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INSTITUTIONAL BROKERAGE AND THE GOVERNANCE OF GLOBAL VALUE CHAINS:
THE CASE OF THE US APPAREL INDUSTRY.

by

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DEDICATION

I dedicate this effort to my family and to all my friends who offered me nothing but encouragement in my pursuit of a doctoral degree at an age in which most people start thinking about retirement, and in particular to my wife Nancy, whose love and support made it all possible.
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ABSTRACT

In this qualitative study of the apparel industry, I analyze the governance of buyer-supplier interfaces in outsourced global value chains through an institutional theory lens. I set forth that transactional and relational cross-national barriers, linked to institutional distance between home and host country in outsourced production networks, and supplier capabilities are key determinants of variations in the governance mode chosen by lead buyers for their outsourced value chain. I further posit that lead buyers respond to the additional costs imposed by home–host country institutional distance and by structural supplier capability constraints, by means of governance modes that provide institutional brokerage, and examine how the lead buyers’ stock and strategic investment in institutional brokerage capabilities moderates both country and supplier level determinants of their governance choice.

This study contributes to theory in two ways: it provides an institutional explanation of lead buyers’ choices of governance mode in their GVCs, and introduces the institutional brokerage construct to describe lead firm strategies aimed at lowering the costs associated with home-host country institutional distance, and with the varying capability levels of supplier in the global value chain. The study also provides a useful contribution to management, by highlighting vital brokerage activities and capabilities that will be critical to implement successful global value chain governance strategies as
apparel global value chains migrate from East and South Asia to lower factor-cost countries, like Myanmar, Ethiopia, Kenya and Ghana, which are characterized by greater institutional barriers and a less mature supplier base.
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CHAPTER ONE

INTRODUCTION

The object of this dissertation is the governance of the buyer-supplier interfaces in outsourced global value chains (GVC). Through the analysis of transactional and relational cross-national barriers between the US and the main apparel suppliers to the US, I set forth that institutional distance (Kostova 1997), which reflects differences in cognitive, normative and regulative characteristics between two countries, and supplier capabilities are key determinants of variation in the governance modes chosen by US lead buyers for their transactions and relationships with suppliers in GVC host countries. I propose that lead buyers respond to the additional costs imposed by home–host country institutional distance and by supplier capability constraints, by means of governance modes that provide institutional brokerage, and further posit that the lead buyers’ stock and strategic investment in institutional brokerage capabilities moderates both country and supplier level determinants of their governance choice.

1.1 IMPORTANCE OF GLOBAL VALUE CHAINS IN THE GLOBAL ECONOMY

Global Value Chains (GVCs) can be described as the complex, interlinked cross-border value creation activities that bring a product to life from conception, to sourcing and manufacturing, and to the logistics and selling activities that deliver it to its end user
Their growing importance in the world economy is reflected in the increased attention from academia and international organizations; in particular, UNCTAD, after devoting the 2011 World Investment Report to non-equity entry modes (UNCTAD 2011), has dedicated the entire 2013 report to Global Value Chains (UNCTAD 2013). The economic importance of GVCs is undeniable: after adjusting for the double-counting inherent in the trade statistics for intermediate inputs of production, the total value of GVC economic output is estimated to be close to US$ 14 trillion by 2010 (UNCTAD 2013), with approximately 80% of the total coordinated by multinational corporations.

In recent years, there has been a strategic shift in structure and ownership of MNCs production networks, shifting from internalization with FDI with manufacturing subsidiaries owned and managed by the firm, towards externalization through global value chains (Buckley 2009). Improvements in communications technology, the upgrading of emerging markets vendor capabilities (Humphrey and Schmitz 2000) and patterns of mutual dependency between lead buyers and suppliers have resulted in wide range of governance structures in which effective control of production is decoupled from ownership of the productive assets (Herrigel and Zeitlin 2010). In many instances, what may have originally been a make-or-buy decision is now de facto a procurement decision, a form of a priori abstention-based outsourcing (Gilley and Rasheed 2000) by large firms that no longer have any in-house manufacturing capabilities, and are headquartered in countries that have lost their production capacity to emerging markets, primarily to China and other Asian regions. This country migration is exemplified by the GAP Inc., U.S.’s largest specialty apparel retailer, which sources 33% of its product in China, 26% in South
Asia and 25% in Southeast Asia, with the remainder located in central America, West Africa and the Middle East, and only 5% in developed countries (UNCTAD 2011). The GAP Inc. is hardly an exception in the US$ 200 billion apparel industry in the US, where 94% of all garments sold are outsourced offshore to developing countries and subsequently imported (Gereffi and Frederick 2010).

This drive toward strategic outsourcing (Hilmer and Quinn 1994) does not stop at dependence on outsourced manufacturing, but it extends to other sourcing services as well, as lead buyers pursue asset-light strategies to focus on core competencies (Prahalad and Hamel 1990), eschewing the investment and organizational complexity associated with non-core overseas operations. The decoupling of control over production from ownership of manufacturing assets raises the importance of governance of the buyer-supplier interface, with lead buyers adopting a variety of governance modes to control and manage their global value chain.

1.2 MOTIVATION OF THE STUDY AND RESEARCH PROBLEM

My interest in studying global value chains is motivated by what I consider a great paradox in IB scholarship: in spite of their importance in the global economy, until recently, global value chains have been generally neglected by IB scholars (Gereffi and Lee 2012), who continue to pursue a research agenda focused primarily on equity entry modes, and on the challenges associated with foreign direct investment by MNCs (Buckley 2002). Research on global value chains, on its end, has continued to be characterized by great unevenness and “theoretical eclecticism” (Gibbon, Bair et al. 2008). The existing research, and most notably by the Global Value Chain Initiative and its lead scholar prof. Gary
Gereffi, emphasizes the role of participation in global value chains for economic development in emerging economies, and looks primarily at transaction cost economics to explain their governance (Gibbon, Bair et al. 2008).

Although the subject of host country institutions has received some attention from scholars (Bair 2005), their role, and lead buyer strategies beyond the outsourcing decision itself, have not been incorporated in the proposed global value chains governance framework, which posits that governance modes are determined by three main factors: transaction complexity, codifiability of production knowledge and supplier capabilities (Gereffi, Humphrey et al. 2005). The neglect of host country institutions and of lead buyer strategies by IB scholarship is even more puzzling considering the transaction frequency that characterizes buyer-led GVCs, and of the governance challenges faced by developed economies MNCs seeking to exercise control over production, without ownership of productive assets, in geographically remote emerging economies, characterized by great cultural and institutional distance.

The broad research objective in this study is to gain a better understanding of the determinants of governance mode choices in global value chains. I propose that the choice of governance mode in each buyer-supplier dyad is shaped by institutional and structural factors, namely home-host country institutional distance and supplier capabilities, moderated by lead firm agency. I build on the liability of foreignness literature to analyze transactional and relational barriers at the cross-national business interface in GVCs within the cognitive, normative and regulative institutional pillars framework (Scott 2008). Framing the liability of foreignness in terms of cross-country institutional barriers,
allows me then to define lead firm strategies aimed at reducing the cost associated with
the liability of foreignness (Eden and Miller 2004) in terms of institutional brokerage.

1.3 RESEARCH QUESTIONS
This study seeks a more complete understanding of the determinants of the lead buyer’s
choice of governance mode for buyer–supplier dyads in the GVC. Specifically, what are the
key factors that play into the lead buyer’s decision whether to internalize the supplier
interface, with direct sourcing, or to externalize it, through agents or trade
intermediaries? To answer this main question, I developed a theoretical model that
identifies the differences between the institutional environments in the home and host
countries, supplier capabilities and lead firm strategies as determinants of the GVC
governance choice, leading to the following research questions:

1. How does home-host country institutional distance affect the lead buyer’s choice
   of governance in each GVC buyer-supplier dyad?

2. How do supplier capabilities affect the lead buyer’s choice of governance in the
   GVC buyer-supplier dyads?

3. How do the institutional brokerage activities and capabilities of the lead firm affect
   the lead buyer’s choice of governance in the GVC buyer-supplier dyads?

1.4 THEORETICAL APPROACH
The main theoretical lens throughout this study is institutional theory, with an ambition
to place some of its building blocks in context, understanding how they apply to global
value chains, and how they operate ‘on the ground’. Opening the ‘liability of foreignness’
(Zaheer 1995) black box, by breaking down institutional distance in a conceptual matrix of transactional and relational cross-national institutional barriers, and structuring my interview protocols accordingly, provided a strong theoretical compass to my field research. Scott’s cognitive, normative and regulative pillars of institutions (Scott 1995, Scott 2008), and the derived institutional distance construct (Kostova 1997) provide a helpful analytical framework to examine in detail the transactional and relational barriers in global value chains, and to understand how the associated costs drive the governance of the buyer-supplier relationship. The global value chains literature contributes greatly to the development of the theoretical model, through its focus on GVC governance (Humphrey 2001, Gereffi, Humphrey et al. 2005), and on supplier capabilities. My theoretical model retains supplier capabilities as a structural determinant of GVC governance. These structural factors, namely the barriers imposed by supplier capabilities, combined with the institutional distance between home and host countries, lead to a strategic response by lead buyers, in either developing or procuring of institutional brokerage to minimize the associated costs, and to maximize the benefits of global sourcing. This strategic response is evidenced in the governance choice.

Institutional brokerage has a static dimension, made up of transactional capabilities, centered on contracting and order management skills, and on sourcing routines and policies leading to operational effectiveness, and a dynamic dimension, founded on relational capabilities that maximize the lead buyers’ access to supplier capabilities and resources, and allow them to sense and respond more rapidly to trend shifts and changes in the global supply environment (Teece, Pisano et al. 1997). While
the former is a set of potentially imitable skills, the latter represents a strategic resource (Barney 1991), founded on a strategic choice to develop and enhance the accumulated stock of international business knowledge and cross-cultural intelligence, and a potential source of sustainable competitive advantage.

The level and type of lead buyer investment in institutional brokerage capabilities is interrelated with the GVC governance choice, with lower investment resulting in the externalization of the buyer-supplier interface to trade intermediaries. Focus on transactional institutional brokerage tends to be associated with a variable cost minimization strategy through direct sourcing, which emphasizes lead buyer control, contracts and transactional effectiveness, while focus on relational institutional brokerage reflects a social capital strategy aimed at maximizing firm product capabilities and access to resources in the global value chain, at a cost premium.

1.5 METHODOLOGICAL APPROACH

Because of the complexity of the phenomenon under study, I chose a qualitative constructivist research approach (Lincoln and Guba 2013), centered on in-depth interviews of key sourcing decision makers in the US specialty apparel retail sector. This particular subset of the US apparel industry is characterized by complete dependence on imports from a handful of developing nations (OTEXA 2015) and represents a perfect ‘laboratory’ for the study, with all firms sourcing through extended global value chains.

First, US specialty apparel retailers import thousands of individual styles (SKUs) from dozens of suppliers, primarily in China, South East Asia and South Asia, with a very
high number of cross-border interfaces. The sheer volume of cross-border transactional and relational ‘points of contact’, and the number of people and firms involved, amplify the barrier effect of institutional distance, and of the capability constraints at the supplier interface, exposing lead buyers to critical governance choices to deal with country risk, to control production, to monitor supplier cost, quality and delivery performance, and to ensure supplier compliance with labor and safety standards (Birnbaum 2015).

Second, the firms in my sample engage in a very large number of cross-border transactions of comparable complexity, producing goods of similar construction. This allows me to control for two of the three governance determinants suggested in the extant GVC governance literature: the complexity of the transaction and the codifiability of the product information (Gereffi, Humphrey et al. 2005). Finally, virtually all the specialty retailers in the sample are focused almost exclusively on sourcing for the US consumer market; this eliminates the concern that marketing interests in the host country (as would be the case of an entry in the Chinese market) could drive the decision where to source and the choice of governance mode.

Sampling for this study was purposive (Merriam 2002), aimed at reaching participants with the experience and a level of executive responsibility that could yield rich description (Geertz 1973), and help develop knowledge of how structural factors in the global value chain drive sourcing decisions and the governance of relations with suppliers. It was vital for this purpose to interview executives who have made governance decisions; the inclusion of executives with different stakeholder roles, key suppliers,
agents and intermediaries, contacted through a referral chain, was also critical to ensure study quality and trustworthiness through source triangulation (Lincoln and Guba 1985). Recorded interviews with 15 retail and apparel industry executives in the US, Hong Kong and Indonesia yielded over 650 pages of transcripts, and an in depth understanding of the interplay of structural factors in the GVC and lead firm strategies.

My preparation and construction of the interviews was strongly influenced by practical guidelines from ethnography (McCracken 1988), however the starting point of this research was a theoretical model, not a tabula rasa, and the participants’ profile required a stronger researcher voice in order to elicit informative responses than recommended in ethnographic studies or grounded theory. Interviewing business elites also requires the ability to challenge participants (Brinkmann and Kvale 2015) used to being interviewed and to expressing opinions ‘on the record’, to contribute more than ‘talking points’ and truisms about industry practices. I sought to use to my advantage an extensive business background in the areas of global sourcing and international trade, and to capitalize on the professional legitimacy coming from over twenty years of experience in business meetings and negotiations at the executive level. The ability to “talk shop” and engage executives with ease contributed to a more open dialogue, often resulting in a natural extension of the time initially set aside for the interview.

While the quality of interview contributions met my highest expectations, and resulted in the desired evolutionary co-creation of knowledge through consensus among participants, the use of interview data imposes natural limits to the generalizability of the
findings. By nature, qualitative studies are more phenomenology-focused than studies of direct cause-effect relationships, and do not result into directly testable hypothesis but rather in conditional propositions, which may not be generalizable beyond the domain to which they apply. That said, this study makes a plausible argument for an institutional analysis of global value chains by successfully applying it to one of the largest industry sectors operating in GVCs. Furthermore, with the institutional brokerage construct, it offers a framework for the inclusion of lead firm strategic capabilities in the governance mode calculus.

1.6 CONTRIBUTION

This study contributes to theory in two ways: it provides an institutional explanation of lead buyers’ choices of governance mode in their GVCs, and introduces the institutional brokerage construct to describe lead firm strategies aimed at lowering the costs associated with home-host country institutional distance and with the varying capability levels of supplier in the global value chain. The first contribution is achieved by breaking down institutional distance into a transactional and a relational dimension, analyzing the transactional and relational impact of cognitive, normative and regulative barriers at the buyer-supplier cross-border interface. In-depth interviews with experienced sourcing professionals reveal that these barriers are persistent and affect exchange at the interpersonal, firm-to-firm and country-to-country levels, and that the associated costs influence firm sourcing strategy. The second contribution proposes that lead firms engage in institutional brokerage, a series of activities that reduce institutional distance and its related costs, to maximize the economic arbitrage opportunities in their global value
chains. The relational complexity and transaction frequency of many GVCs, combined with lead buyers’ dependency on global production networks makes institutional brokerage more than just a series of operational effectiveness tasks, a checklist of I’s to dot and T’s to cross.

The study also provides a useful contribution to management, by highlighting brokerage activities and capabilities that will be critical for success, as apparel global value chains continue to migrate to lower factor cost countries, like Myanmar, Ethiopia, Kenya and Ghana, which are characterized by greater institutional distance and a less mature supplier base. Investments in institutional brokerage capabilities by the lead buyer or its intermediaries will be essential to overcome the barriers to exchange and coordination in these new sourcing markets. The optimal governance mode for the buyer-supplier relationship will depend on whether the firm directly, or its intermediaries can provide institutional brokerage.
This research studies the choice of governance mode of lead buyers in global value chains, in response to institutional differences between the home and host countries, and to differences in supplier capabilities. It builds on the existing literature on global value chains and analyzing governance choice through an institutional theory lens. In this chapter, I review the foundational literature on global value chains, with a special focus on their governance, and the relevant institutional theory, with emphasis on the pillars of institutions and on institutional distance.

2.1 GLOBAL VALUE CHAINS

The concept of value chain, first introduced by Porter, describes the full range of activities that firms and workers perform to bring a product from its conception to its end use and beyond (Porter 1985). These activities include design, production, marketing, distribution and support to the end consumer. Value chain activities can be internalized within the firm or divided among different firms. In the last few decades, value creation has spanned across borders, giving rise to complex global commodity chains (Gereffi and Korzeniewicz 1994). International production, which started with arms-length contract manufacturing and assembly work in low labor cost nations, gradually evolved to a more complex and strategically important component of the corporate strategies of developed market lead
firms. Technological upgrading of overseas vendors and export driven development strategies favored the emergence in developed economies of asset-light strategies that focused on core competencies, relying on smart outsourcing of a greater number of functions of increasing complexity (Gereffi 1999). This evolution gave rise to producer driven global commodity chains in capital and technology intensive industries (e.g. automotive), and to buyer-driven commodity chains in low tech, labor intensive productions such as apparel, footwear, toys, housewares, small appliances and consumer electronics (Gereffi 2001), which we call Global Value Chains. While the globalization of value chains has certainly been enabled by the operational efficiencies resulting from these technological and trade policy factors, the scale and scope of cross-national trade in global value chains (UNCTAD 2013), their growing importance seems to reflect a more permanent shift of the boundary of the firm, as MNCs refocus from internalization of activities and functions (Buckley and Casson 1976) to outsourcing.

The first articulation of this shift redefines the firm as a portfolio of competencies (Prahalad and Hamel 1990). Under this view, the future of organizations depends on their ability to develop (faster, and at a lower cost than the competition) core competencies that will spawn unanticipated products, technology or application breakthroughs that can translate into sustainable competitive advantage. It is critical to that effect that the firm dedicates all its available resources to the development of these core competencies. The valuable, rare, non-imitable and non-substitutable strategic resources so critical to sustainable competitive advantage (Barney 1991) are then the result of an unrelenting focus on core competencies. In order to focus on the skills that constitute them, firms can
make a strategic choice to outsource a number of non-core activities to outside firms (Quinn 1994); not only does strategic outsourcing reduce investment in non-essential or low value-added activities and functions, but it also allows the firm to outsource them to other specialized firms that make those particular functions and activities their own core competency, often resulting in superior components and greater operational efficiencies.

The reduction of trade barriers, especially after the Tokyo and Uruguay rounds of GATT, starting in 1973, combined with the emergence of ISO global standards in containerized shipping starting in the late 1960s, improvements in information and communication technology, and other advances in logistics created the premises for the slicing of the value chain across firm boundaries and national borders (Krugman, Cooper et al. 1995). These factors accelerated a trend towards the disintegration of production, enabling firms to offshore manufacturing activities to countries with lower factor costs, and eventually to outsource them to remote and geographically dispersed (Herrigel and Zeitlin 2010), and vertically specialized (Jacobides and Winter 2005) third party firms.

Global Value Chains (GVCs) are defined as a complex transnational chain of coordinated parallel and sequential value-added activities that transform raw materials into finished goods. Often directed by developed economies MNC firms, they represent the natural evolution of the international division of labor from simple trade of inputs of production and contract manufacturing to the de facto disintegration of production and its dispersion to geographically remote developing countries with more favorable factors and inputs of production. Production organized in GVCs is for the most part outsourced
to offshore production networks and is characterized by multi-step production and trade of intermediate inputs of production, which are finally shipped to the lead buyer as finished goods. Typically, the lead firms focus on the design and marketing of the products, and on directing and monitoring the GVC, while externalizing production and logistics to the firms that make up their Global Value Chains. The growth of Global Value Chains can be ascribed to the convergence of three synergistic factors. From the policy perspective, the reduction of trade barriers promoted by successive GATT Rounds beginning from the late 1950s enabled most low-income countries in East Asia to eschew import substitution in favor of export driven industrialization models, exploiting their labor cost advantages in low-tech production and assemblies. Lower tariffs and trade barriers, combined with various government industrial incentives to domestic and foreign investors, and the creation of special economic zones with tax and tariff exemptions, all contributed to creating a vibrant industrial base in East and Southeast Asia. Technological improvement in information and communication technologies, in particular after the advent of the internet is the second contributing factor. These advances have lowered transaction cost in dealing with remote vendors, and fundamentally moved the bounds of human rationality. More complex knowledge and information can now be codified, transmitted to geographically dispersed production sites and its use monitored in real time, in parallel and synchronously. It is now technologically possible for any manager to monitor production and intervene in case of any deviation from desired inputs or outputs, simultaneously at multiple locations from any office with an internet connection. This technological revolution shifts the make-or-buy calculus in favor of coordinated market
exchanges, further contributing to the disintegration and geographic dispersion of production.

