished, goods, and footwear are missed due to the major informal cross-border trade in these sectors (*int.* KLDC; KFMA; LAEA). Regarding raw material, KLDC estimates that a 15-20% of the total value may be missed due to smuggling activities.
Source: Author's elaboration based on official export figures.

Table 4.12: Exports to the Region by functional stage in absolute values, disaggregated by year

	Raw Material	Wet Blue	Crust Leather	Manufacture
2006	$8,891,263	$32,288,353	$1,295,123	$3,186,779
2007	$2,186,779	$45,318,275	$1,266,317	$2,383,610
2008	$589,281	$45,250,938	$1,851,262	$2,570,837
2009	$363,270	$26,788,527	$521,644	$4,313,474
2010	$160,285	$48,038,867	$2,711,920	$9,580,551
2011	$1,289,212	$71,032,245	$5,457,621	$6,681,862
2012	$5,315,192	$70,224,825	$6,057,171	$8,092,976
2013	$1,347,289	$85,765,078	$6,359,317	$9,887,756
2014	$1,260,397	$72,004,340	$6,303,117	$5,914,851
2015	$1,168,081	$49,550,999	$6,888,361	$4,033,176

Source: Author's elaboration based on official export figures.

Table 4.13: Exports to the South by functional stage in absolute values, disaggregated by year

	Raw Material	Wet Blue	Crust Leather	Manufacture
2006	$1,307,228	$10,847,660	$618,827	$16,065
2007	$637,726	$11,951,220	$305,295	$4,257
2008	$158,155	$11,830,130	$948,973	$586,612
2009	$141,320	$7,177,144	$134,192	$2,489
2010	$6,371	$12,127,396	$120,292	$89,266
2011	$409,891	$16,223,650	$433,668	$61,196
2012	$978,392	$14,340,250	$24,880	$168,712
2013	$42,611	$13,472,798	$1,540	$37,674
2014	$107,590	$16,112,525	$45,597	$18,172
2015	$28,977	$10,898,488	$34,588	$42,001

Source: Author's elaboration based on official export figures.

Table 4.14: Exports to China by functional stage in absolute values, disaggregated by year

	Raw Material	Wet Blue	Crust Leather	Manufacture
2006	$7,488,328	$8,000,105	-	$719
2007	$1,455,719	$8,712,237	$39,211	$582
2008	$409,506	$12,495,332	-	-
2009	$220,849	$13,014,584	$215,402	$16,770
2010	$153,066	$19,922,002	$308,615	$4,531
2011	$699,862	$21,383,701	$773,744	$199
2012	$4,287,995	$23,852,943	$1,764,214	$3
2013	$1,295,828	$29,746,356	$2,626,381	$11,090
2014	$1,148,570	$20,149,023	$2,231,214	$10,058
2015	$1,100,099	$13,357,414	$1,794,399	$4,186

Source: Author's elaboration based on official export figures.

Table 4.15: Robustness regressions for table 4.3 (functional stages on market trajectories)

Dependent Variable: Functional Index						
	(1) Raw Material=0; Wet Blue, Crust Leather, Manufacture=1		**(2) Raw Material, Wet Blue=0; Crust Leather, Manufacture=1**		**(3) Raw Material, Wet Blue, Crust Leather=0; Manufacture=1**	
	Gologit (no SI)	**LPM**	**Gologit (no SI)**	**LPM**	**Gologit (no SI)**	**LPM**
Region	0.382 (0.854)	.057 (0.036)	5.124*** (0.369)	0.506*** (0.11)	4.191*** (0.749)	0.495*** (0.136)
China	-4.52*** (0.356)	-0.218** (0.093)	-2.345*** (1.066)	-0.245** (0.104)	-4.607*** (0.566)	-0.219** (0.102)
South	-3.128*** (0.358)	-0.06** (0.030)	-1.771*** (0.489)	-0.23*** (0.077)	-1.992*** (0.499)	-0.195** (0.091)
SI	-	0.014*** (0.004)	-	-0.051*** (0.009)	-	-0.059*** (0.012)
Constant	4.380*** (0.699)	0.646*** (0.084)	-1.658** (0.723)	1.013*** (0.156)	-1.830** (0.775)	1.089*** (0.185)
Observations	28,471	28,435	28,471	28,435	28,471	28,435
R-squared	0.4699	0.2125	0.4699	0.7182	0.4699	0.7789

Notes: SEs clustered by firm are reported in parenthesis.
P-values (***, **, * indicate significance at 1%, 5% and 10% levels).
Control variables not reported are year-dummies (2006-2015).
Weights – both regressions are weighted by the ln of the respective transaction real value.