These favorable trade winds and the shift in the information and communication technological frontier enabled a change in the strategic investment focus of developed country firms from core products to core competencies. Strategic outsourcing allowed firms to invest in strategic resources such as R&D, design, marketing and branding, while transferring large parts of production and shedding many non-core functions to third-party vendors, domestically and more commonly overseas, in lower labor cost emerging economies. This movement towards strategic outsourcing quickly reached a point of no return in the 1990s, as vendor capabilities quickly surpassed in-house capabilities, and greater economies of scale were achieved by vendors serving multiple buyers, with the risks associated with asset specificity better pooled at industry level rather than at the firm level. The benefits of specialization and lower transaction costs favored the disintegration of production in extended chains of specialized vendor-buyer relations, driven by lead buyers that design and market products but in many cases, have no substantial manufacturing assets. Because of this shift in capabilities, value creation has progressively shifted from production to ‘softer’ skills, with profits deriving not so much from economies of scale but rather from research, design, sales and marketing, and from the orchestration of supply capabilities with demand (Gereffi 1999). It is in this context that many lead apparel brand marketers became ‘manufacturers without factories’. In the buyer driven apparel global value chains, which are the focus of this study, lead buyers maintain a high level of control over production mode and on the value added along the
chain, compressing suppliers’ profits. The ability to coordinate remotely and closely control the activities of multiple vendors, enabled lead-firms to forego in-house production altogether, and to shed traditionally costs support functions like technical design, pattern-making, grading, and sample-making by transferring them to overseas contractors. This transfer was facilitated by a convergence of interests of suppliers seeking to upgrade their service capabilities to capture higher value added activities in the commodity chain, and the desire of discount stores such as Wal-Mart and Target, specialty retailers, and brand marketers to focus on design, sales and marketing. Thus, the vendor capabilities and lead buyers’ procurement approach continued to evolve from basic assemblies like cut, make and trim (CMT) in the apparel industry to full-package production, which includes inputs in design, raw material sourcing, and logistics (Gereffi 1999).

While, in theory, strategic outsourcing is a means to free up firm resources towards capabilities development, in practice, its fundamental calculus is transaction cost minimization, whereby the benefits of outsourcing must exceed the transaction and governance costs associated with market exchanges, a perspective that remains dominant in the analysis of global value chains. As a result, the commodity chains (Gereffi and Korzeniewicz 1994), that originally fed the procurement needs of lead buyers in developed markets, were initially characterized by strategies of tariff circumvention and international labor cost exploitation investments (Dunning 1981), with triangular trade among Europe, the US and developing countries, mostly in East Asia, where export driven
development strategies were embraced far earlier than in other low-factor cost regions (Dicken and Thrift 1992).

Outsourcing firms have benefitted from strategic outsourcing to global value chains in both cost leadership strategies and differentiation strategies (Gilley and Rasheed 2000). Some of the advantages of outsourcing are associated with the irreversible shift of economies of scale in production from the individual lead firm level to cluster or industry level, resulting in many industries in the substitution of the hierarchical vertically integrated firm with modular organizational forms (Schilling and Steensma 2001). By using specialized third-party vendors, lead firms not only reduce their investment in production specific assets, lowering their hurdle rate and break-even point, but also gain technological and commercial flexibility, benefitting from lower production switching costs. These tangible advantages are often accompanied by improved product quality resulting from the use of the best available outside resources. Taken to the extreme, strategic outsourcing has allowed the emergence of successful marketers of manufactured goods that have outsourced all production from their inception, a phenomenon described as abstention based outsourcing (Gilley and Rasheed 2000). Several apparel retailers in this research sample fit this description.

Countering the obvious gains in operational efficiency from strategic outsourcing, some scholars have pointed at serious risks associated with excessive reliance on it. Key among them are a decline in innovation capabilities of the lead firm, with a loss of R&D competitiveness (Teece, Pisano et al. 1997), and loss of touch with industry technological
breakthroughs (Kotabe 1992). The potential hollowing out of lead firms (Levinson 2013) due to this erosion of capabilities, is coupled with the risk of competitive market entry by suppliers (Prahalad and Hamels 1990), a phenomenon observed in recent years in the cases of Samsung and HTC in electronics, and Li & Fung in apparel. Concerns with the growing power and concentration of capabilities by large sourcing intermediaries have on occasion influenced lead buyer’s GVC governance choices, motivating the GAP’s to buy out Li & Fung’s equity stake in GAP International Sourcing Ltd, and Wal-Mart’s to bring in-house to its Walmart Global Sourcing subsidiary’s relationships with suppliers that were previously handled through Li & Fung (WSJ 2015).

2.1.1 GVCs IN THE INTERNATIONAL BUSINESS LITERATURE

In spite of the economic scale of global value chains, with value added close to 20% of total world GDP (UNCTAD 2013), until recently (Gereffi and Lee 2012), they have not received their due attention in the International Business scholarship as an entry mode at par in importance with equity entry modes, a research skew attributable to the legacy of the discipline’s early years. The IB field’s original focus was in some way an extension of theories of the firm, seeking to explain why firms internalize assets and activities across national borders, and choose to enter foreign markets with equity entry modes. The legacy of the internalization lens shared by original IB research (Hymer 1960, Buckley and Casson 1976, Johanson and Vahlne 1977, Dunning 1981, Johanson and Vahlne 2009) is that internationalization became somewhat synonymous with FDI, and with equity entry modes in general, leading the discipline to focus on the management challenges of MNCs investing abroad.
Global value chains represent a different course. Productive and non-core activities are externalized because, due to the trade policy evolution and technological revolution in the last half century, some of the premises for internalization no longer hold true. Lower transaction costs and accelerated knowledge codification and transfer, thanks to advanced computing and telecommunication, opened new opportunities for MNCs to outsource production and service activities, and to coordinate them across complex transnational networks of specialized vendors and subcontractors. In many cases, with the possible exclusion of capital-intensive oligopolistic industries, the locus of the MNC’s ownership advantages is their human capital and not the factory, and internationalization takes places largely without FDI. Internationalization through GVCs is largely asset-light, seeking to exploit location advantages through externalization of production. Unlike FDI, it keeps the boundaries of the firm in the lead firm’s home country, with the possible exception of some sourcing support functions that may be transferred to overseas subsidiaries.

2.1.2 GVC GOVERNANCE

The organization of production in networks of geographically dispersed clusters, across industry-specific agglomeration and industrial districts (Sturgeon 2001) raises governance costs for lead buyers seeking to control extended outsourced supply and production chains, supplier performance and their compliance with acceptable labor and safety standards. These global value chains tend to be neither markets, nor hierarchies but rather networks (Powell 2003) in which informal mechanisms of non-market coordination tend to be predominant because developing host countries do not have the market-
supporting institutions that characterize the US economic system (Sable and Zeitlin 2004), where an ad hoc arms-length contracting model is dominant (Langlois 2003). As a result, economic exchanges in global value chains are often coordinated within long-term informal buyer-supplier relations that require the lead firm to make substantial relationship-specific investments in staffing, systems and support activities, thus increasing their governance costs.

Governance choice, and the resulting level of control and power asymmetry (from market to hierarchy) in the apparel industry global value chains has been linked in the literature to three key factors (Humphrey 2001):

1. The complexity of the tasks transferred
2. The codifiability and institutionalized standardization of the requisite knowledge
3. Supplier capabilities, enhanced through industrial upgrading (Gereffi 1999)

Governance mechanisms in a product value chain are in place to control what goods are produced, the specifications and technology to be employed in producing the goods, the locations where production can take place, the timing of production, and the price of the various inputs of production and of the final goods (Humphrey 2001). Building on these three determinant factors, seminal work on the governance of global value chains has identified five modes, on a continuum from pure markets governance to pure hierarchy (Gereffi, Humphrey et al. 2005):

1. Market governance is characterized by contractual arrangements with third party firms to manufacture goods on behalf of the lead buyer. This type of governance
is based on transient contractual relationships to manufacture production intermediates or finished goods within specific tolerances, with expendable suppliers who compete on price with one another, with relatively low switching costs.

2. *Modular governance* is preferred when greater coordination between the parties responsible for different stages of the value chain is required; in these cases, the activities of the suppliers of inputs of production and finished are linked in coordinated production modules, to make the finished goods as specified by the buyer. The modules are relatively interchangeable and compete with one another on price.

3. *Relational governance* is dominant when the complexity of the supply chain imposes tighter coordination among the different stages of the value chain, with a steep learning curve in the buyer-supplier relationship that raises switching costs. In this governance mode, well-performing incumbents generally have a marked advantage over new suppliers, and a significant part of contracted work is given to the same suppliers from season to season.

4. *Captive governance* can effectively substitute for lead firm ownership of the manufacturing assets when dedicated production lines are a strategic driver for the lead firm. In this arrangement, the lead buyer has a long-term exclusive manufacturing contract with a third party that uses up its capacity. The underlying contract between the two firms reduces transaction costs on both ends, and makes switching uncommon and costly.
5. **Hierarchy.** In this instance, the lead buyer’s GVC is vertically integrated but may be geographically dispersed to various locations, depending on cost and availability of inputs and factors of production. This arrangement minimizes transaction costs and maximizes control over procurement, production processes and intellectual property.

The governance mode determines the network topology, the boundaries of the firm and the key international business interfaces. The apparel industry appears to rely largely on relational governance, with supplier and agent networks, and on modular governance, relying on trade intermediaries like Hong Kong based Li & Fung to orchestrate a modular value chain. The focus on transaction costs, industrial upgrading and governance in the outsourcing and global value chains research has been critiqued by some scholars, who press for greater attention to the institutional context in which the GVCs are embedded (Bair 2005). Specifically, Bair identifies institutional factors that can be as important as transaction costs and vendor capabilities in determining GVC governance. Among them, regulatory mechanisms and trade policies shape the geography and configuration of GVCs and the power relations among its participants; transnational agreements can influence location choices as much as factor costs. This is evidenced by the development of a very large apparel sector in a ‘difficult’ country like Bangladesh, in large measure because of its duty-free status with the European Union and the absence of production quota with the US. Finally, local social and institutional frameworks where the GVC operates, and where the local actors are embedded, have dramatic impact over their viability and efficiency.
This criticism by Bair echoes views of comparative capitalism scholars who view institutional arbitrage as equally important as factor arbitrage in internationalization. It has been shown for example that institutional factors (e.g. the protection of IPR) will limit offshore outsourcing in certain instances more than the intrinsic value of internalization (Doh 2005). In this context, relation building capabilities, and knowledge-sharing routines and systems appear critical for the firm to engage in strategic outsourcing. These drivers, combined with the commoditization of organizational practices, give rise to hybrid organizational forms and increased levels of network governance (Lewin and Peeters 2006). Global value chains represent a permanent shift in strategic firm boundary decisions that hinge on the relative efficiencies of markets vs. hierarchies (Holcomb and Hitt 2007). Many of the same transaction cost considerations that apply to offshoring of production apply to offshore outsourcing of services, with perhaps greater emphasis on organizational costs and on the uncertainties associated with relationship development (Ellram, Tate et al. 2007); as the support services component of outsourced production increases, these considerations increase in importance for global value chains as well.

As relationship development rises in importance, cultural and institutional distance between the lead buyer’s home country and the GVC host countries become more salient. Greater distance can be generally associated with rising relational costs, possibly affecting supplier and country selection, and as global value chains become more information-rich, interaction costs are emerging as critical determinants of the outsourcing decision (Walters 2007). These interactions are often complicated by the higher level of informality in economic coordination and exchanges in developing
markets, especially in East Asia, where vendors tend to be embedded in networks of social relationships (Granovetter 1985). These emerging economies see the prevalence of trust-based network governance structures (Gibbon, Bair et al. 2008) that can be incompatible with the more formalized system of contract based relations more prevalent in the US (Langlois 2003).

2.2 INSTITUTIONS

The GVC literature has given only cursory attention to host countries institutions (Bair 2005), and to the effects of cultural and institutional distance in global value chains (Gereffi and Fernandez-Stark 2016). However, it is reasonable to expect that both would have significant impact on the entry decision and on the governance of the buyer-supplier relationship, because of the transaction intensity and because the relational complexity intrinsic to its modular production networks. An argument could be made that business scholarship on institutions began with the acknowledgement of market imperfections, and with the question of the origins of the firm (Coase 1937), a vital institution in economic life that can be treated as an entity in economic modeling, but whose existence cannot be fully explained in a world of perfectly efficient markets. Institutional theory implicitly accepts market imperfections and the existence of the firm, and other forms of non-market coordination, to focus on defining institutions, and on explaining the behavior of economic actors as the resultant of institutional structure, and of economic and social agency.

A widely-adopted definition of institutions, and a starting point of institutional scholarship that would follow, is provided by North who defines institutions as “the
humanly devised constraints that shape human interaction and influence social, economic and political exchange. They can be described as the rules of the game in society” (North 1990). North further defines the field by explicitly distinguishing between institutions, the constraining structures, and organizations, political, economic and social entities created purposefully to exploit the opportunities afforded by the particular institutional framework and by economic opportunity. In taking advantage of these opportunities, organizations are also agents of institutional change. By defining institutions as both formal and informal constraints, North’s seminal work opened the field to a wide range of institutional effects, to analyze the influence of human society as it is with all its complexity on the organization and coordination of production and economic exchange. On the other hand, in continuity with the field of economics’ view of institutions as market imperfections, by defining them as “humanly devised constraints” (emphasis mine), North also oriented the field’s research towards a treatment of institutions as moderator variables, as inefficient and costly hurdles to economic exchange to be managed and overcome.

Although not impervious to change, formal and informal institutions tend to be stable, and in the short run they can be treated as social facts, external influences on individuals, that exert a coercive power on the individuals by means of education, social rules and norms, religion, and/or laws that are internalized by individuals (Durkheim 1893) and taken for granted. The process by which such internalization takes place has been described as institutionalization (Selznick 1956), a process that takes place in organizations, leading to the adoption of practices, norms and behaviors that over time
become infused with value, outliving their utility, to the point where the existence of the institution itself becomes the purpose of the institution. In an international context, the differences in institutionalized practices, norms and behaviors are part and parcel of the liability of foreignness. Owing in part to Durkheim’s social determinism, the early work on institutions tended to be top-down (structural, deterministic) models of institutional influence (Scott 2005), with social and economic actors as institution-takers. A more dynamic framework in which social and economic actors interact with stable institutions and bring about institutional change, was another key contribution of North’s research on institutions. In his analysis, institutions are stable in the short run, and but susceptible to path-dependent change effected by social and economic actors (North 1990).

Richard Scott extended North’s work on institutions and sought to refine the definition of institutions to include both formal and informal structural elements of social organization, identifying “cultural-cognitive, normative and regulative elements that, together with associated activities and resources provide stability and meaning to social life” (Scott 2008). This particular articulation of the pillars of institutions provides a versatile tool for comparative analyses of those cross-national institutional differences that are of particular interest in global value chains as sources of comparative institutional advantage that firms can exploit through institutional arbitrage (Hall and Soskice 2001). Under this lens, institutions are not just viewed as constraints, barriers to be lowered and overcome but also as factors of production, with specific cultural, normative and regulative institutional endowments favoring specific types of production, and contributing to determine the international division of labor. By subsuming both cognitive
and value-based interpretations of culture under the institutional domain, the pillars framework overcomes the shortcomings of approaches to institutional distance that limit themselves to the comparison of measures of formal institutions efficiency (e.g. World Governance Indicators). By accounting for all the formal and informal institutional factors affecting economic actors in cross-national business, the pillars framework paves the way for an institutional analysis of the liability of foreignness (Zaheer 1995).

2.2.1 INSTITUTIONAL DISTANCE

The additional costs associated with doing business abroad have been linked to ‘distance’; whether defined from the subjective perspective of psychic distance (Johanson and Vahlne 1977), or through purportedly more objective measures like cultural distance (Kogut and Singh 1988) or institutional distance (Kostova 1997, Kostova 1999, Kostova and Zaheer 1999, Xu and Shenkar 2002) ‘distance’ appears to be positively correlated with the liability of foreignness, raising transaction costs, influencing entry decision, and the specific choice of equity entry mode (FDI, acquisition or JV).

The concept of distance was introduced by the Uppsala School (Johanson and Vahlne 1977). Taking a firm-centric approach to distance, these scholars introduced the concept of psychic distance, defined as the perception of the risks posed by differences between the firm’s home country and host country environments to the free flow of information between firm and markets. Psychic distance is greater as linguistic and cultural differences increase, which leads firms to expand following an ink stain pattern, investing in countries that are more similar first, often neighboring countries, and only subsequently entering markets that are more distant (Johanson and Vahlne 1977). This
first operationalization contains *in nuce* many of the conceptual challenges for the distance construct, starting from the definition and measurement of culture and ‘environment’, down to questions of relevance of national boundaries in analyzing culture. In this context, Hofstede’s original work on national culture, measured along four dimensions (Hofstede 1980), subsequently extended to five (Hofstede and Hofstede 2001), has provided great impetus to the research on cultural distance: not only could differences between nations along key cultural dimensions be given a numerical value, but also the direction of those differences could provide insights on national differences in value systems, and help predict cross-national management challenges.

Hofstede’s four original dimensions were combined to create a single numerical cultural distance index, CDI, which in turn was used to predict MNC entry mode in foreign markets (Kogut and Singh 1988). The leading hypothesis of research on cultural distance is that the greater the cultural distance, the more the entering firm would prefer an entry mode that gives it greater control on its investment, choosing wholly owned subsidiaries to joint ventures and acquisitions. In many ways, this is simply an application of transaction cost economics and internalization theory, whereby high cultural distance is associated with higher information costs, more difficult transfer of corporate skills, and in general with greater outcome uncertainty, which can be mitigated through internalization of activities within the firm (Williamson 1985). Agency costs have also been shown to rise as an effect of cultural distance (Roth and O’Donnell 1996). This effect, however, varies across industries, and with firm experience with cross-border investments (Eriksson, Johanson et al. 1997). Furthermore, individual cultural dimensions
have sometimes proven to be better predictors than the CDI, as in the case of uncertainty avoidance (UAI) and FDI (Barkema and Vermeulen 1997, Shenkar 2001) suggesting that different cultural dimensions have different weights and that their influence may be domain specific. Extensive research on cultural dimensions and finance (Kwok and Tadesse 2006) also show more satisfactory greater predictive and explanatory power for individual cultural dimensions as opposed to the CDI.

In spite of its appeal and parsimony, the CDI oversimplifies an intangible and hard-to-measure construct (Boyacigiller, Kleinberg et al. 2004) and has been critiqued on several grounds. Shenkar, for example, argues that cultural distance is not symmetric (Da->b ≠ D b->a), that its effect on FDI is not linear, and that the casual link with entry mode is questionable (Shenkar 2001). More importantly, he questions whether besides being conceived as a hurdle, a negative moderator, cultural distance could also be in certain circumstances complementary and attractive, which would result in a reversal of predicted firm behaviors, and outcomes. The impact of cultural distance also seems to be mitigated over time by the process of acculturation, the diffusion of cultural elements in both directions (Berry 1980), and by staffing strategies, with expatriates and bi-cultural individuals catalyzing cross-fertilization (Shenkar 2001) at the cross-national interface.

In light of these complexities, it is not surprising that the overall evidence of the effects of cultural and institutional distance is mixed (Tihanyi, Griffith et al. 2005). Firstly, there are intrinsic issues with the reduction of a complex phenomenon to a simple scale: in the case of cultural distance (Kogut and Singh 1988), there are validity issues with both
the underlying dimensions of national culture (Hofstede 1980) and their combination in a non-weighted index (Shenkar 2001). Secondly, macro-economic factors such as GDP, GDP per capita and market size dwarf distance as determinants of FDI flows: a significant proportion of FDI is market-seeking and as result flows within developed countries, which are more homogenous in institutional development and tend to be geographically concentrated in North America, and in the European Union. Developed economies plus China, which takes the lion share of FDI outside of developed economies, account for over 73% of total FDI stock, and over 53% of total FDI flows (UNCTAD 2013). Finally, firm experience in internationalization also appears to play a role in the entry decision, and in the FDI entry mode, with more experienced firms choosing wholly owned subsidiaries over joint ventures even in market characterized by greater institutional and cultural distance where the distance model would predict externalization of risk.

The effect of cultural and institutional distance on the strategic choices of internationalizing firms has been analyzed under two lenses: the entry decision itself, and the entry mode, namely the MNC ownership and control decisions in the foreign market. Although the empirical findings have been somewhat mixed, there is a consensus that distance matters (Ghemawat 2001), and that MNCs tend to prefer entry in markets that pose fewer distance challenges. The challenges faced by firms entering markets with greater distance stem from an inferior understanding of the local culture and business norms (Meyer & Rowan 1977), and from the conflict between isomorphic local legitimization pressures and internal consistency within the MNC itself (Di Maggio & Powell 1983; Kostova & Zaheer, 1999). There is a natural tension between mitigating
entry risk by choosing joint ventures with local partners and exercising full control by
internalizing the risk with wholly owns subsidiaries. The cost of the trade-offs between
ownership and control seems to rise with distance.