Table 4.16: Robustness regression for table 4.5 (functional stages on government policy)

Dependent Variable: Function (raw material=0; wet blue, crust leather, manufacture=1)	
	LPM
Post '07	0.020 (0.029)
Post '12	-0.011 (0.021)
Post*Treatment '07	0.373*** (0.144)
Post*Treatment '12	-0.182* (0.094)
Treatment '07	-0.555*** (0.133)
Treatment '12	-0.738*** (0.096)
Constant	0.956*** (0.031)
Observations	28,471
R-squared	0.4679

Notes: SEs clustered by firm are reported in parenthesis.
P-values (***, **, * indicate significance at 1%, 5% and 10% levels).
Weights – regression weighted by the ln of the respective transaction real value.

Appendix to chapter 5

Example of interview questionnaire with answers:

(1) Address and contact:

(2) Ownership (nationality and how acquired):

(3) History:

(4) Annual production in square feet (2006 vs. 2015):

(5) Number of employees:

(6) Total production (2015):

(7) Maximum level of processing achieved (wet blue/crust/finished):

(8) Production % of wet blue / crust / finished:

(9) What levels of quality do you produce of wet blue (grades) and crust and finished?

(10) How did the quality of this production change?

(11) Main export markets and what you export to them:

(12) Best export market for quality:

(13) Agent or direct relations? Why?

(14) Market strategy (what do you want to achieve in the next 5 years):

(15) Have you ever made a change to the production process due to a request made by one of your client?

(16) Certifications:

(17) Functional upgrading (insource + outsource / new stages / branding / new markets)?

(18) Process upgrading (process standards, new machines, new managerial organisation, data automation)

(19) Product upgrading (new products, new styles/grades, new packaging or branding approach)?

(20) Logistics:

(21) Supply (one or multiple, owned or not):

(22) Are your workers unionised?

(23) Any other CSR activity done for workers (special allowances, canteen)?

(24) For the main countries you sell, indicate whether clients tend to remain the same or whether they change constantly:

Buyer	Always same	Small change	Keep changing
NORTH			
CHINA			
SOUTH			
REGION			

Further comments:

(25) For each of the 5 customers indicate whether your relationship is based on contracts (for multiple containers across a certain time); single but constant orders (delivered with regularity); sporadic orders (without regularity):

Buyer	Contracts	Constant orders	Sporadic orders
NORTH			
CHINA			
SOUTH			
REGION			

Further comments (payment method):

(26) For each of the 5 customers indicate the type of standards/specifications they require (use + to indicate low standards; ++ to indicate medium standards; +++ to indicate high standards; leave blank if no standards are required):

Buyer	Product	Process	Social	Environment	Origin	Others
NORTH						
CHINA						
SOUTH						
REGION						

(27) How does each of the 5 customers evaluate the quality of the supplied material?

Buyer	Trust	Direct control at production site	Direct control on arrival	Third party evaluation (e.g. agent)
NORTH				
CHINA				
SOUTH				
REGION				

(28) For each of the 5 customers indicate who is more "stingy" in negotiating prices and tend to impose its price on you:

Buyer	Imposes its own price or harsh negotiations	Accept your price or relaxed negotiations
NORTH		
CHINA		
SOUTH		
REGION		

(29) For each of the 5 customers, please rate the following characteristics in terms of their importance given by the buyer (0-not important / 5-very important):

Buyer	Volume	Price	Quality	Variety
NORTH				
CHINA				
SOUTH				
REGION				

Appendix to chapter 6

Table 6.6: Tanneries' functional upgrading

	Employees	Month sqf (hides)	Month sqf (skins)	Functional Stage			
				wet blue	crust	finished	shoes
Tan-1	300	1,300,000	1,600,000	70%	20%	10%	-
Tan-2	170	600,000	1,000,000	100%	-	-	-
Tan-3	100	300,000	500,000	90%	X	10%	-
Tan-4	80	600,000	800,000	90%	X	10%	-
Tan-5	150	500,000	300,000	90%	X	10%	X
Tan-6	90	400,000	100,000	100%	-	-	-
Tan-7	100	600,000 sqf finishing only		-	X	100%	X
Tan-8 (S)	80	700,000	-	98%	X	2%	-
Tan-9 (S)	50	400,000	100,000	75%	X	25%	X
Tan-10	125	600,000	400,000	30%	30%	40%	-
Tan-11	60	200,000	200,000	97%	X	3%	X
Tan-12	40	200,000	100,000	98%	X	2%	-
Tan-13 (S)	70	-	1,000,000	80%	X	20%	X
Tan-14	10	40,000	50,000	90%	X	10%	X
Tan-15	2	500-1000sqf mixed		X	X	100%	-
Tan-16	-	On hold					
UGANDA							
Tan-17	400	2,300,000	1,200,000	100%	-	-	-
Tan-18	150	450,000	900,000	100%	-	-	-
Tan-19	200	700,000	1,200,000	100%	-	-	-
Tan-20	96	800,000	-	95%	X	5%	-
Tan-21	50	600,000	-	100%	-	-	-
Tan-22	65	200,000	200,000	50%	X	50%	X
Tan-23 (S)	10	100,000	100,000	95%	X	5%	-
Tan-24	10 (25)	2,500 mixed		-	X	100%	X
Tan-25	(on hold)	-	5000 skin-yr	80%	X	20%	-
Tan-26	61	110,000	350,000	100%	-	-	-
Tan-27	70	675,000	-	100%	-	-	-