The need for a more comprehensive treatment of distance that would capture the
complexity of cross-border exchanges leads to the concept of institutional distance
(Kostova 1997), which applies Scott’s pillars directly, by proposing the creation of country
institutional profiles, and then using them to measure institutional distance in home-host
country dyads. This study acknowledges that with institutions, thus defined, institutional
distance cannot be gauged through a fixed objective measure, but because it affects
different industry and areas of management differently, it requires a domain specific
instrument for its measurement to have applicable validity. Subsequent empirical work
using survey instruments with regulatory, normative and cognitive items in the
entrepreneurial domain (Busenitz, Gomez et al. 2000), and in the adoption of
organizational practices (Kostova and Roth 2002), confirms the promise of this approach
and lend support to this study’s use of the pillars framework in the analysis of institutional
distance in the domain of buyer-led global value chains. The IB interface is not only
affected by the cross-national differences in culture discussed above, but also by the
institutional environments of the host country, and by the institutional distance between
the home and host country (Kostova 1999). Based on the cultural-cognitive, normative
and regulative pillars of institutions (Scott 1995, 2008), the institutional distance
construct subsumes cultural distance, and accounts for differences in both formal and
informal institutions on firm internationalization strategies. By looking at institutionalized
culture it overcomes the dichotomy between cognitive vs. value based views of culture, finding place for both, with the cognitive pillar accounting for cognitive differences (language and schemata) operating at the interpersonal interface, while the normative pillar accounts for the organizing effects of host country values and norms at firm level. The interface between internationalizing firm and host country formal institutions is captured under the regulatory pillar.

Institutional distance poses conflicting demands on the MNC, with host country isomorphic pressure to adopt local practices to establish legitimacy (Kostova and Zaheer 1999) on one hand, and the need to transfer its successful corporate practices unchanged, unmitigated by the local environment (Kostova 1999). This situation of institutional duality (Kostova and Roth 2002) can give rise to internal strains within the organization, and possibly tilt the entry strategy to non-equity entry modes, when the internal costs associated with these strains exceed the anticipated costs of partnering with a host country firm. This could be the case, for example, when the level of informality of the host country’s economic exchange environment is incompatible with, or substantially different from strict formal governance structures in the MNC home country. There is a clear link between institutional distance, liability of foreignness and cost of doing business abroad (Eden and Miller 2004). However, the fact that the distance literature focuses exclusively on MNC equity mode market entries may be responsible for less than overwhelming evidence of decisive institutional effect on MNC entry decisions and on subsidiary performance (Tihanyi, Griffith et al. 2005). The impact of capital investment, and MNC characteristics may make established MNCs less subject to isomorphic legitimacy
pressure from the host country than the distance literature would predict, leading some scholars to suggest that MNCs entering foreign markets with equity entry modes operate in their own institutional field, shielded from host country institutional pressures (Kostova, Roth et al. 2008).

2.2.2 CROSS-BORDER BARRIERS AND INSTITUTIONAL DISTANCE

The domain specificity of country institutional profiles (Kostova 1997) suggests that institutional distance operates differently in different contexts and that the barriers to economic exchange can vary as a function of its associated activities. It is useful to this effect to analyze institutional distance in terms of the cognitive, normative and regulative barriers it creates at the cross-border business interface in global value chains.

The most obvious cognitive barrier in global value chains is linked to language: although English has become the lingua franca of trade, for most of the overseas suppliers it is a second or third language, learned in school and through trade. At the simplest level, these language barriers affect every aspect of the transaction, increasing search, contracting and monitoring costs, and complicate execution, where instructions are misunderstood and key information is ‘lost in translation’. The impact of communication failures is compounded by communication styles (Hall 1976) and, for many Asian hosts, by mianzi, the need to save ‘face’, which prevents them from acknowledging the communication breakdown. The linguistic barriers may have a more profound effect on both transactions and relations between US buyers and their overseas suppliers if we consider that linguistic differences may contribute to different perceptions of reality, as exemplified by the different ways in which English and Mandarin speakers think of time.
(Boroditsky 2001). Far from supporting a strong Whorfian hypothesis, I submit that different language structures combined with the different metaphors used to describe reality in different cultures may prevent the emergence of ‘shared meaning’ across cultures even with fluent English speakers.

The communication gaps that can result from the interplay of cognition and culture (Nisbett and Norenzayan 2002) lead to divergent, and at times incommensurable schemata, as can be seen in the case of the ancient Chinese and Greek traditions. While the Greek tradition tends to be deterministic, emphasizing abstraction and objective ontology in knowledge through logical use of categories and rules, the Chinese tradition tends to have a more subjective ontology, it is experience-based, holistic (Nisbett, Peng et al. 2001), with greater tolerance for ambiguity and for the coexistence of opposites, reconciling or transcending differences.

Individuals from different cultures will automatically fit experience within their culturally available schemata, or representations of knowledge (DiMaggio and Powell 1991), resulting in different behavioral scripts; combined, these schemata and scripts constitute institutionalized culture, a set of cognitive shortcuts that promote efficiency and accuracy in exchanges within a society. These taken-for-granted schemata operate almost as the operating system of our ‘auto-pilot’ fast mind (Kahneman 2011) and are responsible for the cross-border barriers to shared sense-making. The constraint is possibly best captured by Gramsci in Culture and Hegemony: “Culture, embedded in
language and in everyday practices constrains individuals’ ability to conceive of alternative views of reality” (Gramsci 1990).

Just as they are embedded in culture, economic actors are also embedded in network of social relations (Granovetter 1985), and as a result, differences in cultural norms and value can raise significant barriers to cross-border exchange. Transactions are complicated by those differences in national culture (Hofstede and Hofstede 2001) that have been framed in the IB literature as cultural distance (Kogut and Singh 1988). This distance manifests itself in differences in business practices and in firm organization that can complicate what lead buyers may conceive as a simple ‘directive’ transactional business relationship, with orders and instructions flowing from buyer to supplier. This cultural difference begins with the role of individuals in the organization. In apparel GVCs, for example the typical merchandiser or technical designer in the supplier organization is not empowered to the same degree as her counterpart in a US retail organization, and is subject to the constraints of a much more hierarchical command structure. These differences are as much the result of business culture, characterized in the top exporting countries by greater power distance index and uncertainty avoidance compared to the US, as they are the result of the active roles that the closed network of business owners and their kin take in the supplier organizations. In collectivistic cultures, individuals tend to view themselves as more interdependent (Nisbett and Norenzayan 2002), and more reliant on family and on the social networks within which they are embedded. With network strength more dependent on closure than on brokerage (Burt 2005), these networks tend to be governed by assurance (Yamagishi and Yamagishi 1994) rather than
true trust relations, and exhibit a strong in-group bias. This affects transaction and communication patterns, and trust development between US lead buyers and the supplier networks. Since access to these remote supplier networks is a critical factor the lead buyers’ strategic options, and ultimately in its performance, distance in the normative pillar could be reframed as “outsidership”, which describes the barriers to network access (Johanson and Vahlne 2009); successful internationalization strategies would then be more heavily dependent on social capital and trust.

Regulative distance will also have an obvious impact on trade transactions. The existence of non-tariff trade barriers, in the form of permits, licenses, fees and number of procedures, delay contract fulfilment, and raise transaction costs directly and indirectly, through increases in organization complexity to manage the production cycle in the host country. Transaction costs will not only rise because of trade barriers, but also because of the deficiencies in the overall legal system, and of the inefficiency and lack of transparency of law enforcement. When specific trade regulations delay and possibly prevent the import of inputs of production such as fabric and trim, the alternative is to transact with local sources, increasing the lead buyer’s exposure to poor contract enforcement, with limited remedies after the fact. In either case, the home-host country regulative distance results in higher governance costs for the buyer supplier interface.

Lax enforcement of labor laws raises serious concerns for the US buyer the areas of supplier compliance with labor law, specifically in the areas of child labor, workplace safety and working hours, requiring increased monitoring through a local presence, which
can either be dispatched from a regional sourcing office or outsourced to a third party. Sourcing agents are also able to providing such monitoring, but do not insulate the buyer as effectively as export intermediaries that take title to the goods, thus offering retailers a level of plausible deniability in the event of some major compliance violation or accident. The risks associated with sourcing directly in non-compliant countries was laid bare by the 2012 Tazreen Factory fire, and by the Rana Plaza incident in 2013, in which 1129 factory workers were killed in the collapse of an unsafe factory building. Lack of transparency and low reporting requirements in the host countries also dramatically increase search costs, exposing the buyer to agency costs associated with moral hazard, and possibly adverse selection that only “boots on the ground” can mitigate.
CHAPTER THREE

THEORETICAL MODEL

Building on the global value chains and institutional theory literature discussed above, in this chapter I develop a theoretical model that extends the aforementioned GVC governance framework (Gereffi, Humphrey et al. 2005) providing an institutional explanation of the lead buyers choice of governance for each buyer-supplier dyads in their global value chain. Figure 3.1 below summarizes the proposed theoretical model.

Figure 3.1 Explaining GVCs Governance Modes

It proposes that the choice of governance mode in GVCs is influenced by one key institutional factor, institutional distance between home and host country, and one
structural factor, supplier capabilities. The effects of these two key determinants are moderated by the lead firm’s agency, in the form of institutional brokerage capabilities.

3.1. GOVERNANCE OF THE GLOBAL VALUE CHAIN

The proposed model retains supplier capabilities from the dominant GVC governance framework; I suggest that, while codifiability of information and complexity of transactions, considered determinants in the GVC literature (Humphrey 2001) are source of variation in governance across industry sectors, they are not as important within each industry sector. The specific subset of the apparel industry chosen for this study was chosen in part because it allows the exclusion from the model of both codifiability and complexity of transaction, by virtue of product similarities among the different specialty retailer brands. Industry characteristics also allow me to eliminate from consideration some of the governance forms proposed in Gereffi’s model. Because of the complexity and scope of the specialty retailers’ product lines, with over a thousand distinct products being sold throughout the year, production is entirely outsourced, almost entirely offshore. As a result, the hierarchy mode, intended as ownership of the production assets, is virtually non-existent. On the other end, product complexity, technical coordination, procurement of inputs of production, and product differentiation make true market governance also impossible: capable suppliers, to produce most garments, are not fungible.

Based on these considerations, the whole governance problem for specialty apparel retailers is one of control without ownership, and one of firm operational boundaries, to find the most effective and least costly way to ensure suppliers’
conformance and performance quality, as well as their compliance with accepted labor and safety standards. Lead buyers are now doing a lot more than placing orders with approved suppliers: they create, shape, coordinate the global value chain through direct sourcing, agents, overseas buying offices, or trade intermediaries like Hong Kong based Li & Fung (Sturgeon 2008), establishing different business routines and interfaces in response to the limits to GVC governance imposed by local institutions and business culture (Sturgeon, Van Biesebroeck et al. 2008). The apparel global value chains tend to be neither markets, nor hierarchies but rather networks (Powell 2000) in which informal mechanisms of non-market coordination tend to be predominant because developing countries that do not have the market-supporting institutions that characterize the US economic system (Sable and Zeitlin 2004), where an ad hoc arms-length contracting model is dominant (Langlois 2003).

Thus, economic exchanges in global value chains are often coordinated within long-term informal buyer-supplier relations that require the lead firm to make substantial relationship-specific investments in staffing, systems and support activities, thus increasing their governance costs. With thousands of products outsourced to dozens of suppliers in four or five different countries, and close to one hundred distinct steps involved from conception to delivery for each garment sourced (Birnbaum 2000), the buyer-supplier interface for a typical specialty retailer is potentially characterized by millions of individual cross-country points of contact, prompting necessary trade-off choices. Three governance choices are then clearly identifiable in industry practice
(Birnbaum 2015), two derived from a cost focus and one from a capabilities-driven strategy:

1. **Direct sourcing.** In this governance mode, the lead firm fully internalizes the buyer-supplier interface, establishing unmediated principal-to-principal relationships with its suppliers (Figure 3.2).

![Figure 3.2 Buyer-Supplier Dyads in Direct Sourcing](image)

S = Suppliers; SC = Subcontractor

**Figure 3.2 Buyer-Supplier Dyads in Direct Sourcing**

The supplier may be viewed as a strategic partner or as a simple order taker, but in either case, the lead buyer’s strategic focus is on control and on variable cost minimization.
(the lowest unit price). This is a highly transactional approach to the global value chain, with great emphasis on buyer requirements, order execution and pricing.

2. **Sourcing through agents.** In this governance mode, the lead firm maintains some direct principal-to-principal relationship with the supplier but outsources most of the interface with the supplier to a sourcing agent with a strong presence in the supplier’s country. This governance mode tends to lead to triangular relationship among supplier, agent and retailer (Figure 3.3), in which supplier and agent are viewed as extensions of the firm, with complementary capabilities.

![Figure 3.3 Buyer-Supplier Dyads with Sourcing Agents](image)

S = supplier; SC = subcontractor

**Figure 3.3 Buyer-Supplier Dyads with Sourcing Agents**
3. **Sourcing from trade intermediaries** (trading companies). In this governance mode, the lead buyer externalizes the supplier interface to a specialized trading company, outsourcing the sourcing function. In this instance, the lead buyer’s focus is fixed cost minimization, and GVC governance is reduced in complexity to a single critical interface with one specialized intermediary (Figure 3.4).

![Diagram of buyer-supplier dyads with trade intermediaries](image)

*S = Suppliers; SC = Subcontractor

**Figure 3.4 Buyer-Supplier Dyads with Trade Intermediaries**
3.2 INSTITUTIONAL DISTANCE IN THE GLOBAL VALUE CHAIN

In the theoretical model that I set forth, institutional distance between the lead buyers’ home country, the US in this study, and the countries to which production is outsourced is a key determinant of the governance mode chosen by the buyer for the buyer-supplier interface. For clarity in context, I first introduce the countries that participate in the apparel global value chains and discuss some of their institutional characteristics. Subsequently, I identify two types of the costs imposed by institutional distance in global value chains: transactional, directly related to transaction frequency and relational, linked to the high degree of buyer-supplier coordination and cooperation required for the GVC to function. I then proceed to set forth propositions linking the different choice of governance mode for the buyer-supplier interface varies with the varying levels of transactional and relational institutional distance.

3.2.1 APPAREL GLOBAL VALUE CHAIN COUNTRIES

The apparel global value chain is a prototypical buyer-led global value chain (Gereffi and Korzeniewicz 1994), with lead buyers located in developed countries and production concentrated in a relatively small number of developing countries, primarily in Asia, and secondarily in central and South America. US firms are responsible for almost 40% of the global apparel production, with imports totaling US$ 84.4 billion in 2015 (OTEXA 2016).
As the data in Table 3.1 show, the top four exporters, and seven of the top ten exporting countries are in Asia, accounting for 69.0% of total apparel imports, with China taking the lion share. With some variation, all the countries in the list are low-wage countries, a critically important factor for garment manufacturing, which despite advances in manufacturing automation, remains a labor-intensive business, centered on the cutting and sewing machines. Low wages alone do not explain the country selection, as economic, infrastructural and institutional factors weigh in the final country selection, which also varies depending on the specific balance among price, quality and speed sought by the lead buyer. Free trade agreements like CAFTA and NAFTA on one hand, and trade barriers like the now expired Multi-Fiber Agreement (MFA) which imposed quota
restrictions on imports from China, contributed to the development of an apparel-manufacturing base in countries that would have otherwise been by-passed. These distortions also account for some national level differences in supplier capabilities. Chinese suppliers, for example, responded to the quota restrictions under the MFA by upgrading their capabilities to higher value-added full-service production, to offset the high duties and the cost of quota, which was traded feverishly while the MFA was in effect. Other countries that still rely primarily on low-wages and moderately skilled labor force, like Bangladesh and Sri Lanka, continue to engage primarily in CMT (Cut Make and Trim) assembly (Gereffi and Frederick 2010). The country selection equation is further complicated by within-country variation in countries like China or India, that are just too large and complex to be viewed as homogeneous in terms of labor costs and institutions, and by country migration of established manufacturers in Korea, Taiwan and Hong Kong who bring their capabilities to lower wage countries like Vietnam and Indonesia. This migration is explained in part by rising wages in China (Figure 3.5), but is also fueled by lead buyers’ desire to balance traditionally China-centric sourcing strategies, by sourcing in other developing Asian countries.
Figure 3.5 Rising manufacturing Costs in China

Thus, although Bangladesh remains specialized in long production runs of cheap knit-tops, while China and Vietnam continue to be the first choices to produce structured garments like suits, pants and jackets, there is a sufficient range of supplier quality and capabilities in most of the top Asian exporting countries, to give buyers more than one country option in each product category (Birnbaum 2008). This analysis is strongly influenced by the factor-seeking nature of apparel GVCs, with developed country lead buyers placing virtually all apparel contract manufacturing in geographically remote developing countries that are all characterized by significant institutional distance. The governance choice for a buyer-supplier dyad in any specific country is of course influenced by supplier and buyer characteristics, which are also the object of this study, so that a variety of governance forms will be observed in each country, however, certain host country characteristics are ‘sticky’ and they tend to predetermine the US lead buyer’s
governance choice, and to limit the ability of suppliers to influence this choice through capabilities upgrading. There is one fundamental difference between equity entry modes such as FDI and global value chains: while FDI flows, in the aggregate, tends to privilege destinations with low institutional and cultural distance, trade has been positively correlated with distance (Slangen 2005). When MNCs internationalize through equity entry modes, they tend to control the isomorphic pressures from the host country’s institutional environment through ownership, and there is some evidence that MNCs investing around the world are in part shielded from these pressures by the investment itself that allows them to carve their own institutional field in the host country (Kostova, Roth et al. 2008).

There is no reason to suppose that lead firms in GVCs are equally shielded from the institutional distance between home and host country. On the contrary, the high frequency of negotiation and transactions would suggest an amplification of distance effects in factor-seeking, non-equity entry modes. While investment tends to privilege low-distance destinations, there is some indication that although it decreases exchange efficiency, distance is not a deterrent of trade. In at least one meta-analysis cultural distance has been found to be positively correlated with trade (Linders, Slangen et al. 2005). This finding is logical given that over 60% of world trade is organized in factor-seeking global value chains, in which MNCs from developed economies source intermediate and finished goods in low-cost developing nations (UNCTAD 2013), which tend to be geographically remote, with different cultural traditions, and lower levels of economic and institutional development.
While institutional distance does not deter trade, we can expect it to create both transactional and relational barriers at the buyer-supplier interface in global value chains, raising transaction costs, and creating a governance problem for the lead buyer seeking to clear a large number of transactions, and to coordinate production across such distance. These transactional and relational barriers faced by the lead buyer in the GVC can be broken down in their cultural-cognitive, normative and regulative institutional components (Scott 1995, 2008), defining a matrix of transactional and relational institutional barriers (Table 3.2) that maps institutional distance, and isolates individual drivers of the cost of doing business abroad.

### Table 3.2 Matrix of institutional barriers in the Global Value Chain

<table>
<thead>
<tr>
<th>Transactional Barriers</th>
<th>Cognitive-Cultural Pillar</th>
<th>Normative Pillar</th>
<th>Regulative Pillar</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Language; schemata; shared meaning</strong></td>
<td><strong>Values and norms; hierarchies; informal local networks</strong></td>
<td><strong>Labor and trade laws; law enforcement; compliance</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Generalized trust; trust building; competence and legitimacy</strong></td>
<td><strong>Universalism vs. particularism; kin and reciprocity; allegiances</strong></td>
<td><strong>Trust supporting institutions; legal system; IPR</strong></td>
<td></td>
</tr>
</tbody>
</table>

The cultural differences begin with the role of individuals in the organization. In apparel global value chains, the typical merchandiser or technical designer in the supplier organization is not empowered to the same degree as her counterpart in a US retail organization, and is subject to the constraints of a much more hierarchical command structure. This is as much the result of business culture, characterized in the top exporting countries by greater power distance index and uncertainty avoidance compared to the
US, as they are the result of the direct role of the business owners and their kin in the supplier organizations. With regard to cultural distance, the intuitive differences between the US and the top apparel exporting countries are confirmed by a comparison of each country’s five cultural dimensions (geert-hofstede.com 2015), with all countries scoring higher in long term orientation and power distance index, and lower in the individualism dimension (Table 3.3).

**Table 3.3 Cultural Dimensions of Top Asian Apparel Exporters to the US**

<table>
<thead>
<tr>
<th></th>
<th>PDI</th>
<th>IDV</th>
<th>MAS</th>
<th>UAI</th>
<th>LTO</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>40</td>
<td>91</td>
<td>62</td>
<td>46</td>
<td>29</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>80</td>
<td>20</td>
<td>55</td>
<td>60</td>
<td>40</td>
</tr>
<tr>
<td>China</td>
<td>80</td>
<td>20</td>
<td>66</td>
<td>30</td>
<td>118</td>
</tr>
<tr>
<td>Indonesia</td>
<td>78</td>
<td>14</td>
<td>46</td>
<td>48</td>
<td>62</td>
</tr>
<tr>
<td>Vietnam</td>
<td>70</td>
<td>20</td>
<td>40</td>
<td>30</td>
<td>80</td>
</tr>
<tr>
<td>India</td>
<td>77</td>
<td>48</td>
<td>56</td>
<td>40</td>
<td>61</td>
</tr>
</tbody>
</table>

Source: www.gert-hofstede.com

The differences between the US and the various host countries are striking (Figure 3.6), suggesting the presence of significant cultural distance barriers for US buyers doing business in Asian developing countries. The most striking differences between the US and the main Asian apparel GVC host countries can be seen in the individualism, power distance and long-term orientation dimensions, which directly affect work organization and the role of individuals in organizations. Unfortunately, although helpful in framing the discourse on the relationship between business and culture, Hofstede’s cultural dimensions and the CDI are a relatively blunt instrument to measure differences among
similar host countries, and taken in isolation, insufficient to differentiate the effects of cultural distance on the GVC governance choices made by US lead buyers.

Figure 3.6 Cultural Dimensions of the top Five Asian Apparel Exporters to the US

A similar problem can be found in instruments aimed at measuring the effectiveness of formal institutions. A commonly used measure of institutional development, the World Bank’s World Governance Indicators (WB 2016), confirms striking institutional differences between the US and the various Asian host countries (Figure 3.7), but it fails to sufficiently differentiate institutional development among host countries in a way that could help explain differences in the lead buyer’s governance choice with suppliers in the various host countries where production is outsourced.
There are however, significant differences among the top Asian apparel exporters, well captured by the World Bank’s Doing Business reports (Table 3.4), which highlight the extent by which East Asian countries outperform South Asian countries in the regulative pillar (WB 2016)

**Table 3.4 DB Rankings for the Top Asian Apparel Exporters to the US (2016)**

<table>
<thead>
<tr>
<th></th>
<th>Ease of Doing Business</th>
<th>Trade Barriers</th>
<th>Contract Enforcement</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>78</td>
<td>96</td>
<td>5</td>
</tr>
<tr>
<td>Vietnam</td>
<td>82</td>
<td>93</td>
<td>69</td>
</tr>
<tr>
<td>Indonesia</td>
<td>91</td>
<td>108</td>
<td>166</td>
</tr>
<tr>
<td>India</td>
<td>130</td>
<td>143</td>
<td>172</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>176</td>
<td>173</td>
<td>189</td>
</tr>
</tbody>
</table>

Part of this research aims at unbundling the different components of institutional distance to understand how the transactional and relational barriers come into play in
the day-to-day management of buyer-supplier relationships in global value chains. It is reasonable to expect that certain institutional distance barriers will have greater influence on the coordination of trade exchanges than others, and that the experience and capabilities of the various participants, as well as established business practices may reduce or mask their effects. However, I set forth that transactional and relational institutional distance are persistent and ubiquitous in the global value chain, and that they are a determinant of the governance mode chosen by US lead buyers in each host country.

3.2.2. DIMENSIONS OF INSTITUTIONAL DISTANCE IN GVCs

The cognitive, normative and regulative barriers to exchange associated with institutional distance are amplified in the apparel GVC by the number of steps and stages in each transaction, by the number of points of contact between the buyer and the overseas supplier, and by the level of cooperation and coordination necessary to ensure that goods of the desired quality are produced and delivered in a timely fashion and at the agreed upon price. Considering the intensely transactional and relational nature of the buyer-supplier interface in GVCs, it is useful to define institutional distance in terms of transactional and relational types, which cut across the cognitive normative and regulative pillars. The first of these two types, transactional institutional distance, relates directly to the cost of doing business abroad (Eden and Miller 2004) and details the effect of institutional distance from a transaction and agency cost perspective. Analyzing transactional cost drivers through an institutional theory lens creates a detailed matrix of effects of institutional distance on transaction costs.
Cognitive factors such as language and mental schemata will affect transactions in all areas where information needs to be gathered and communicated, resulting in loss in translation and equivocation, misunderstanding of instructions leading to errors in production and cost overruns. Far from being a one-way barrier to communication from the buyer to the supplier, cognitive barriers will limit the quality of information a buyer can effectively gather on supplier capabilities, with an adverse effect on supplier selection. Normative factors such as business culture and the embeddedness of suppliers in local networks and allegiances can hinder effective monitoring of production and be

<table>
<thead>
<tr>
<th>TRANSACTIONAL BARRIERS</th>
<th>Cognitive Pillar</th>
<th>Normative Pillar</th>
<th>Regulative Pillar</th>
</tr>
</thead>
<tbody>
<tr>
<td>Search Barriers</td>
<td>Language; cultural schemata</td>
<td>Communication styles; social norms on disclosure</td>
<td>Disclosure laws; privacy laws</td>
</tr>
<tr>
<td>Contracting Barriers</td>
<td>Bounded rationality (contingencies)</td>
<td>Dominant governance form</td>
<td>Contract law</td>
</tr>
<tr>
<td>Execution Barriers</td>
<td>Understanding meanings / terms of contracts</td>
<td>Level of informality of organizational forms (e.g. modularity; subcontracting)</td>
<td>Trade laws, industry, and labor environmental laws</td>
</tr>
<tr>
<td>Monitoring Barriers</td>
<td>Data collection and interpretation</td>
<td>Cooperation with monitoring (allegiances); dispute resolution practices and norms</td>
<td>Law enforcement; judicial system efficiency</td>
</tr>
<tr>
<td>Moral Hazard</td>
<td>Universalism vs. Particularism</td>
<td>Work ethics; typical incentive structure</td>
<td>Legal compensation and incentive structures</td>
</tr>
<tr>
<td>Adverse Selection</td>
<td>Inadequate information</td>
<td>Ethical standards</td>
<td>Disclosure requirements; bid rules</td>
</tr>
</tbody>
</table>
detrimental to the timely communication of problems as they arise, such as late delivery of inputs of production, machinery issues, or quality in production. In environments in which it is the messenger who “gets shot”, immediate self-reporting of defects or errors, which could allow remedies to be sought early on, limiting their overall costs, is unlikely to fit the business culture. Besides these informal institutions, a country’s trade and labor regulation can also have a dramatic impact on the cost of doing business there, and the vagaries of ill-defined property rights, contract law and their enforcement can limit the remedies available to a foreign firm, and dramatically complicate outsourcing production to that country and limit the remedies available to a foreign firm.

In light of the costs associated with transactional institutional distance, and given the ever-changing demands of fashion, the extent of production outsourced overseas by US specialty retailers, and the desired degree of process and production control by the buyer, the apparel GVC would be best served by lasting buyer-supplier relationships founded on trust, with a two-way flow of information and knowledge. The ability of the lead buyer to develop such relations is limited by the relational institutional distance between the home and host country, a dimension that relates directly to the organizational complexity and the costs associated with the development of trust and with the transfer of knowledge and practices between the buyer and the overseas supplier. As in the case of transactional institutional distance, the analysis of barriers to trust development and knowledge transfer through an institutional lens creates a detailed matrix (Figure 3.6) of drivers of transactional institutional distance.
The first hurdle to trust development is practical: there are significant cognitive barriers to assessing the competence of the other party, a prerequisite of trust in a contract manufacturing arrangement. Although primarily inhibiting trust development by US buyers because of the business at risk and because of their focus on performance in trust development, both parties may distrust each other’s competence. Matters are
complicated by the level of scrutiny required to assess performance, which may be undesirable for the suppliers’ organization, and possibly counterproductive in trust building. The lack of trust-supporting formal institutions in some host countries, such as disclosure and transparency, as well as timely dispute resolution mechanisms will also contribute to higher perceived risk for the buyer in trusting the competence of suppliers. Trust itself is not a universal, invariant concept: much cross-cultural research on trust has highlighted striking country-level differences in generalized trust (Yamagishi and Yamagishi 1994), and in social and behavioral norms designed to reduce the risk of uncertainty in social and economic exchanges. At the risk of generalizing the findings, in collectivistic cultures trust is more likely to be based on kin, and on embeddedness in a highly networked social structures, strongly favoring the in-group (Chua, Morris et al. 2009), while individualistic cultures are more likely to develop trust through economic exchange, based on performance. The fact that US business people are more open to establishing ad hoc trust relationships makes their trust behaviors more transient, and in the eyes of their counterparts in Asia more expedient.

Conversely, Asian particularism (Trompenaars and Hampden-Turner 1998) presents a challenge for US buyers in assessing suppliers’ trustworthiness, clashing with Western universalism, a culture that excludes the coexistence of opposites, founded on a dichotomous nature of truth (either true or untrue) and on the law of the excluded middle. These differences and different concepts of the ‘self’ complicate the assessment of trustworthiness in the buyer supplier relationship. The Chinese interdependent self (Nisbett, Peng et al. 2001, Na, Grossmann et al. 2010) brings with it a set of trust
obligations to his kin, his friends and his support network that precede any obligation to an unrelated individual with whom he enters an arm’s length contractual agreement. The absence of strong trust-supporting institutions in the host country, such as clear contractual rights, rapid and transparent contract enforcement, raise the transaction risk and therefore transaction costs for the US buyer.

Without a suitable mechanism to develop trust across high institutional distance, the transfer of knowledge and business practices from the buyer to the supplier is also hampered by lack of trust on the buyers’ part, and by cognitive barriers on the suppliers’ end. Lack of trust and cognitive barriers may also present legitimacy challenges for the lead buyer, as suppliers fail to understand and subscribe to the practices that buyers seek to transfer and embrace the requirements that these impose (Kostova and Roth 2002). This can be troublesome for a US retailer, if the suppliers fail to honor or only pay lip service (Meyer and Rowan 1977) to compliance requirements in areas of product safety, or working conditions or child labor.

3.2.3 INSTITUTIONAL DISTANCE AND CHOICE OF GOVERNANCE MODE

Figure 3.8 below visualizes the above discussion. If we analyze institutional distance between the home and host country in terms of the transactional and relational barriers to cross-border exchange and cooperation, we can represent it in a 2x2 matrix defined by assigning low and high values to each type of barrier. This results in three possible combinations of values for transactional and relational barriers:
a. Low/Low in the lower left quadrant, corresponding to the lowest level of institutional distance

b. Low/High in the upper left quadrant, corresponding to an intermediate level of institutional distance

c. High/High in the upper right quadrant, corresponding to the highest level of institutional distance. The fourth quadrant representing an unrealistic country, with low relational and high transactional barrier and as such it is excluded from further analysis.

Figure 3.8 Transactional and Relational Institutional Distance

Institutional distance is then defined in a continuum from low to high, represented by the arrow, in direction of increasing distance. As institutional distance increases, from low to high, lead buyers face greater transactional and relational cross-national barriers,
giving rise to greater governance challenges. In the extreme, high institutional distance may lead to a decision not to enter the host country. If the lead buyers decide to source there, they may find managing the transactions and the relationships with suppliers prohibitively expensive, and outsource the supplier interface to a third party.

**Proposition 1.** As the institutional distance between the lead buyer’s home country and the host country increases, the lead buyer will tend to choose governance modes that externalize the supplier interface to sourcing agents or trade intermediaries.

The fact that for the outsourcing firm, greater institutional distance is associated with a governance mode that externalizes the supplier interface, appears to contradict the accepted view that in the equity entry mode, firms will respond to large institutional distance by internalizing the activities within the firm (Xu and Shenkar 2002), for greater control. The apparent contradiction however is explained by the different drivers of outsourcing, namely the externalization of non-core activities to firms that make those activities their core competency. Greater institutional distance with the country hosting production imposes greater demands on the lead buyer’s resources, and a set of capabilities that falls farther from the retailer’s core activity, which consists in designing and selling apparel. In these high distance countries, the buyer will effectively lower its governance costs by outsourcing management of the interface with supplier to a single trade intermediary, simplifying the GVC governance to a relationship with one vendor for the whole country.
Proposition 2. As transactional institutional distance between the lead buyer’s home country and host country increases, then the lead buyer is more likely to externalize the supplier interface to international trade intermediaries.

The high intermediation costs associated with using trading companies, as well as concerns with supply chain visibility motivate the lead firm to exercise direct control over its suppliers, and to transact directly with them. When transactional barriers in a host country are low, lead buyers will prefer to enter a principal-to-principal contractual relationship with the actual supplier (the manufacturer) rather than with an intermediary. If the relational barriers in the host country are persistently high, then the lead buyer will typically choose to outsource the relationship with suppliers to local sourcing agents, with experience in dealing with the specific culture and institutions of the host country, and in mediating with US buyers.

Proposition 3. As the relational institutional distance between the lead buyer’s home country and host country increases, then the lead buyer is more likely to externalize the supplier interface to sourcing agents.

Conversely, when transactional and relational barriers with the host country are low, the buyer will avoid all intermediation costs and source directly from the supplier, managing both transactions and relationships with suppliers in that country directly, either from headquarters or from its own regional sourcing office.
Proposition 4. As transactional and relational distance between the lead buyer’s home and the host country decrease, then the lead buyer is more likely to internalize the supplier interface, through direct sourcing.

Figure 3.9 below visualizes the above propositions. The 2x2 institutional distance matrix shown above (Figure 3.8) can be applied to define the relationship between institutional distance and GVC governance modes (Figure 3.9).

![Figure 3.9 Institutional Distance and GVC Governance](image)

In the resultant matrix, the arrow represents increasing institutional distance, associated with greater externalization of the buyer-supplier interface (Proposition 1), and each quadrant corresponds to different levels of institutional distance, each corresponding to a distinct governance mode. The TRADE INTERMEDIARIES quadrant
includes countries with highest level of institutional distance from the lead buyer’s home country, with high transactional and relational barriers to exchange, where governance tends to be externalized to trading companies (Proposition 2). The AGENT quadrant, including host countries characterized by an intermediate level of institutional distance from the lead buyer’s home country, with low transactional barriers but high relational barriers, with governance externalized through sourcing agents (Proposition 3). The DIRECT quadrant, representing host countries with lower institutional distance, in which governance is internalized in a direct buyer-supplier interface, without intermediaries (Proposition 4).

3.3. SUPPLIER CAPABILITIES

For the purposes of this research, a supplier is a maker of goods, that owns garment manufacturing facilities, unlike other types of ‘vendors’ in the apparel global value chains, such as agents and trading companies. Offshore outsourcing of garment production was originally a relatively simple arm’s length contract manufacturing arrangement in which a buyer, usually a retailer, or a marketer of branded goods from a developed economy, designed a garment, selected and purchased the fabric and trim, which would then be cut and made into a finished garment following the buyers’ specifications by the factory in a low labor cost country. The garment would then be inspected and picked up at that location by the buyer, who would then arrange for its shipment and distribution. This arrangement, known in the industry as Cut, Make & Trim (CMT) has fallen largely out of favor, at least in its original form, as buyers sought to transfer more functions and responsibilities onto its suppliers in the global value chain, and suppliers sought to capture
a larger share of the value added. In today’s market, the closest thing to a CMT factory will at least purchase the fabric and trim, and move goods to the port, selling on an FOB (Free on Board) port basis; for simplicity, and following industry practice (Birnbaum 2000), I will still refer to this type of basic contract manufacturer as CMT.

Over the decades, the buyers’ strategic outsourcing impetus and supplier upgrading (Sturgeon 2006) have led to a much wider range of supplier capabilities, and to different levels of buyer reliance on them. Factories become much more involved in the pre-production phase, developing varying level of competence in technical design, sample production, grading, fit, dyeing and testing, fabric and trim sourcing and in post-production services performing packing, labelling tagging, and then managing logistics. The best, most sophisticated suppliers can be expected to engage in product design, bringing their own ideas to buyers and in keeping buyers abreast with evolving trends and technologies.

Proposition 5. As supplier capabilities increase, lead buyers will tend to choose governance modes that internalizes the buyer-supplier interface.

From a transactional perspective, supplier production service capabilities can be envisioned as a continuum from enhanced CMT factories to full service, but they tend to be clustered at the two polar ends, with suppliers focusing either on manufacturing efficiency and cost, or on providing a full range of creative, technical services that complement and supplement the buyers’ own capabilities. For the purposes of this study, this clustering allows the simplification of this continuum into a dichotomous variable, defined by low and high transactional capabilities, corresponding to enhanced CMT
suppliers and full service suppliers respectively. The buyers’ desire for services and control is necessarily tempered by the associated transaction costs and organizational complexity; low service capability suppliers tend to locally embedded firms regarded solely for their manufacturing assets, with limited potential benefits from direct partnership. As a result, low service capability suppliers tend to be the domain of trading companies, who provide the ‘boots on the ground’ to monitor production and compliance, taking responsibility for delivery and product, performing their traditional role as experts and guarantors of quality in a principal-to-principal relationship. This type of suppliers tends to be locally embedded, with underdeveloped relationships with raw material supplier and global retailers, offering primarily low-cost manufacturing. Although technically capable of producing garments of acceptable quality, they impose significant transactional burdens to potential lead buyers, requiring assistance in procuring raw materials, extensive monitoring during production and logistical support to ship the finished goods.

**Proposition 6. If a supplier has low cross-border transactional capabilities, then the lead buyer is more likely to externalize the supplier interface to trading companies.**

Conversely, suppliers with greater service capabilities bring more valuable strategic resources to the exchange, and are more suitable for partnership, with higher level of direct coordination, cooperation and strategic planning, with a more direct interface between buyer and supplier. As the relationship with the supplier becomes
more valuable to the lead buyer, the supplier’s relational capabilities become more salient. The preferred governance mode with suppliers with full service capabilities can be either a triangular relationship mediated by a sourcing agent, or a direct principal-to-principal relationship between the lead buyer and the supplier, depending on the supplier’s capability to deal with global buyers on a relational level. The critical supplier characteristic that determines the governance choice is their level of global integration, and just as in the case of service capabilities, suppliers in China and in Southeast Asia, the suppliers’ capabilities tend to be clustered at the two ends of the integration continuum.

Some suppliers invest in production capacity and development capabilities, but remain locally embedded order-takers. These are often single-plant, single category factories in the top exporting countries with large production capacity, and full package/full service capabilities that remain however profoundly embedded in their local business culture, relying on a local network of suppliers and subcontractors; the business owners may take great pride in their production capabilities, but lack the business sophistication to develop and maintain a direct principal-to-principal relationship with US based lead buyers. At the same time, considering their scale and full-service capabilities, these firms are often unwilling to submit themselves to constraints of becoming part of the modular production networks orchestrated by the large trading companies like Hong Kong based Li & Fung.
Proposition 7. If a supplier has greater cross-border transactional capabilities but limited relational capabilities, then the lead buyer is more likely to externalize the supplier interface to sourcing agents.

On the other end of the global integration continuum, we find a class of globally integrated, second and third generation multinational factory groups, the descendants of the early apparel suppliers, originally based in Hong Kong, Korea and Taiwan, that over time have moved their production facilities into China, Vietnam, Indonesia, Malaysia and Thailand. These factory groups have made the strategic investments in manufacturing capacity in low wage countries, while developing the full-service capabilities desired by global buyers in their home countries, with technical staff from the best local universities overseeing the technical aspects of product development and technical design, and western educated ownership and top management facilitating the relationship with global lead buyers. These firms are best suited for direct principal-to-principal governance with US buyers, and tend to by-pass intermediaries, agents, and in many cases even the buyer’s own local office, if there is one.

Proposition 8. If a supplier has greater cross-border transactional and relational capabilities, then the lead buyer is more likely to internalize the supplier, with direct sourcing.