Notes: "pl" stands for a plan enter this stage in 1 or 2 years; "S" next to the tannery name indicates that the tannery is a subcontractor for more than 50% of its production.
Source: Author's elaboration (survey data).

Table 6.7: Percentage of sales by market (2015)

KENYA	North	South	China	Region	Subcontract
Tan-1	62%	5%	28%	5-10%	-
Tan-2	20%	26%	47%	7%	-
Tan-3	-	27%	63%	10%	-
Tan-4	48%	12%	25%	15%	-
Tan-5	5%	40%	45%	10%	-
Tan-6	15%	40%	33%	12%	-
Tan-7	-	-	-	100%	-
Tan-8 (S)	-	-	-	2-3%	97%
Tan-9 (S)	-	-	-	25%	75%
Tan-10	43%	3%	4%	50%	-
Tan-11	-	67%	30%	3%	-
Tan-12	-	90%	8%	2%	-
Tan-13 (S)	-	-	-	5%	95%
Tan-14	-	90%	-	10%	-
Tan-15	-	-	-	100%	-
Tan-16	-	30%	70%	-	-
UGANDA	**North**	**South**	**China**	**Region**	**Subcontract**
Tan-17	-	-	100%	-	-
Tan-18	20%	30%	50%	-	-
Tan-19	40%	20%	40%	-	-
Tan-21	70%	10%	20%	-	-
Tan-20[200]	15%	5%	65%	5%	-
Tan-22	5%	40%	5%	50%	-
Tan-23 (S)[201]	-	-	10%	5%	85%
Tan-24	-	-	-	100%	-
Tan-25	80%	-	-	20%	-
Tan-26	-	60%	40%	-	-
Tan-27	20%	30%	50%	-	-

Notes: Data based on export transaction dataset for Kenya (see chapter four) and author's interviews with tanners; “S” next to the tannery name indicates that the tannery is a subcontractor for more than 50% of its production.
Source: Author’s elaboration (survey data).

[200] 10% of total production goes to Tan-7 as subcontractor.
[201] Tan-23 sells 75% of its production to Tan-7 as subcontractor.

Table 6.8: Process and product upgrading among Kenyan and Ugandan tanners

Tannery	Product and Process Upgrading (last 5 years)	Unit price WB Hides 2015	Score
Tan-1 + Tan-18	Wet white technology; finishing and tanning machineries; acquisition of subcontractors; technicians	2.19	+++
Tan-2 + Tan-19	New management organisation; technicians; waste water plant; finishing and tanning machineries	2.51	+++
Tan-3	New tanning and finishing machineries; drying conveyer; technicians	-	++
Tan-4	Tanning and finishing machineries; technicians.	2.00	++
Tan-5	New Tanning and shoemaking machineries	1.33	+
Tan-6	Tanning machineries; technicians	1.71	+
Tan-7	Process curtailing (sold tanning equipment), subcontracting tanning	-	-
Tan-8 (S)	Finishing machineries, manufacturing machineries	-	+
Tan-9 (S)	None	-	-
Tan-10	Packaging and finishing machineries; truck; football leather; drying conveyer	3.15	+++
Tan-11	Finishing and tanning machineries	1.51	+
Tan-12	Finishing and tanning machineries	1.49	+
Tan-13 (S)	Finishing and shoe making machineries	-	+
Tan-14	Maintenance only	1.7	-
Tan-15	None	-	-
Tan-16	None	-	-
UGANDA			
Tan-21	New tanning machineries; land acquisition; skins introduction; technicians		++
Tan-20	Management and workforce reorganisation; new tanning machineries; finishing machines; no more skins		++
Tan-17	New tanning machines; land and company expansion and new labour organisation		++
Tan-22	Company acquisition; new tanning and finishing machines; skins processing		++
Tan-24	Finishing machineries and land acquisition		+
Tan-23 (S)	None		-
Tan-25	None (facilities rented)		-
Tan-26	New drums for skins, water waste treatment plant		+
Tan-27	New drums and land; plan to acquire crust machines		++