Figure 3.10 below visualizes the propositions on supplier capabilities. The four supplier-related propositions can be illustrated schematically treating the suppliers’ cross-border transactional and relational capabilities as dichotomous, low-high variables.
In the resultant matrix (Figure 3.10), three general types of suppliers of can be identified, each corresponding to a distinct governance mode:

![Diagram showing supplier capabilities and GVC Governance]

**Figure 3.10 Supplier capabilities and GVC Governance**

The TRADE INTERMEDIARY quadrant includes locally embedded suppliers with low service capabilities, with governance externalized to trading companies (Proposition 6). The AGENT quadrant, includes locally embedded firms with high service capabilities, with governance externalized through sourcing agents (Proposition 7). The DIRECT quadrant includes globally integrated suppliers with high service capability, with governance internalized in a direct buyer-supplier interface, without intermediaries (Proposition 8). The fourth quadrant corresponds to an unrealistic supplier type, with high level of global
integration and low service capabilities, which was excluded from further analysis. Finally, the arrow represents the degree of internalization of the buyer-supplier interface, which increases as supplier capabilities increase (Proposition 5).

3.4. INSTITUTIONAL BROKERAGE

In the preceding discussion, I identified institutional distance and supplier capabilities as key determinants of the governance mode that lead buyers choose for their cross-border interface with suppliers in their Global Value Chain. The primacy of structure over agency has a long tradition in institutional theory with roots that date back to Durkheim’s social determinism (Durkheim 1895), and was further developed in more modern times in the neo-institutionalist literature that views social and economic actors under isomorphic pressures from their institutional environment to gain legitimacy (DiMaggio & Powell 1983). Variations in firm behavior and in economic outcomes seem however to suggest that the relationship between structure and agency is more dialectical, and that outcomes are the resultant of their interplay (Bourdieu 1984); while economic actors will necessarily operate within the bounds of institutions (March 1994), creativity and competence play a role in the strategies employed in response to institutionalized structure and contribute to explain the observed variation. The dialectic tension between structure and agency is observed in institutional entrepreneurship (Eisenstadt 1980; DiMaggio 1988) in which individual and collective actors effect institutional change; the internationalizing firm can induce change in the institutional environment in which it operates, or at the very least carve its own institutional field in the host country and largely avoid isomorphic pressure (Kostova, Roth and Dacin 2008) by virtue of its own investment.
Lead firms in global value chains have a smaller institutional footprint: they may not be cultural dupes (Hirsch Lounsbury 1997) but they are, to a large extent, institution-takers who seek to seek to control outcomes with their activities and with the governance of the buyer supplier interface. I propose that the relationships specified in the above propositions are moderated by the lead firm’s institutional brokerage, which I define as institutional work (Lawrence and Suddaby 2006) consisting in a set of activities and their associated capabilities that lower institutional distance and structural barriers to cross-national exchange at the buyer supplier interface, minimizing the associated transaction and relational costs, maximizing exchange efficiency, and allowing the full realization of economic arbitrage opportunities in their global value chains. The concept of institutional brokerage owes to social capital theories of brokerage and closure (Burt 2005) and to actor network theory: when institutional distance is instantiated at the international business interface, institutional brokerage bridges the institutional gaps between the lead buyer and host country supplier networks, which tend to be governed by closure.

Institutional brokerage functions very much in the same way as a chemical catalyst. In organic chemistry, many exothermal reactions, reactions that are favored to take place on energy considerations alone, do not take place unless energy is provided, or a catalyst is used to lower the potential energy barriers to the reaction. Once initiated, the exothermal reaction will then self-sustain. Similarly, the interaction of a lead buyer and a supplier in the GVC will only generate its potential economic advantages if the costs associated with cross-national transactional and relational institutional barriers to exchange are somehow lowered by institutional brokerage. The overall effect of
institutional brokerage on the exchange efficiency in the global value change is illustrated in Figure 3.11. The full unit cost of production outsourced offshore rises at first, as an effect of institutional barriers to the new relationship, which materialize in greater front-end set up costs and suboptimal pricing, and then declines as a natural effect of learning curves. By reducing barriers to exchange, institutional brokerage activities play a key role in reducing the break-even quantity to be outsourced thus making more buyer-supplier relationships viable, and make the attainment of ‘stretch’ unit cost goals possible, maximizing the economic value of the exchange for the lead buyer.

![Figure 3.11 Institutional Brokerage Effect on GVC Costs](image)

Analyzing institutional distance and supplier capabilities in terms of their transactional and relational dimensions, leads me to identify two types of institutional brokerage that represent lead firm strategic responses to the barriers to coordination and exchanges in the global value chains: transactional and relational institutional brokerage.
As discussed above, the transactional and relational barriers faced by the lead buyer can be broken down in their cultural-cognitive, normative and regulative institutional components (Scott 1995, 2008), and in their transactional and relational components, defining a matrix (Table 3.2) that maps institutional distance and isolates individual drivers of the cost of doing business abroad. At the IB interface, institutional barrier costs arise from a variety of regulative, normative as well as cultural-cognitive factors that constitute the essence of institutional distance. At the host-country firm level, these factors hamper the realization of comparative institutional advantage by impeding trust development, raising governance costs and decreasing the willingness to commit to relationship specific investment that would facilitate knowledge and practices transfer from the GVC lead buyer. This leads to inefficiencies in management of the buyer/supplier relationship, resulting in reduced opportunity. For the lead firm, all these factors impose additional burdens from increased organizational and vendor interface complexity, and higher overall GVC governance costs. The cumulative effect of institutional barrier costs can be high enough to suppress exchange opportunity altogether, leaving the host country potential untapped. In this case, besides lowering interface barriers, lead buyers’ institutional brokerage activities lower host country marketing costs, enabling the realization of latent host country comparative institutional advantages, and the capture their economic value.

More generally, institutional brokerage activities in the GVC will yield gains in operational effectiveness that maximize lead buyers’ return by lowering cross-national interface barriers and host country suppliers’ marketing costs, reducing overall market
friction and enhancing exchange efficiency. Institutional brokerage in GVC encompasses a complex set of related activities, which vary as a function of firm objectives, scope of the international operations, and of the institutional profile (Kostova 1997) of each country hosting the production network. Institutional brokerage represents then the agency response of the lead firm to structural constraints imposed by home-to-host country institutional distance, and by supplier capabilities, and moderates their effect on the GVC governance choices.

Institutional brokerage can be viewed as a form of institutional work (Lawrence & Suddaby 2006). It can come in the form of transaction enabling activities work, contractual and normative in nature, often in the form of routines and detailed specifications and standard operating procedures, monitoring and policing activities, mostly in the form of inspections, and deterring activities mostly in the form hold up of payment and future orders to address the moral hazard agency problem. Each of these types of activities represent a transactional response to categories of transaction costs.

The essence of transactional institutional brokerage consists in embedding and routinizing the lead buyer directed normative foundations of the buyer supplier relationship into the suppliers’ staff daily work life (Lawrence and Suddaby 2006). Great emphasis is placed on lowering the country level transactional barriers, on developing efficient, transparent and consistent practices aimed at controlling behavior variation on the supplier’s end. Typical activities and skill sets associated with transactional institutional brokerage seek to optimize economic exchanges and reduce transaction
costs, focusing on order processing skills, and detailed order management routines and procedures, aimed at minimizing the transaction costs associated with the institutional barriers characteristic of each host country. The relationship with the supplier tends to be directive, with information flowing in one direction, from buyer to supplier; it has a strong contractual connotation, founded on master vendor agreements and on detailed purchase orders. Transactional institutional brokerage tends to promote arm’s length principal-to-principal contract manufacturing relationships, in which suppliers are seen primarily as manufacturing resources.

Transactional institutional brokerage tends to overlook the relationship effects that are stable and enduring elements of institutions (Law 1992), which reflecting the dynamic struggle between competitive buyers and the supplier actor-networks, which act as institutional structures and instantiate institutional distance. This dynamic tension is the focus of relational institutional brokerage which takes a different approach, seeking to lower the country level relational barriers through more collaborative buyer-supplier partnerships, maximizing lead firm access to supply resources and maximizing its capabilities. Developing efficient, transparent and consistent practices aimed at controlling behavior variation on the supplier’s end is still important, but perceived as less critical compared to value creation through partnering. Lead buyers engaged in relational institutional brokerage will view vendors as firm resources with complementary capabilities, and will put greater strategic focus on maximizing firm access to suppliers’ product creation resources, capabilities and know-how. The relationship with the supplier tends to be collaborative, with a two-way flow of information and knowledge between
buyer and supplier, and aims at developing trust and understanding in the GVC. Relational institutional brokerage strategies emphasize the importance of individual and organizational cultural intelligence, of knowledge and understanding of each host country’s institutional make-up. The firm’s focus is on the continuous improvement in managerial and executive cross-cultural communications and negotiations skills, placing trust development in the buyer-supplier relationship above short-term gain. As a result, relational institutional brokerage is often characterized by triangular relationships in which a direct buyer-supplier relationship coexists with a mediated relationship through a local sourcing agent, which complements and supplements the direct buyer-supplier connection.

Institutional brokerage activities have significant associated costs. Buyers with sourcing strategies focused on minimizing fixed costs characteristically limit their investment in the associated capabilities, and will be more likely to externalize the supplier interface to trade intermediaries in the face of high country level institutional barriers. While, as posited above, greater institutional distance in the GVC tends to be associated with the externalization of the buyer-supplier interface, investment in transactional or relational institutional brokerage capabilities offer a wider range of governance choices to the lead firm, and the ability to engage in a more direct interface with suppliers in the countries hosting their global value chains, and can moderate the effect (Figure 3.12).
Figure 3.12 Institutional brokerage, Institutional distance and GVC governance.

Proposition 9. Lead buyer institutional brokerage activities moderate the relationship between institutional distance and choice of governance mode for their GVC, reducing the buyer’s preference for externalization of the buyer-supplier interface that would be expected with greater institutional distance.

While the essence of institutional brokerage is primarily defined by the country level institutional barriers to be lowered in the global value chain, the associated activities translate directly into the lead buyer’s ability to work with overseas suppliers, in response to their different capabilities level. The same type transactional institutional brokerage activities that help overcome the transaction barriers that generalize across suppliers in each host country, will naturally facilitate direct buyer-supplier relationship regardless of
the host country. By the same token, relational institutional brokerage will make the establishment of long term trusting relationships with suppliers with good productive and service capability but who don’t necessarily have the level of sophistication, and the global integration required to sustain on their own a direct buyer-supplier relationship with a global buyer. In both instances, we can see that institutional brokerage capabilities facilitate a more direct governance mode of the relationship between global buyer and local suppliers in the global value chain. Institutional brokerage therefore enhances the supplier capability effect on governance choice, because its activities contribute to bridging supplier-specific transactional and relational capability gaps (Figure 3.13)

![Figure 3.13 Institutional brokerage, supplier capabilities and GVC governance.](image)

Proposition 10. Lead buyer institutional brokerage activities enhance the relationship between supplier capabilities and choice of governance mode for
their GVC, whereby greater supplier capabilities are associated with greater internalization of the buyer-supplier interface by the lead buyer.

If we combine the various levels of institutional distance and supplier capabilities, in one single 3x3 matrix (Figure 3.14), we can see the possible combinations and the resulting governance modes. Four possible combinations are effectively competed out, leaving a total of five combinations, with three combinations in which the governance mode predicted by institutional distance and supplier capabilities coincide and are therefore univocally determined. In the two instances in which the predominant governance choice is not univocally determined (quadrants AGE ITI and ITI AGE), lead buyer institutional brokerage type tends to be the tiebreaker. In these instances, relational institutional brokerage will resolve in favor of principal to agent relationship leading to governance of the buyer-supplier interface through sourcing agents (AGE), while transactional IBR resolves in favor of a principal to principal relationship, externalizing the buyer-supplier interface to trade intermediaries (ITI).
Figure 3.14 Institutional Brokerage and GVC Governance Modes

Proposition 11. The type of institutional brokerage chosen by the lead firm determines the lead buyer’s choice of governance mode in instances in which predictions based on institutional distance and supplier capabilities diverge. Transactional institutional brokerage will resolve in favor externalization of the buyer–supplier interface to trade intermediaries, while relational brokerage will resolve in favor of externalization of the buyer-supplier interface to sourcing agents.
CHAPTER FOUR

METHODOLOGY

4.1. INTRODUCTION AND OVERVIEW – PURPOSE OF THE STUDY

This research started from inception as a qualitative study based on theory, seeking in depth understanding of the limits imposed by institutional barriers and structural factors on possible governance modes of the buyer-supplier interface in the global value chains, and of the way lead buyers’ capabilities and strategies influence their final governance choice. With this study I seek to complement and supplement existing literature on the governance of global value chains according to which the combination of three main factors: complexity of transaction, supplier capabilities and codifiability of information results in five main GVC governance modes, along a hierarchy to markets continuum (Gereffi, Humphrey et al. 2005). I retain supplier transactional and relational capabilities, from earlier models, shifting the focus to two other important determinant factors which have only received cursory attention in the global value chains literature: institutional distance between the lead buyer’s home country and the host countries to which they production is outsourced, and the lead firm’s agency, in the form of institutional brokerage, which lowers the transactional and relational challenges barriers imposed by the institutional and structural conditions surrounding the buyer-supplier dyad.
4.2. RESEARCH QUESTIONS

This study posits that institutional barriers at the buyer-supplier interface and the supplier capabilities are structural determinants of the governance mode for each supplier-buyer dyad, and that suppliers’ agency, their institutional brokerage, moderates these determinants; it also assumes that there is sufficient variation in each of these factors to propose a model that explains the variation in governance choices based on them.

The thrust of this research is to understand what determines the choice of the governance mode of lead buyer–supplier dyads in the GVC by answering the following research question:

1. How does home-host country institutional distance affect the lead buyer’s choice of governance in each GVC buyer-supplier dyad?
2. How do supplier capabilities affect the lead buyer’s choice of governance in the GVC buyer-supplier dyads?
3. How do the institutional brokerage activities and capabilities of the lead firm affect the lead buyer’s choice of governance in the GVC buyer-supplier dyads?

4.3. RATIONALE FOR QUALITATIVE RESEARCH

The selection of a qualitative research method is a direct result of the nature of the phenomena under investigation. I am studying complex phenomena at the nexus of national culture, country institutions and industry structure, as well as the perceptions of these phenomena by key decision makers in the GVC, seeking to understand how the strategies derived from these perceptions translate into governance choices. More
specifically, I am seeking to shed light on the way objective institutional and structural factors, through subjective judgements by key GVC decision makers, play out in the governance decision in determining the degree to which the lead buyer will internalize or externalize the buyer-supplier interface. While the level of analysis regarding governance choice by the lead buyer is the firm-to-firm (buyer-supplier) dyad, the cognitive, normative and regulative barriers to cross-country exchange operate at multiple levels, interpersonal, inter-firm, and country-to-country, influencing key decision makers’ perceptions and strategies. Institutional theory and transaction cost economics provide useful frameworks to break down the overall cross-country barriers into smaller analytical units, suggesting that the costs associated with each type of barrier are determinants of sourcing and governance strategies. However, there is no theory-based way to prioritize and rank order all these factors, and to determine whether and how, in light of existing practice and solutions, they actually affect lead firm behavior. Not only are there no data on most of these factors, but preliminary interviews and reviews of specialized apparel industry press indicate that most specialty retailers do not actually measure the true cost of doing business in the various countries that host their GVC, and that there is no agreement on which metrics could be used. For the most part, all sourcing overhead costs are evenly allocated across all products (Birnbaum 2015), regardless of where the costs are incurred.

For these reason, in-depth interviews of key participants in the global value chains have been the primary intended source of data from this study’s inception. At the cost of oversimplifying the methodological question, the starting point of this choice is summed
well in one widely cited text on qualitative research: “If you want to know how people understand their world and their lives, why not talk with them?” (Kvale and Brinkmann 2009). The use of in depth interviews as the primary source of data fits the exploratory nature of this research and its quest for an emergent construct such as institutional brokerage. It also matches the discovery process used by practitioners in international trade and global sourcing, for whom hands-on experience and face-to-face interaction with the participants in the global value chain is exceedingly critical in making judgments and business decisions when faced with so much incomplete information.

4.4. RATIONALE FOR CONSTRUCTIVISM

Scientific positivism tends to assume the existence of foundational, objective truths that can be universally known, and views science primarily as progressing by means of tests of hypotheses through measurement and quantitative studies. This approach, however, leaves a lot to be desired when we seek to understand complex phenomena pertaining to culture and human society; reality in such complex systems can be emergent and knowledge contextual. The positivist idea of an objective, knowable reality may simply not be adequate in the social sciences (Lincoln and Guba 2013). The assumption of an objective ontology of reality demeans human abstraction capabilities and oversells the objectivity of our sense perception and its measurement instruments. Are the patterns that we can observe in human behavior less real and our hypotheses about them less scientific because they cannot be measured with a scale, a tape measure, or in dollar value?
Historically, much scientific progress has been engendered by breaks from existing accepted paradigms that enabled scientist to formulate new theories providing improved understanding of previously unexplained phenomena (Kuhn 1962). The emergence and gradual gain of acceptance of the subjective ontology underlying the postmodernist view of the social construction of social reality, and of the partiality of all truths, is quite possibly a methodological paradigm shift in science. The constructivist ontology is subjectivist, with multiple constructed realities rather than a single true ‘objective’ reality, the result of cultural context and individual’s experiences and perceptions, and the researcher-participant interaction. Socially constructed knowledge can be then transmitted within societies, and concepts pertaining to reality become institutionalized through custom into what is perceived as objective reality, and taken for granted; this process of socialization can then align subjective reality with the institutionalized objective reality (Berger and Luckmann 1966). 13. If reality is in truth relative, subjective and contextual, then human science entities are matters of definitions and convention: they exist in the minds of the researcher but they do not really exist.

“Realities exist in the form of multiple mental constructions, socially and experientially based, local and specific, dependent for their form on the persons who hold them.” (Guba 1990).

This means that we construct knowledge through our lived experiences and through our interactions with other members of society. As such, as researchers, we must participate in the research process with our subjects to ensure that we are producing
knowledge that is reflective of their reality (Lincoln, Lynham et al. 2011). In a constructivist approach, the construction of knowledge is dynamic and evolutionary, taking place through sense-making (Lincoln and Guba 2013) and through the development of constructs that can turn the random congeries of sense-perception into an ordered conceptual structure, dealing with confusion of an unordered reality by means of semiotic organization (Lincoln and Guba 2013) 45. This theoretical knowledge is developed during in depth interviews through a conscious systematic sense-making effort, with individual and collective reconstructions coalescing around a consensus (Guba 2005) 196 to develop a deeper, more inclusive and more sophisticated construction of reality than currently available. The goals of constructivist research is necessarily emic and idiographic (Ponterotto 2005), seeking to understand the meaning of social phenomena, through an in depth investigation of the participants lived experiences (Schwandt 1994).

The starting point however can never be a tabula rasa: participants and researcher bring their stock of knowledge and experiences, with theory built on theory. I came to this research with a small set of theoretical assumptions: that the buyer-supplier interface governance choices by lead firms follow patterns, and that these patterns are explainable as the resultant of structural factors such as country level institution, and supplier level characteristics, and of firm agency. Consistent with a constructivist approach, I have used these theoretical frameworks as foundations, but did not embrace a priori any specific hierarchy of governance determinants, nor did I assume a rank order of the governance choices. In fact, I had great uncertainty as to whether, for example, I would find sufficient
variation in institutional distance between the US and the focal Asian host countries to influence the governance choice, or whether supplier capabilities might cluster by country. Another source of uncertainty came from the lack of suitable metrics for my informants to assess the importance, and economic impact of the determinants I set forth, exposing me to the risk that they could summarily dismiss them, without an in-depth discussion. This was a critical risk considering the centrality in constructivist research of the dialectical investigator-participant interaction in the co-creation of knowledge, through consensus and source triangulation. I was able to largely avert the risk of participant default from the process of knowledge co-creation thanks to clues provided by pre-interview conversations with some key informants and by practitioner publications, which ensured the centrality of the object of my research for key sourcing decision makers in my focal industry, and the potential usefulness of my findings to practitioners.

4.5. THE RESEARCHER ROLE

“What is the relationship between the researcher and that being researched?” (Creswell and Clark 2007). The answer to this key epistemological question in qualitative research descends directly from the subjective ontology views underlying constructivism, which casts the researcher as an active participant in the creation of knowledge. In this methodological approach, the centrality of the investigator-participant interaction is a distinguishing characteristic: inquirer and inquired are fused into a single entity (Guba 1990), and findings are literally co-created in the interaction between the two (Guba 1990):
“As such, as researchers, we must participate in the research process with our subjects to ensure that we are producing knowledge that is reflective of their reality (Lincoln, Lynham et al. 2011).”

The starting point of any quest for new knowledge is therefore not a tabula rasa, but rather participant and researcher bring their stock of knowledge and experiences, and the results of sense making of result of cultural context, individual experiences and perceptions. If knowledge is co-created, then process of research should be

“Hermeneutic, dialectic: individual constructions are elicited and refined hermeneutically, and compared and contrasted dialectically, with the aim of generating one or a few constructions on which there is substantial consensus (Guba, 1990) 27”

The need for in depth interviews in this research descends from the fact that governance decisions are affected by professional and personal judgments that do not get measured or tested, and operate subconsciously, through heuristics and biases. Key business decisions are frequently made with incomplete information, often based on experience and anecdotal knowledge, and important causal relations and decision outcomes are often overlooked and under-analyzed. In-depth interviews of key decision makers and operatives offer an opportunity to probe their understanding, past the management clichés and ‘truisms” and the automatic-pilot answers that would be obtained using survey instruments. Reluctant participants will often have to be coaxed
towards awareness of the higher order complexity of their environment and experience, to elicit responses that are more sophisticated.

From this perspective, the researcher needs a unique set of personal and professional skills and experiences to assume the role as orchestrator of knowledge construction (Creswell and Clark 2007). In my specific case, this was the result of over two decades of managerial and entrepreneurial experience in global sourcing and international trade in the same countries that host the apparel global value chains, and knowledge derived from twenty years of family involvement in the apparel industry. This background, known to all participants, facilitated a more open and higher level discussion with the interview participants than would be possible for a researcher with no field experience in international business, expediting the discovery process. More importantly, over two decades of experience in cross-cultural business negotiations supported my research agenda with professional legitimacy, allowing me to challenge the elite interview participants, as often as necessary to elicit deeper analysis, beyond pre-packaged or condescending answers (Brinkmann and Kvale 2015) 171.

4.6. INFORMATION NEEDED

The research design reflects the complexity of the information needed to shed light on the study’s research questions. The first step is to assess the relevance of some key underlying ideas and assumptions upon which the theoretical model guiding this research is built, specifically:
1. That institutional distance between the US and the GVC host countries manifests itself in the form of transactional and relational barriers to cross-border exchange, which result in additional transaction costs borne by the two parties of the exchange.

2. That qualitative and quantitative variation in institutional distance between the home and host countries is in fact a determinant of the different governance choices made by the lead buyer for their interface with suppliers in each country.

3. That variation in suppliers’ transactional and relational capabilities is in fact a determinant of how lead firms choose to govern their interface with each supplier, as suggested by prior research.

4. That lead buyers vary in their critical brokerage capabilities aimed at lowering transactional and institutional barriers, and that variation in such institutional brokerage capabilities channels the governance decision in different directions.

Borrowing freely from early interactionist theory (Lewin 1935) which postulates that behavior is a function of the individual and his environment \( B = f(P,E) \), the guiding idea behind this study is that governance is a function of the lead firm (its strategic investment in institutional brokerage capabilities) and its environment (institutions and suppliers), the result of the interaction of institutional and industry structure and firm agency. The challenge in this research is to build on a background of contextual information from trade data, industry publications and scholarly studies to map how subjective perceptions and experiences by lead firm sourcing executives regarding these structural factors engender a strategic response, and affect their GVC governance
choices. While there is an abundance of available trade data (OTEXA 2016) to determine the most important host countries on which to focus during the interviews, the governance of the buyer-supplier interface is typically proprietary information and an analysis of supply chain presentation and documents from lead specialty retailers yields limited information. Thus, I relied primarily on the interview process to gain knowledge on the buyers’ governance choices and their drivers.

4.7. RESEARCH SAMPLE AND SAMPLING STRATEGY

The apparel industry, together with consumer electronics and auto parts is one of the three largest finished goods sectors that rely extensively on global value chains to fulfill their customer demand (UNCTAD 2011), with a traded goods value in excess of US$ 200 billion, about 40% of which is imported by the United States (OTEXA 2016). Following the virtual demise of domestic apparel manufacturing, with import penetration in excess of 94% (Gereffi and Frederick 2010), the US apparel is completely dependent on the apparel global value chains, eliminating the need to control for competition with domestic firms. The supplier choice will therefore be strictly a function of supplier capabilities and of the host country characteristics.

The top US specialty apparel retailers are an especially suitable subset for this study for several reasons. First and foremost, they are economically important, taking the lion share of the US$ 200 billion in total apparel sales, with the top 25 specialty retailers accounting for about 40% of the total US apparel sales (APPENDIX F.). Second, there are a number of large firms of comparable size and product complexity that choose different
governance modes for their interface with suppliers; this effectively controls for two of
the three determinants of GVC governance in the extant literature, transaction frequency
and codifiability of product information (Gereffi, Humphrey et al. 2005). The reduction
of this original set of variables to just one, supplier capabilities, allows me to introduce
two other proposed determinants of the governance choice, country level institutions and
lead firm brokerage capabilities, without sacrificing parsimony. Third, transaction
frequency (thousands of transaction in average for each retailer), and repeated business
with key suppliers allows me to expose the transactional and relational country level
institutional barriers that persist after learning curve gains are exhausted, and despite the
significant gains in capabilities and sophistication of the supplier base (Gereffi and
Memedovic 2003). Finally, the US specialty retailer subset is uniquely suited for this
research because of the insularity of its brands. Almost none of the top specialty apparel
brands have significant product sales outside the US and Canada, which removes the
concern that market-seeking considerations (for example entry in China) may affect
sourcing location choices and distort the findings.

Drawing from a commercial database of apparel retailers (CSG 2014), I extracted
a subset of specialty retailers engaged in sourcing their own proprietary lines, trying to
limit as much as possible the subset to women’s wear apparel lines to reduce the variation
of product complexity and target markets within the sample. Thus, retailers specializing
in children wear, accessory, and men’s wear were not included. Retailers who purchase
primarily in the merchant markets such as Nordstrom, or Saks Fifth Avenue, retail
consolidators like the Marmaxx Group, and mass retailers that do not disaggregate
apparel sales data like Target and Wal-Mart, were excluded from consideration. Foreign firms like Zara, H&M, Gucci and Armani were also excluded, as the study focuses on the sourcing activities of US lead buyers. After all these exclusions, I identified a subset of 43 specialty retailers (Appendix F.) accounting for over one third of total US apparel sales, and over 50% of US women’s wear.

Consistent with the constructivist approach, my sampling strategy was purposive (Merriam 2002) and the individuals, selected directly, and then through referral (snowball sampling), were chosen based on their potential to be most informative (Patton 1990) and to contribute to knowledge creation with thick description (Geertz 1973). Experience at the executive level before and after the Multi-Fibre Agreement (MFA) was phased out in 2005, eliminating the quota restrictions that limited garment sourcing in China, was also an important consideration in selecting participants. A second important criterion in the sample construction, namely the interviews of suppliers and intermediaries in Asia, seeks to address issues of research quality, providing much needed source triangulation across stakeholder roles. I was fortunate enough to be referred to chief executives at some of the top suppliers and intermediaries in the industry, giving me a more critical and three-dimensional view of lead buyer activities and characteristics.

One of the expected advantages of selecting senior executives was their willingness to have a probing but wide-ranging discussion on their own industry, and their desire to be heard. With very few exceptions, that expectation was exceeded in the field, as almost all participants appeared eager to contribute, extending the time originally set
aside for the interview. Most found the process rewarding and expressed interest in learning about the research outcome. As a practical matter, for retail sourcing executives, I used the following criteria for inclusion:

- At least 10 years of executive level sourcing experience, at Sr. Director and Vice President or above at one or more top 100 specialty retailers
- At least 10 years of experience directing a sourcing team.
- At least 15 years of experience travelling to Asian manufacturing locations.
- P/L sourcing responsibility for annual volume greater than US$ 100 MM wholesale.

Participants in other roles were

- A principal of the world largest sourcing intermediary, based in Hong Kong.
- The CEO and one Vice President of the largest US apparel intermediary, based in New York.
- The Managing Director and one Vice President of one of Hong Kong’s premier apparel sourcing agents, based in Hong Kong.
- The former Indonesian managing director of a Hong Kong based sourcing agent.
- The principal and CEO of the world’s largest shirt factory, based in Hong Kong.
- A principal of the world’s largest knit sweater manufacturer, based in Hong Kong.

The participant demographics are summarized in Table 4.1.

At the time of the interview, the participants with retail background were either working or had worked in recent years in executive sourcing capacity, for a total of 14 of
the top retailers listed in Appendix F., accounting for about 50% of the subset’s sales. This
direct industry coverage is supplemented by the insights from intermediaries and
manufacturers, whose customer base includes most of the other firms in the subset,
providing further depth and scope to the analysis.

Table 4.2. Interview participant demographic profile

<table>
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<tr>
<th>ID</th>
<th>Sourcing Experience</th>
<th>Executive experience</th>
<th>Top 100 Retailers</th>
<th>Top Agent</th>
<th>Top Mfg</th>
<th>Education</th>
<th>Gender</th>
<th>Age range</th>
<th>Location</th>
<th>Interview length</th>
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<td>M</td>
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The sample size is consistent with the intent of an interview based qualitative
study. The objective here is not to generalize across industry and contexts, but rather to
gain in depth knowledge of sourcing activities through an institutional lens in a large
subset of the US apparel industry. The main thrust of the research is to bring to light
activities and capabilities that practitioners do not usually rationalize, but that make up
an industry culture. Lead US retailers tend to source in the same countries, and source
from the same pool of qualified suppliers, relying either on their own sourcing office or
on a relatively small group of well-known sourcing agents and intermediaries. Mobility of executives and managers within the industry also contributes to the diffusion of the generalized set of assumptions about the challenges of cross-border exchanges that constitute this industry culture. Thus, this study can be viewed as a study of variation within one industry culture, seeking to cast light on how individual perceptions of key decision makers bring about variability in strategic responses to these shared challenges. A study of this nature seeks richness of information through purposive sampling which by itself makes the concept of sample size, inherently linked to statistical power in quantitative studies, largely irrelevant. My sample size, with 15 distinct participants and content-rich interviews averaging just short of two hours each, fits within existing guidelines for sample size for interview based qualitative studies, which range from a low of eight (McCracken 1988) to 20-30 (d'Andrade 1995), and is sufficient to gain in depth understanding of the phenomenon under study, as well as to ensure study quality and trustworthiness through source triangulation (Lincoln and Guba 1985).

4.8. RESEARCH PROCESS

This research started with a simple observation in the global apparel global value chain, that specialty retailers rely to a varying degree on the services of sourcing agents and trade intermediaries to interface with suppliers in their sourcing regions, despite the significant intermediation costs, and that they do so even though they have fully staffed sourcing departments. The research process emerged in three distinct stages:

Stage 1. The first critical stage was the definition of the research question, more specifically understanding considering existing theory what critical function is being
performed by intermediaries in the apparel GVC and the extent to which these functions can be performed by the lead firm directly. Also important in the problem definition was a thorough review, and continuous monitoring of industry data and publications to ensure that the emergent theoretical research questions were relevant to industry practice.

Figure 4.1 Research Development: Defining the Research Problem
The definition of the research problem, illustrated in Figure 4.1, was the lengthiest stage, as it entailed a thorough review of theoretical literature, the examination of retailer annual reports and presentations, case studies, and industry studies from international organizations, think tanks and industry watchdogs, as well as respected books on apparel sourcing, and industry paper and online publications. From the examination of existing information, it became apparent that only in-depth interviews with key decision makers in the apparel GVC with a constructivist approach could create theoretically insightful and reality-proofed knowledge on the emergent research questions regarding the structural and strategic determinants of firm boundaries in offshore outsourcing.

Stage 2. With the research problem framed and an initial theoretical model as a guideline, I moved on to the second stage, developing the field study (Figure 4.2). I tackled at first the critical issue of securing the participation of a sufficiently diverse sample of industry sourcing executives that could bring depth of direct knowledge regarding both daily practice and strategic decision-making, and at the same time allow the required source triangulation to ensure the quality and trustworthiness of the study’s findings.
Sampling for the interviews was purposive, seeking to include global sourcing executives with experience at multiple top US specialty retailers. Source triangulation was ensured by interviews with executives with the industry’s premier agents and intermediaries in the US and in Asia, as well as with owners of large factory groups in Asia, who serve many of the other retailers not directly included in the sample. I then
developed an interview protocol (Appendix B), based on the study’s theoretical model, with questions on the pros and cons of the different supplier interface governance modes, followed by multiple questions and prompts for each of the determinant variables under study. I conducted the interviews in three distinct rounds scheduled a few weeks apart, which allowed me to adjust the interview protocol between rounds. The different stakeholder roles of agents and intermediaries in the GVC also required the development of a related but distinct interview protocol for them (Appendix C). In the process, I removed questions that only lead buyers can answer, and adding a few supplemental questions on trust in the GVC, to investigate more in depth the relational barriers in the buyer-supplier interface, and how trust gaps in cross-border exchange are brokered.

Stage 3. The field work was concluded a few weeks after the last round of interviews, with the verbatim transcription of all interviews, ushering the study into its third stage (Figure 4.3.), that consisted of analysis of the findings, their mapping against the theoretical model and the final write up.
As a first step, I edited the verbatim transcriptions to remove certain colloquialisms, occasional banter, and some of the characteristic choppiness of conversational oral communication. In the process, I also added some initial coding and comments, in MS Word document comment format. These codes were developed in progress, primarily to allow a first mapping of the participants’ statements against the theoretical model and the study’s eleven propositions in an extensive Excel spreadsheet,
to assess patterns of concordance and patterns of contrast in the responses. This is a critical part of the constructivist approach, in which knowledge is constructed through consensus in the participants’ contributions. In consideration of the volume and sophistication of the information collected, as well as the dialectic nature and the variations in order and content of the interviews, I opted against the use of software tools like NVivo to code and analyze the transcription. Word clouds developed for the full interviews, and for the response portions failed to yield interesting insights, but rather appeared to reflect the idiosyncratic use of language of the individual participants. The number of non-native English speakers, as well as the different national contexts in which the participants live and work also contributed to my choice to eschew the use of text-analysis software, and to map the results manually.

4.9. PRELIMINARY DATA COLLECTION

While there is relatively little literature analyzing GVC governance choices through an institutional lens, there is an abundance of trade information and practitioner publications that have been a great aid in ensuring that the phenomenon under study was relevant, and that the analysis stayed solidly anchored to the real-world practice. The initial data collection from secondary sources served three main functions: a) defining the research problem, b) limiting the scope of the study and c) preparing for the in-depth interviews. To accomplish this, I followed two parallel tracks: a theoretical track consisting of an extensive literature review, identifying the state-of-the-art and the potential gaps in the strategic outsourcing and global value chains literature, and a practitioner track consisting of the review and monitoring of industry studies by international organizations,
trade press, and apparel trade data to identify the key exporters to the US. The practitioner track also included the review of top retailers’ annual reports and sourcing presentations, and of studies published by the Global Fung Institute, a research center funded by Hong Kong based Li & Fung, the world’s largest apparel sourcing intermediary and agent. Finally, pre-interview conversations with three key informants and online searches helped me identify a few sourcing books widely used by practitioners as references, enhancing my understanding of real world sourcing functions and of the critical issues in lead buyers’ interface with suppliers in the key sourcing countries. The most helpful resources are summarized in Table 4.3.

Two tragic events that took place during the early stages of this research widened the scope of perspectives to be included during the interviews. The Tazreen Fashion factory fire in late 2012 and the Rana Plaza factory building collapse in May of 2013 in which over 1000 workers perished brought the institutional weaknesses of certain apparel-exporting countries to the forefront, highlighting the importance for lead buyers to assess and ensure compliance with international safety and labor standards among the determinants of the governance choice.
### Table 4.3 Select Secondary Industry data and Information Sources

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### 4.10. PRIMARY DATA COLLECTION: INTERVIEWS

Recorded in-person interviews with sourcing executives in the apparel global value chain have been the intended method of primary data collection for this study from inception. Their successful execution posed significant practical and methodological challenges, not the least, optimal use of travel funds from the CIBER research grant that supported this study. To conduct the interviews, in most instances, I travelled to the participants’ office locations in Fort Myers FL, New York City, Hong Kong, and in Seminyak Indonesia, consistent with recommendation that interviews be conducted in the participants’ natural work environment (McCracken 1988). The interviews of two recently retired
executives were conducted in the business lounge of my hotel, and at one at the participant’s home, at her suggestion, to avoid interruptions.

As a first practical consideration, I took a series of steps to ensure that the interviews be properly recorded in digital form and to ensure the preservation of the interview recordings. For the purpose, I chose to use two recording devices in each session: a SONY Digital Voice Recorder 27-ICD PX440, with 4GB built-in flash memory, which generates very high quality digital recordings, easily transferred to my computer by means of a micro-USB cable, and I also used my IPhone 5s Voice Memo as a recording back up. Both devices performed flawlessly throughout the process. At the end of each interview, I transferred the recording to my laptop computer in .MP3 format, and saved a back-up copy in Seagate Slim Portable Drive. At the end of each round of interviews, I also created an additional back-up file on my home desktop computer.

I conducted the interviews in three rounds a few weeks a part, and after each round, I personally transcribed each interview verbatim into a MS Word document, a time consuming but critical process that I felt should not be contracted out. Listening to the recordings multiple times to transcribe them accurately resulted in crucial improvements in my line of inquiry and in the phrasing of questions, helping me identify critical areas of resistance to the process of discovery. Transcribing the interviews shortly after conducting them also allowed me to perform a review of the quality of each interview in terms of their actual content and contribution, beyond my subjective perceptions regarding their ease and flow, and to make critical improvement to my interviewing style and ‘voice’. I named the transcription files to include the identity of each participant, the
company name and interview date, and to ensure their preservation saved them in an ‘Interview Transcriptions’ folder that I duplicated and stored in multiple locations.

The interviews were semi-structured by design, guided by an interview protocol (Appendix I) based on my theoretical model. As could be expected in expert interviews, some participants were particularly eager to speak about their lifelong professional experience, to share their insights, and to participate in the emergent process of theory creation, leaving me no choice but to treat the interview protocol as a checklist, marking off answers as they flowed naturally from the conversation, to maintain control and to limit scope creep in the interview (McCracken 1988) p25. In other cases, participants struggled to speak *ad lib* and it was necessary to follow the protocols more closely. In the initial design the interview process was to follow a series of standardized steps:

1. Prior to the interview, each participant would receive a copy of participant invitation and informed consent letter describing the study, stating their rights as participants and addressing any concerns with regard to confidentiality and anonymity, as required.

2. I would then read and record a pre-interview statement

3. I would record the interview

4. I would read and record a post-interview statement thanking the participants, and asking whether they had any questions before we concluded the interview.

Time constraints and friendly feedback from two of my key informants, who found the use of pre- and post-interview statements contrived and unnecessary, imposed some
deviation from this plan, especially with participants whom I reached through referrals from trusted colleagues or customers. In most cases, the invitation and informed consent letter was sent to the participants ahead of time via e-mail attachment, accompanied by an additional explanation of the research intent as a pre-condition for their participation in the body of the e-mail. Disposing with these formalities before the meetings saved time, and ensured friendlier introductions, that contributed to create a more free-flowing discursive climate throughout the interview.

In preparation for the interviews I relied heavily on insights from two well-know and authoritative books on the methodology: McCracken’s The Long Interview (McCracken 1988) which provides a “systematic guide to the theory and method of the long qualitative interview” (McCracken 1988) and Kvale and Brinkman’s InterViews (Brinkmann and Kvale 2015), which analyzes in greater detail the interviews styles and the challenges depending on the different type of participants. This proved particularly useful in interviewing top executives and owners of top firms in the industry:

“Elites are used to being asked about their opinions and thoughts, and an interviewer with some expertise concerning the interview topic may provide for an interesting conversation partner. The interviewer should be knowledgeable about the topic of concern and master the technical language, as well as be familiar with the social situation and biography of the interviewee.” (Brinkmann and Kvale 2015) 171
Most importantly, this source alerted me to a potential challenge to the quality of responses that experts may pose to an interviewer lacking academic and professional legitimacy to challenge the opinions expressed in the course of the interview: “[Experts may] have prepared “talking tracks “to promote the viewpoints they want to communicate by means of the interview, which requires considerable skill to get beyond” (Brinkmann and Kvale 2015) 172.

Professional experience also contributed to my awareness of these challenges, preparing me to adopt interview strategies that could break-up the virtual dance in which the various participants, linked through decades in their stakeholder roles in the apparel GVC, were engaged with one another, trying to preempt and counter one another’s opinions during the interview process. Part of the strategy to counter the “talking tracks” involved exhibiting a high level of professionalism, in everything from attire to diction level, to assert my legitimacy not just as an academic researcher, but also as an experienced trade professional on my own, to retain control of the interview and to politely remind the participants of the existence of well-defined meeting objectives when the conversation strayed too far from the research agenda.