Notes: Scores are assigned based on the number of upgrading steps implemented and the absolute value of unit values compared to other tanneries. Whenever the unit value is above average and the tannery has implemented 3 or more upgrading steps, they are attributed 3 points, 2 if either the price is above average or a minimum of 3 upgrading steps have been implemented, and 1 if less than 3 activities have been implemented despite the price being below average. In the case of Ugandan tanneries only upgrading steps were considered with a maximum score of ++.
Source: Author's elaboration (survey data).

Table 6.9: Tanneries procurement channels and strategy

	Integrated	Loans and Centres			Trader-managed			Third
	Integrated slaughter	Soft-loans	Training	Collection centres	Premium quality	Trust based	Price based	Third party
KENYA								
Tan-1		X	X	X	X	X		
Tan-2		X			X	X		
Tan-3					X	X		
Tan-4					X	X		
Tan-6				X	X	X		
Tan-5					X		X	
Tan-7					X	X	X	
Tan-10	X						X	
Tan-13							X	X
Tan-14					X		X	X
Tan-9					X		X	X
Tan-15						X	X	
Tan-8						X		X
Tan-11							X	X
Tan-12							X	
UGANDA								
Tan-17		X	X	X			X	
Tan-18		X	X	X		X		
Tan-19		X			X	X		
Tan-21		X	X			X		
Tan-20						X		
Tan-22						X		
Tan-23							X	X
Tan-24							X	
Tan-25							X	
Tan-26					X	X	X	
Tan-27					X	X	X	

Notes: Tanneries listed by overall export turnover (2011-2015). “Integrated” refers to tanneries owning a slaughterhouse; “soft-loans” refers to the provision of advanced payments and loans to traders; “training” occurs if the tannery trains traders in procurement and selection; “collection centres” refers to tanneries that own external collection centres or curing premises; “premium on quality” is linked to the payment of a bonus based on grade; “trust-” and “price based” refers to whether the transaction was perceived by the tanner as being based on trust or exclusively on price as mirror of quality; finally, “third party” implies that the tannery does not procure the raw material itself.
Source: Author’s elaboration (survey data).

Appendix to chapter 7

Interviews were conducted with 24 tanners. This figure includes the entire population in Kenya (i.e. 15 tanneries) and 9 out of 11 tanneries in Uganda. Interviews were structured around the following themes:

- Address and contact
- Ownership details
- History of the company
- Production capacity
- Raw material supplying system (upstream governance)
- Levels of processing achieved and percentage of production by product and functional stage
- Recent product, process and functional upgrading activities and main reasons that triggered and/or facilitated their occurrence
- Future upgrading plans and motives to undertake them
- Main markets / clients: what do they buy, governance relationship (client stability, type of contracting, pricing and payment, standards)
- Labour conditions: employees, wages, working conditions, unionisation

Whereas most descriptive information defining the leather value chains are reported in chapter three, interviews have been conducted to determine sourcing practices, governance relations, and social and economic upgrading across the chain. For this purpose, the researcher has interviewed:

- Kenya Leather Development Council (KLDC)
- Kenya Department of Veterinary Services
- Kenya Footwear Manufacturer Association (KFMA)
- Kenya Shoe and Leather Workers Union (KSLWU)

- Leather Article Entrepreneurs Association (LAEA)
- Uganda Leather and Allied Industries Association (ULAIA)
- Footwear and Leather Goods Manufacturers and Exporters Association Uganda
- Informal footwear and leather goods manufacturers, as well as 2 finished leather retailers in Kariokor Market, Nairobi
- Ministry of Agriculture
- COMESA Leather and Leather Products Institute (LLPI)
- Kenya Revenue Authority (KRA)
- Kenya National Bureau of Statistics (KNBS)
- Export Promotion Council (EPC)
- Kenya Association of Manufacturers (KAM)
- Kenya Tanners Association
- The Kenya Industrial Research and Development Institute (KIRDI)
- The Training and Production Centre for the Shoe Industry (TPCSI)
- 3 formal shoe factories and 3 leather goods workshops
- 1 slaughterhouse and 2 skins and hides traders
- 1 international experts and leather agent
- 2 tanners and leather manufacturers in Italy
- 1 tanner in India and main buyer of Kenyan semi-processed material
- 65 manufacturers of leather goods (these are analysed in chapter seven)

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