One of the concerns in the interview process was to elicit a deeper reflection from individuals in positions of high responsibility, extremely pressed for time, who over the years have devised solutions within their global value chains that may not be optimal, but that offer a path of least resistance to global sourcing, and are taken for granted. To take the discussion beyond industry truisms such as “You always use an agent in Bangladesh”,
I occasionally resorted to cognitive dissonance, contrasting responses from other interviews with the ones offered by the participant, or changing the level of analysis, stimulating a switch from the fast to the slow mind (Kahneman 2011), eliciting a more conscious, thought-through response. As observed elsewhere (McCracken 1988), many participants engaged in this lively discovery process ‘con gusto’, giving the interviews more time than initially allocated. This challenging approach had to be tempered by the existence of the same cultural barriers that are the object of this study, between me, a male middle-aged American businessman and academic researcher with Italian upbringing, and the male and female interview participants from the US, the UK, China, Hong Kong, Indonesia, and India. This cross-cultural dynamic is further complicated by the level of global integration, experience and cultural sophistication of participants, by their ability to bridge cultural gaps with their learned cultural repertoires (Swidler 1986), which can mask their deeply rooted cultural schemata (Erez and Earley 1993), thus increasing the probability of “talking-track” responses. This was a particular concern with participants who do not think in English. In these instances, I approached the interviews with a less pressing style, cognizant of the possibility that I might not be able to pierce the cultural wall, and that respondents might volunteer more practical industry information and possibly examples, but less interpretation and analysis.

4.11. DATA ANALYSIS AND SYNTHESIS

From inception, this study was not intended as an interview-based survey, but rather as a series of semi-structured expert interviews, seeking rich description and a dialectic creation of knowledge through a dynamic interviewer–participant interaction. Time
constraints and the insights that each participant had to offer imposed significant deviation from the interview protocols, requiring me to make quick judgement calls regarding interview flow, line of questioning and usefulness of the responses, and to adjust accordingly. Since I was not willing to sacrifice emergent discovery to maintain a rigid interview sequence, I did not expect the collected data to be particularly suited for automatic codification, and planned to perform manual mapping of the interview data. 

In the first editing phase after transcription, I sought to include in my interview transcripts ALL CAP notations from a hierarchy of codes (Saldaña 2012) flowing directly from the theoretical model, and from the interview protocol, that was itself patterned according to the model’s hierarchy. Four general themes directly correlated to the theoretical model’s variables:

- Buyer-supplier dyad interface governance (the dependent variable)
- Institutional distance (country effects – an independent variable)
- Supplier capabilities (the other independent variable)
- Lead firm institutional brokerage (the model’s moderator)

I placed significant effort in the identification a priori of theoretically and practically useful categories specifically related to transactional and relational dimensions in the variables, and their constituent items; each of these themes, categories and items were given their own code to facilitate mapping of the interview data in the editing process. I added a code for trust, which was an emergent theme during the interviews, and for the eleven propositions, to label comments that directly addressed them. The resulting coding scheme (Appendix III) is relatively lean (Creswell 2013), with four main
themes, ten categories and total of 49 codes, including codes for the propositions. Following the release of NVivo 11 Pro, I subsequently used the software to code the interview transcripts according to the same coding scheme, which enabled me to assess more rapidly the most relevant categories through code mapping and other visual tools provided by the software.

It’s important to note that coding is only one possible way of analyzing interview data, to facilitate interpretation of text (Saldaña 2012), and, although it can aid in the mapping of emergent consensus among interview participants, it is not designed to turn qualitative data into quantitative. The findings of a true subjectivist qualitative study are fundamentally incommensurable with quantitative approaches (Lincoln, Lynham et al. 2011). Interview transcriptions are qualitatively different from interview recordings which are the actual data collected, and there is a certain “loss in transcription” that coding can accentuate; maximum richness of description in which not only the words, but also respondent emphasis, or hesitation are captured can only attained by combining reliance on interview transcriptions with a frequent review of the original interview recordings in the final write-up. To bridge the quality gap between transcriptions and the interview experience with each participant, I have compiled a summary report for each interview, identifying key contributions, unique insights, and interview sticking points, describing the overall interview flow, and highlighting possible concerns with the quality or validity of any responses, including judgements on respondent comprehension and biases.
The reporting format of interview studies is the object of intense criticism, not least among which the overall dullness of the writing (Brinkmann and Kvale 2015), typically because of length and of the excessive use of interview quotations. Most critically, the researcher also often fails to capture and communicate the significance of the findings, and to connect them logically in themes that pertain to the research questions. To streamline the presentation of my findings, I chose to follow closely the theoretical model in the presentation of the data, discussing the areas of consensus among participants, contrasting them with any unique perspectives that may have emerged in the interview process and relating these to the research propositions. It is in this area that the use of NVivo was most helpful as I could arrange and sort interview fragments by node and arrangement in an order that follows the theoretical model and create a main narrative thread using exclusively interview materials prior to the final write-up, in which I limited the use of direct quotes to the most eloquent and enlightening, that required the least amount of editing. Finally, I conclude by synthesizing my findings in relation to the research intent, with focus on the institutional approach to the study of governance in global value chains and assessing the validity and usefulness of the concept of institutional brokerage and its associated capabilities in the study of firm strategies in cross-border economic exchanges.

4.12. ISSUES OF RESEARCH QUALITY AND TRUSTWORTHINESS

One of the greatest challenges for qualitative research, and especially for the constructivist approach to understanding complex human phenomena, is to overcome skepticism regarding research validity. Can the standards of research quality based on
positivist criteria be extended to research conducted from a subjectivist perspective? The epistemological and ontological paradigms adopted by the researcher necessarily determine the applicable standards of research quality, and although the general issues of validity, credibility, rigor and trustworthiness are pertinent to all research, the goodness of qualitative inquiry must be assessed based on the paradigm of the research (Morrow 2005). The inapplicability of the objective standards of research quality for quantitative studies does not imply that qualitative research is ‘a free for all’ (Saldana 2014), where anything goes; however the standards to ensure and assess the quality of co-constructions of reality through constructivist research will necessarily differ from the traditional positivist measures.

There seems to be some agreement among researchers on general post-positivism criteria: credibility, transferability, dependability and confirmability, which correspond directly to internal and external validity, reliability and objectivity. Lincoln and Guba suggest that credibility can be obtained by prolonged engagement with participants and participant checks, and co-analysis (Lincoln, Lynham et al. 2011). Transferability is truly a decision of the audience; however, it is facilitated with full disclosure of the relationships between researcher and participant and of the context. The researcher should seek full awareness and disclosure of his own assumptions and biases, a process for which phenomenologists use the term bracketing, becoming fully aware of them and setting them aside to avoid influencing the research (Husserl 1931). In practice, this is done through triangulation and member checks. Credibility and research trustworthiness is direct result of data adequacy, with data collected to the point of redundancy (Lincoln
and Guba 1985). For this purpose, more important than sample size are the sampling procedures: quality, lengths and depth of interview data and variety of evidence.

To ensure sample quality, its selection for this study was purposive and criterion based, not random: I sought participants with extensive high-level experience in the apparel global value, who could provide the most information-rich data. Snowball, chain referral sampling factored in the process, with the first participants having a greater influence on the final make-up of the sample. Referrals from three distinct key informants led to the participation four distinct types of stakeholder, with different backgrounds and roles in the GVC, decreasing the risk of community bias. I used great care to protect from anchoring. This was achieved by selecting participants of very high professional level across the sample and though the sequence of the interviews, grouped by design based on participant role and, for practical reasons, by geographical area, with interviews in Asia coming last. The grouping of interviews by functional role and geographic location also facilitated triangulation of data. Most critical to the ontological authenticity, to the quality of the findings and understandings developed throughout the interview process were my openness of purpose, and trusting relationships with respondents (Lincoln, Lynham et al. 2011), extensive preparations, and my personal knowledge of the industry which contributed in most cases to a relaxed and engaging interview climate, allowing the participants to explore their own work experience through a different, more theoretical lens.
Of course, a relaxed interview climate is not by itself a guarantee of quality of information. Several of the participants are quite accustomed to being interviewed by the trade press on issues related to apparel sourcing, some have been the object of case studies in Harvard Business Review and, in at least one instance, have themselves authored books on the apparel global value chain. Introducing elements of cognitive dissonance (McCracken 1988) to challenging the most media savvy participants (Brinkmann and Kvale 2015), has proven critical in eliciting original responses, beyond what I had already found in secondary sources.

4.13. ETHICAL ISSUES

Interview based research raises significant ethical issues regarding confidentiality during the interviews and in reporting the findings, regarding access by third parties and retention of the recordings and their transcriptions and to the use and publication of their contents. Many of these concerns were addressed following guidelines of the Institutional Review Board of the University of South Carolina. All participants received an informed-consent invitation letter (Appendix E.) explaining the research purpose and their rights as participants, providing details on access, use and retention of the recording and their transcriptions, and assuring their complete anonymity in the dissertation and in any future publication that may be derived from it. Additional details were sent to participants in Asia, who were all sourcing agents, intermediaries and apparel suppliers whom I reached through referral from other retail executives, to assure them that none of their statements would be shared with their referents, or any other clients or competitors.
Managing confidentiality posed some interesting challenges during the interviews because of the need to balance the usefulness of the knowledge built from previous interviews and of statements from various participants in eliciting deeper reflection and more sophisticated responses, with the obligation to keep interview contents confidential. Any breach of confidentiality during an interview would not only represent a violation of my code of conduct as a researcher but also compromise the participants’ trust in the integrity of the research process, reducing their willingness to share their views with openness, and to contribute with invaluable examples from their experience with specific firms in the apparel global value chains. Fortunately, the process of referral itself, gave all participants a degree of awareness of my connections within the industry, and the caliber of my referents afforded me a level of ‘borrowed trust’ in discussing specific firms and industry dynamics. Because of the referral chain, many interviews went in much greater detail discussing my referents’ present and past firms, as well as insights on other firms in the industry with which I had no known connection. A few participants presented me with an unexpected twist in the issue of confidentiality, as they probed me for opinions and views from their clients and competitors, on and off the record. While their curiosity opened interesting lines of inquiry, confidentiality took precedence. The preliminary data collection, specifically industry press articles, books and case studies proved invaluable in these instances allowing me to pursue these unplanned threads making references to published views rather than breaching other participants’ confidentiality.
CHAPTER FIVE

RESEARCH FINDINGS

In this chapter I follow the basic outline of the theoretical model to present the results of the field work associated with this study, and to discuss the finding in relation to the model’s propositions. The completed field work consisted in in-depth interviews with a total of fifteen sourcing executives, agents, suppliers and trade intermediaries, conducted in the US, Hong Kong and Indonesia; in addition to the interviews, I was invited to attend an internal training seminar for country managers at Li & Fung’s headquarters in Hong Kong, featuring a presentation by the firm’s COO and principal. The interview recordings span close to 30 hours, averaging 1h 53’ per interview, yielding 322 single spaced pages rich with content, as all formalities to introduce the research topic and regarding informed consent, were addressed via e-mail prior to the meetings, to maximize useful interview time in consideration of the participants’ schedule constraints. Besides the interview transcriptions, I have created interview reports with additional observations regarding each participant’s main contributions, recording issues that arose during the interview.

The analysis of the transcripts benefitted greatly from the use of NVivo 11 Pro for coding, which greatly facilitated the manipulation and extraction of data. The theoretical
model (Figure 5.1) which provided the basis for the interview protocols was also the basis of the initial coding scheme (Appendix III).

![Diagram of GVC Governance Mode]

**Figure 5.1 Determinants of buyer-supplier governance mode in apparel GVC**

In addition to the codes, categories and themes from the study’s theory development, I included nodes for the eleven propositions, and a code for quotable statements to facilitate their retrieval when presenting the data. Overall, the interviews yielded 1370 references to 35 nodes, and 73 direct references to the 11 propositions. These 1370 references represent the data points of the research and feature prominently in the presentation of the results, which I organized in sections by variable: I begin the presentation with a discussion of the GVC governance, the dependent variable, followed by the two independent variables, institutional distance and supplier capabilities, and concluding with the moderator variable, institutional brokerage. A quantitative mapping of the data points shows how the data fit against the theoretical model (Figure 5.2)
In order to organize the data, I have subdivided each variable section into subsections corresponding to the original coding scheme, I extracted all coded content for each node, weeded out non-usable or redundant passages, and then created a master document pasting all relevant coded data in their corresponding subsection. The resulting document maps out over 500 participants’ original contributions, edited only for clarity, preserving all the data pointing at emerging consensus, as well as those revealing divergence of opinions. Finally, I write up the results weaving the data points in a narrative, assessing the validity of a priori assumptions made in the theory development, and gauging the concordance of the model’s propositions with the opinions and preoccupations of the research participants. The interpretation of the findings presents
challenges linked to cultural difference between Asia participants and US participants as well as difference in roles and positions in the value chain, as for example between an agent and a manufacturer. Another subtler challenge is posed by the immanent nature of many participants’ concerns, and the occasional banality and one-sidedness of some of the opinions offered as expertise. One executive at Li & Fung, the world’s largest Hong Kong based apparel intermediary, used an old Buddhist parable to describe the cognitive challenges ahead, as he described the narrow views and misconceptions among the industry buyers, suppliers and competitors about Li & Fung’s business model, and its role in the global value chain:

*Iti3*: you know the old parable of the elephant and the blind men? They take a bunch of blind men and ask them to tell you what an elephant looks like: and the first blind man feels the elephant’s trunk so he says: “I know what an elephant looks like: it looks like a snake“ another one feels his legs and says “No, no it is like a tree“ the third one feels the body and says “No, an elephant is as big as a house ...”

**5.1 THE END OF INTERMEDIATION?**

At the end of 2004, the expiration of the Multi Fibre Agreement which had regulated for 30 years the apparel and textile exports from developing nations, primarily in Asia, to the US and EU by establishing export quotas, was expected to revolutionize the apparel industry, spelling doom for exporting nations like Bangladesh, where a garment industry had developed to circumvent quota restrictions on Hong Kong and China. With the
elimination of export quotas, industry insiders wondered not whether China would become the only significant sourcing market for apparel brands, but how quickly. Besides the expected geographical shift, another momentous change was being predicted: the end of intermediation. In the words of the CEO of one of the largest US based sourcing intermediaries:

**ITI1**: “Up to 2005, until quota went away, our business proposition was: because we had quota we got the orders. Fundamentally, we were a trading company, and because we had the quota we would get the business. (...) [We] invested in Hong Kong quota over the years. We had the largest quota portfolio in Hong Kong, and developed the capabilities everywhere to go get quota. We always had quota. We traded on quota.

**AP**: That was a nice part of the profit ...

**ITI1**. That was THE [respondent’s emphasis] profit. So back in the 90s, one of the biggest reasons for intermediation was that we had quota. As straight-forward and fundamental as it could get. And when quota went away, we started thinking about what’s our value. When quota went away, the prediction was that intermediaries were going to go away.”

The elimination of quotas, and combined with accelerating evolution of information and communication technologies and productivity software, and web-based system integration were expected to allow buyers to source from remote factories in the apparel GVC, contracting and monitoring production directly, with low transaction costs,
and no intermediation costs. As one ex-sourcing executive, now owner of a small apparel company recollects:

**RET2:** I was at [a large specialty retailer] between 2003 and 2008, and we were already hooked up with some of the factories directly with the Gerber PDM system [a product data management software system]. Our spec systems were hooked directly into the factory, so there was no delay associated having to go through an agent’s office, if the spec had already been approved.

Both sets of predictions proved to be widely exaggerated. On the geographic front, the competitive advantages of exporting countries like Vietnam, Indonesia and Bangladesh and, to a lower extent, India remained sustainable, keeping China’s share of US total apparel imports below 40% (OTEXA 2016). All specialty apparel retail executives interviewed have indicated that they source in at least three countries, besides China, for a significant percentage of their total business, and that they are implementing corporate strategies aimed at making their value chains less China-centric. On the governance end, contrary to expectations, intermediaries and agents have actually flourished (KSA 2016), a phenomenon best evidenced by the emergence of Hong Kong based sourcing giant Li & Fung, which alone accounts for almost 10% of global wholesale apparel sales. Not only have other intermediaries and agents grown in size and scope, but some of the traditional functions of intermediaries have also been taken over by the emergent manufacturing multinational companies, the “super vendors” (KSA 2016) based in Hong Kong, Taiwan
and S. Korea, who provide a number of brokerage services as they seek to capture a larger share of the value chain, at times competing with traditional intermediaries.

**AGE1: The big multinational factory groups: TAL [HK based TAL Apparel], Esquel [HK based Esquel Group] ... they are manufacturing all over the world. Are they factories, are they agents or are they trading companies? They are falling into a hybrid role, and that results in a lot of turf wars.**

Both the survival of intermediaries and the assumption of brokerage functions by these emerging Asian multinational manufacturing groups seem to confirm a broad assumption of this research: that the challenges in the apparel global value chain are far greater than simple transactional effectiveness, and that the capture of the economic arbitrage opportunities between developing economies and the US rests on a broader set of skills and activities required to overcome the transactional and relational barriers between buyers and suppliers.

**5.2 THE RESEARCH QUESTIONS**

As the apparel GVC continues to be dispersed across multiple developing countries, with even greater geographic complexity if we consider the origin of the inputs of production, fabric, yarns and trim, lead buyers are confronted with a series of strategic decisions on country and supplier selection, and then with operational pressures regarding the governance of hundreds of supplier relationships spanning across multiple countries. This research seeks to shed light on the drivers of the governance decision, the institutional and structural determinants of the governance decision, and the role that lead buyer
strategic response to these determinants play into the governance choice for their GVC. Building upon widely recognized work on the governance of global value chains (Gereffi, Humphrey et al. 2005) which identifies transaction complexity, codifiability of information and supplier capabilities as the determinants of GVC governance, I apply an institutional theory lens to shed light on the impact of host country institutional factors, and then explore the role lead buyer agency on the choice of governance mode. In the analysis of dyadic buyer-supplier governance, my theoretical model retains supplier capabilities as a key determinant, but controls for transaction complexity and codifiability of information through sample selection, focusing on a sizeable industry subset, US specialty apparel retailers, within which these two factors are fundamentally invariant. The validity of this underlying assumption, inferred from trade publications and expert opinion (Birnbaum 2000), was confirmed in the course of the interviews by virtually all participants. This line of inquiry leads to three broad research questions:

1. How does home-host country institutional distance affect the lead buyer’s choice of governance in each GVC buyer-supplier dyad?

2. How do supplier capabilities affect the lead buyer’s choice of governance in the GVC buyer-supplier dyads?

3. How do the institutional brokerage activities and capabilities of the lead firm affect the lead buyer’s choice of governance in the GVC buyer-supplier dyads?

Although there are anecdotal accounts of the additional costs associated with institutional distance between the US and the various host countries, there are no reliable
data of its effect on cross-border transactions and relationships. Several retailers have indicated that they apply transactional metrics and scorecards, but they do not even try to assess the differential in true cost of doing business in the various countries. Even more metrics-driven executives like the CEO of the world largest shirt factory, and owner of a network of factories in China and in four southeast Asian countries expressed serious doubts that applying activity based costing to country costs would yield actionable insight worth the expense. Ultimately, the upper limit of the value of cost information that Could be gathered analytically is set by the cost of alternative governance choices in which the complexity associated with doing business in any country is externalized to a third party. The cost of doing business in the various host countries appears to be inextricably embedded in a web of transactions and buyer-supplier relationships, and is linked to the cognitive, normative and regulative barriers instantiated at the IB interface; the governance choice represents the lead buyer’s strategic response to these transactional barriers and to the trust gaps inherent to the GVC. The lack of suitable metrics and the complexity of the phenomena under investigation call for a qualitative inquiry, however, it also presents an epistemological challenge as the lack of metrics is also responsible for respondents’ cognitive blind spots, whereby (expensive) existing solutions mask the transactional and relational barriers in the GVC and their associated costs. Participants take these solutions for granted, underestimating the problems currently resolved by suppliers, agents or intermediaries.

Another challenge is posed by a degree of cross-fertilization of ideas and practices among retailers, due to job mobility. The seven retail sourcing executives I interviewed
have worked for a combined 14 different top 50 specialty retailers at multiple levels of responsibility and multiple divisions. One respondent (RET1), a sourcing executive at five different specialty retailers over the last two decades, lamented a degree of “sameness” across retailers in the same space, and the diffusion of certain industry truisms about country selection, vendor mix and “best practices”. Below the surface, however, during the interview, her experience revealed more variation in sourcing practices, and governance choices that are reflective of distinct lead buyers’ strategic stances regarding their global value chains.

5.3 GVC GOVERNANCE

With virtually all garments sold in the US imported from developing countries, the US apparel brands are completely dependent on the apparel global value chain, bringing country and supplier selection and the governance of the supplier relationships to the forefront. Owing to the evolution of specialty retailing in the direction of multichannel retailing, with more SKUs and smaller orders, the industry is characterized by a generalized trend toward the transfer of operational responsibilities onto third parties. The growing number of styles developed and booked by a typical top 50 U.S. specialty retailer (most sourcing executives put that number of booked styles between two and three-thousand) greatly increases organizational complexity due to cross border interface demands with more factories, more with fabric, yarn and trim suppliers, in more countries, increasing the pressure to outsource some functions to suppliers and to lower cost countries. At the same time, this extreme level of offshore outsourcing strains the lead buyers’ ability to control production, ensure compliance, and coordinate the
activities of their geographically remote and dispersed value chains, making the choice governance mode of the buyer–supplier interface ever more critical. For most specialty retailers, the governance decision has two dimensions: a global level decision regarding the role of sourcing activities in the organization and the resources, and a dyadic level, concerning the governance of individual buyer-supplier interfaces. At the global level, the retailer must decide the degree of direct control that it wants over its supplier base. In the view of one large Hong Kong based supplier, the global decision is a function of whether sourcing is viewed as a core function:

**MFG2:** “How important is sourcing in the view of the C level executives? Is just something that you need to get done so you can sell, or is it truly part of your strategy to get into the whole manufacturing, so that you have value-add in your product at the end of the day. If you really feel it gives you value-added, then you’ll want more control over it.”

The global level decisions include the size of the sourcing department at headquarters, whether to have a regional sourcing office, commonly in Hong Kong, and possibly local offices in key sourcing countries. The decision is often one of degrees, as most U.S. specialty retailers in the billion dollars plus range often work in a variety of directions, they may have their own offices, they may supplement their offices with agents, they may find some factories with whom they work direct from headquarters. At the dyad level, the governance decision is more directly influenced by the institutional characteristics of the host country and supplier capabilities; an important effect of the
global governance decision is that it may limit the countries in which the lead buyer can source and the type of suppliers it can engage.

The interviews confirmed the three governance modes inferred from trade publications and set forth in my proposed theoretical model: for the specialty retail subset of the apparel industry they are limited to direct sourcing in which the lead buyers interface directly with the supplier (factory), and indirect sourcing either through agents or through trade intermediaries (trading companies). While one industry veteran regaled me with tales of travel, in the 1980s, to civil war stricken Sri Lanka to set up a bra manufacturing joint venture for the nascent Victoria Secret brand, the days of direct investment by specialty retailers are largely over, and there have been no recently reported equity investments in production by US specialty retailers. There are a few instances of important brands, with narrower product offering, and in the mass market space that own all or some of their manufacturing facilities, but none in the specialty retail space; strategic ownership of production assets is more an exception, as in the case of Hanesbrands (http://www.hanes.com/corporate), or a legacy of acquisitions, as in the case of the denim and active wear brands of the VFC group (www.vfc.com), than the norm. There are also very limited instances of the captive production set forth as a governance mode in the literature (Gereffi, Humphrey et al. 2005) as both specialty retailers, and their vendors (factories, agents and intermediaries) deliberately avoid relationships that represent more than 30-50% of the total capacity, or the lion share of any particular product category. Finally, the market governance mode is not truly
applicable to the apparel global value chain, which appears to be built on idiosyncratic buyer-supplier relationships, however governed.

**5.3.1 DIRECT SOURCING**

With direct sourcing, the lead buyer establishes a principal to principal transactional relationship with a manufacturer that bears the greatest similarity with traditional contract manufacturing. The interface with suppliers can be managed directly from headquarters, or through local and regional offices, most commonly in Hong Kong. It is a high fixed costs strategy, with a large headcount that gives the lead buyer the greatest level of control over its global value chain, and when implemented correctly the lowest variable costs. Although economies of scale can be significant, making direct sourcing more common with the larger retailers like the GAP, size alone is not a predictor of whether a retailer will go direct, as evidenced by the variability of governance choices across the direct competitors of similar size, as in the case of Ann Inc., with its focus on direct sourcing at the time of the interview, and Chico’s with its hybrid sourcing strategy.

Direct sourcing has some obvious advantages: it can yield lower prices, greater cost transparency and supply chain visibility, and overall greater control on production and potentially greater quality. It also saves 6-12% in intermediation cost compared to indirect sourcing. In theory, direct relationships with the manufacturer minimize the ‘loss in translation’ that can be experienced going through a third party, because the supplier is hearing about the design and requirements directly from the source. Finally, direct sourcing provides the highest level of control over compliance and subcontracting,
minimizing the risk of exposing the brand to damaging involvement in catastrophic events such as the Tazreen factory fire or the Rana Plaza factory collapse.

Managing direct sourcing from headquarters is relatively easy option with well-defined products, and for simple production; product complexity hinders the ability to go direct without ‘boots on the ground’ from regional and local offices. An obvious downside of direct sourcing is the high cost of large regional buying offices, which are typically based in Hong Kong and don't necessarily give adequate coverage outside of China. Hong Kong buying offices frequently face cultural and operational difficulties in managing countries like Indonesia, or Bangladesh, and tend to revert to their preferred supplier network in China, giving rise to a potentially costly agency problem. Opening small effective local offices in countries like Indonesia or India becomes economically viable if the volume of business exceeds 11-12 MM on an FOB basis, according to a former sourcing executive involved in the decision to open a local office in India. For most retailers larger than 1 billion in sales, three to five countries meet this threshold. Overall, even for retailers who seek to source directly from the manufacturer, large regional offices (typically in HKG) are losing favor in part because of their cost, but also because the traditional tensions between headquarters and subsidiary are accentuated by the cultural distance between HK and the US, which can impede the transfer and adoption of company practices. In the words of one retail executive who ran a sourcing office in Hong Kong for six years “you think you can control these people, but you really can’t.”
The owners of two large factory groups contribute a different perspective: to source directly, the buyer needs an in-depth, thorough understanding of the manufacturing process, and needs adequate staffing to deal with detailed order processing and management. Direct sourcing is time consuming, expensive in terms of staffing and travel, with high search costs because of the sheer number of transactions, but also because of steep cultural, normative and regulative barriers in the host countries. Thus, the large manufacturing groups are often the main beneficiaries of direct sourcing, because of the western schooling, level of sophistication of owners and management, and their experience doing business with US retailers.

5.3.2 SOURCING THROUGH AGENTS

Sourcing agents in the apparel industry are specialized firms with embedded relationships with a network of factories in one or more country; industry consolidation has led to the survival of a relatively small number of large sourcing agent firms such as W.E. Connor in Hong Kong, New Times Group in Hong Kong and Taipei, and MGF (formerly MAST Industries) in New York, Triburg in India, and the largest, Hong Kong based Li & Fung. Many of these firms will have offices in multiple countries to manage the suppliers and in New York to interface with their clients, the lead buyers. Sourcing agents are commission based buying agents who do not take title to the goods, but place orders with the factories on behalf of the lead buyer and manage them for a commission that is typically in the range of 6% of FOB value. While some of the firms mentioned operate exclusively as commission agents, notably W.E. Connor, others have a dual business model, in which they also operate as trading companies. Although this appears blurs the lines between
the two types of intermediation, in practice most intermediaries keep the two forms quite
distinct in terms of services provided and capabilities deployed. As one of the principals
of the largest apparel trading company put it: “How much facilitation do you want? Do
you want us to help the factory buy the fabric you have chosen?”. As this quip suggests,
trading companies tend to remain transactional in their approach when they operate as
agents.

The best traditional agents set themselves forth as extensions of the lead buyer in
sourcing and in product development. From the contract manufacturing perspective, the
lead buyer saves manpower, with the agent providing boots on the ground to manage
orders and monitor production, and opening better access to local manufacturing
resources in the countries where they have supplier relationships and offices. Because
agents do not take title to the goods, the supplier interface is managed in a triangular
relationship with the lead buyer, guaranteeing a desirable level of supply chain visibility
and cost transparency. Beyond manufacturing, the best agents have invested in product
development and design support, proposing themselves as 'resources' that shift the
retailers’ development costs from fixed to variable cost. Although sourcing agencies
position themselves closer to the lead buyer in the value chain, they have embedded
relationships with a network of local suppliers and serve an important role as brokers of
trust between geographically and culturally distant parties, providing local management
expertise and mediating buyer-supplier communication. Typically, agents also have
greater visibility at executive and ownership level with both the buyers and the suppliers
facilitating problem solving and mediating conflict. Several agents have shown an acute
awareness of their unique position in the global value chain and of the importance of the
social capital that they bring to the table:

**AGE2:** Yes. Absolutely (...) we do broker trust, because our clients are
trusting that we are going to deliver for them and, frankly, the other way
around, our vendors trust that, when we represent a client, they are
reputable and that they are going to see their commitments through. We
have been very blessed to create a very high standard of delivery, and that
trust is self-perpetuating over multiple markets and clients. That’s how [our
firm] moves: we are less transactional.

5.3.3. SOURCING WITH TRADE INTERMEDIARIES

Apparel trade intermediaries operate as traditional trading companies, acting as
aggregators of supply and demand, and performing an essential role as experts (Biglaiser
1993) in global trade, as guarantors of quality (Spulber 1996), and as transactional
clearinghouses. Trading companies like MGF, Li & Fung Triburg and New Times will
contract the entire sourcing and production on the lead buyers’ behalf, and deliver the
finished goods to the retailer’s distribution center on a landed duty paid basis, or in some
more advanced arrangements directly to the stores. Sourcing through trade
intermediaries allows the lead buyers to distance themselves from manufacturing,
outsourcing a lot of the organizational complexity associated with managing and
monitoring remote and dispersed global value chains, while focusing on one specialized
relationship with the intermediary:
**RET6:** “I am looking at companies like MGF and Li & Fung [trading companies] as companies that can be used to lower fixed costs, who can replace your firm’s staff with theirs in performing certain functions.”

Among the advantages of dealing with trade intermediaries is their ability to finance their suppliers, while extending credit to the lead buyers with greater ease than remote suppliers; intermediaries will also source and finance fabric and trim for the supplier, when necessary. The ability to broker the financial side of the transaction is due not in small part to the institutional advantages of Hong Kong, where virtually all Asian intermediaries are based. From their base in Honk Kong, the intermediaries direct the work of local offices in countries like Bangladesh and Cambodia, that are home to factories that offer cost advantages but that would be for the most part unmanageable for the retailer. The best trade intermediaries bring to market a turn-key operation, with good systems integration with both ends of the supply chain giving buyers gain access to instant plug-in sourcing options in lower cost and less compliant countries transferring the commercial, as well as reputational risks associated with possible violations of labor and safety standards onto the intermediary. Like sourcing agents, apparel trading companies are brokers of embedded social capital, orchestrating access to an extensive trust network in the whole supply chain, but compared to agents they have greater upstream presence in the value chain, position themselves closer to the supply base, and maintain a more transactional view of the buyer-supplier interface, as noted, not without a nod and a wink at some international business stereotypes by one Hong Kong Chinese participant:
ITI3: Just think about it: a very big, very rich company in America gives an order to a small guy in China: he gets the order, he needs to have a factory, he needs to pay his people, he needs to buy the raw materials. There is a huge amount of trust involved because you don’t get paid until you produce everything properly. And then you still worry bankruptcies, customers buying the wrong thing and trying to get out of the goods. There is a huge amount of trust needed, and that’s where we have been bridging that gap, for a long time already.

The complete reliance of the factories on orders from the trade intermediaries accounts for the intermediaries’ ability to load-balance capacity utilization, and to keep some necessary slack in the supply chain for fast response to emergent fashion trends and to sudden changes of conditions on the ground as in the case of natural disasters, or flare-ups of socio-political instability in any of the main sourcing countries, giving the intermediary a greater ability reposition orders at the last minute compared to inflexible retailers’ supply chains. In the words of the principal of a large trade intermediary “Some [retailers’] supply chains are wound just a little too tight.”

Some brands have grown and thrived relying exclusively on trade intermediaries for global sourcing; the most notable perhaps is Tommy Hilfiger, which sold its sourcing operation to Li & Fung in 2007 and extended the agreement to include its home furnishings and furniture line in 2015. Other agreement however, have had less positive outcomes as in the case of Liz Claiborne in 2001, or Talbots in 2010. While it is impossible
to separate sourcing outcomes from the brands’ identity struggles, several interviewers with direct knowledge of these sourcing deals have pointed at the downside of using intermediaries as part of the reason for the brands’ struggles (and, in the case of Liz Claiborne, its demise). The most obvious downside is the cost of intermediation itself, which according to veteran executive at a US intermediary is no less than 9% of the value of the goods, plus other margin opportunities along the global value chain that are outside the buyer’s control, due to a lack of transparency in the financial arrangements between intermediary and supplier, fabric and trim supply arrangements, and potential double dipping, earning a sales commissions from suppliers, above and beyond the trade mark-

One sourcing executive pointed explicitly at grey areas with regard to on double-dipping in the language of a contract with a Hong Kong intermediary, as the main reason for the eventual failure to reach a sourcing agreement.

Beyond cost and contractual issues there are other disadvantages: a significant loss design integrity as production is put through the intermediaries’ manufacturing black box, something that retailers describe as a ‘loss in translation’. This loss in translation is in part explained by the transactional nature of the buyer-intermediary relationship, in which each transaction has its cost sheet. Given the more transient nature of their relationships with buyers, intermediaries have interest in reducing supply chain visibility and in limiting knowledge transfer between the buyer and supplier. This information asymmetry built in the principal to principal relationship with the intermediary creates path dependencies making it more difficult for the lead buyer to regain control over their value chains.
AGE2: If you use a trade intermediary, or a trading organization you often just are not given that information [supplier identity and capabilities], they will not declare this information to you. That’s their profit source and they don’t want to share that with you. Just literally “No, I am not communicating that to you.”

5.4 INSTITUTIONAL DISTANCE AND GOVERNANCE

Institutional distance, as defined in the literature (Kostova 1997), incorporates both formal and informal institution, is a very comprehensive construct built on Scott’s cognitive, normative and regulative pillars of institutions (Scott 1995, Scott 2008). By virtue of its scope, the concept is suitable to gauge broad dyadic level institutional barriers between two countries, and potentially reducing them to a numerical scale, using domain specific country institutional profiles (Kostova 1997). Because of its qualitative methodology, this study stops short of an attempt to index institutional distance between the US and the GVC host countries, but it stipulates the importance of institutional distance in the apparel global value chains and proposes it as a key determinant of the governance choice. Institutional distance is instantiated at each cross-border buyer supplier interface, affecting transactional effectiveness and the development of the relationships required to coordinate production and to lower the cost of doing business abroad. There are several reasons to expect institutional distance to be especially important in the global value chain of US apparel retailers: a.) virtually all production is outsourced in geographically and culturally distant emerging economies; b.) the number
of transactions (over 1000 every year), the number of steps, about 100 distinct steps per SKU, more than half across borders, and the scope and number of distinct cross-border interfaces in each transaction (Figure 5.3) can be reasonably expected to amplify the institutional challenges dealing with suppliers in GVC host countries. c.) the high need for coordination of production, to deliver the desired product quality, and the required speed of delivery at the specified target prices.

Figure 5.3 Lead buyer cross-border interfaces (green boxes) in apparel GVCs

The transactional and relational barriers associated with the high cultural, normative and regulative distance between the countries hosting production and the US are important cost drivers and key determinants regarding the inclusion of countries in the sourcing base, and then on the governance of the buyer-supplier interfaces once a country is selected. Most retailers do not employ formal country risk assessment tools, nor are there reliable metrics for the cost of doing business in the various host countries:
“I don’t think a lot of companies really look at the true cost of doing
in a particular country; having bought a particular product, everyone looks
at IMU [Initial mark-up], based on selling price, and FOB price or landed
cost. There is a lot more to assessing the true cost than the IMU, and the
metrics necessary to really look at whether that arrangement in that
country is profitable ...I think many companies just look at IMU. [The cost
of doing business in a country] should be loaded, but often it is not: there
are few companies that are savvy enough to do that where they can see
the exploded costs, and see if that particular arrangement is making sense,
if it’s worth having the ten extra people.”

Because of the lack of specific country level cost metrics, the sourcing decisions
are typically based on a combination of a combination of hard economics and logistics
considerations filtered through the individual professional experience of the lead buyer,
Industry “truisms” and country biases. An example of powerful intra-regional country
bias, Chinese perceptions of Indonesia, emerged in the discussion with a Jakarta based
agent:

“During the political turmoil of the late 90s, at the time when
Suharto stepped down, there were riots and the Chinese were targeted.
The merchandisers [buying offices and agents] in Hong Kong wanted
nothing to do with Indonesia. There has always been a conflict between the
Muslim Indonesians and the Chinese Indonesian, but the perception is
much worse than reality, and you get these merchants in Hong Kong who say to their husbands, their wives, their neighbors “don’t go to Indonesia! It’s not safe!! You won’t like it”. There is a negativity toward Indonesia.”

Perceptions, judgments and sometimes the exclusions of certain countries may be unduly influenced by the performance of individual suppliers or intermediaries, and by the persistence of anachronistic views of countries’ characteristics based on experience. All interview participants, however, could be described as biased towards action rather than avoidance, with long histories of success at the highest level in the apparel GVC, sourcing or producing in ‘difficult’ countries. Their professional record of achievement and performance in many of the key exporting countries, give us a window onto the practical interplay of these institutional distance barriers with the demands of supply chains driven to action by unforgiving retail calendars, with strict seasonal deadlines, and constantly changing consumer preferences.

The practical manifestations of institutional distance and their costs are clearly a source of great anxiety for all the retailers interviewed, as revealed explicitly by the participants and by the scope and cost of their sourcing operations: making the GVC work is laborious, time consuming and costly. Distance operates as a form of friction every step of the way (Shenkar, Luo et al. 2008), more death by a thousand cuts than one deep fault line, and is burdensome to both buyers and suppliers, with the wear and tear associated with institutional distance even leading to the defection of several Chinese suppliers who
have chosen to focus on producing for the domestic retail market in spite of significantly lower piece rates as compared to US retailers.

RET1: ...in China, we were competing for space with factories producing for the local market, and they may prefer to do that because it is simpler, easier. Because we can be a little demanding, we would get bumped because they have domestic orders, we can’t get additional capacity, or not even get space.

The first research question in this study seeks to establish whether and how institutional distance affects the lead buyers’ choice of governance for the interface with suppliers in the most various countries hosting apparel production. Although the proposed theoretical model rests on the assumption that institutional distance is in fact a significant factor in the business experience of decision makers in the apparel GVC, many of the questions and prompts are designed to first ensure that the categories and themes derived from literature and from preliminary industry research are in fact relevant, to isolate the most important among them, and then to assess how they affect the country selection and governance choice. In consideration of the highly transactional and relational nature of buyer-supplier interfaces in the apparel GVC I treat institutional distance in terms cognitive, normative and regulative barriers along transactional and relational dimensions. For the transactional dimension, I have focused on barriers in the transaction cost economics tradition, namely search, contracting, executing, monitoring and conflict resolution (Williamson 1981), and on the agency problems associated with
moral hazard and adverse selection. For the relational dimension, I have looked at legitimacy barriers hindering trust development (Zaheer and Zaheer 2006), and the transfer of information, knowledge and practices from buyers to suppliers. The items and prompts in my interview protocols were grouped accordingly, to assess their relevance and importance “on the ground”. This line of inquiry starts from the participants a priori awareness and perceptions of the issue, and seeks to bring to the surface latent knowledge and experience, while seeking to avoid the quantum paradox of altering the nature of phenomena by the act of measuring them. During the interviews, this manifests itself as dual challenge to deepen the participants level of analysis by probing their responses, but eventually following their lead in identifying the essential themes, and abandoning the dead branches of inquiry.

The interviews clearly reveal that not all the analytical themes and categories used as initial guides for my inquiry are equally important or useful, even when I probed and prompted the respondents to take a second look. This is evident in Figure 5.5, which displays the first-round coding node frequency for the theoretically derived constitutive items of institutional distance: only traditional transaction cost barriers and barriers to trust development elicited significant data.
Not apparent from these diagrams, but emergent from the responses of all US retail sourcing executives, is a hierarchical organization of the institutional distance barriers, whereby transactional barriers to exchange need a resolution to satisfactory degree of resolution before the relational barriers come into play in the possible development of deeper buyer-supplier partnerships.
5.4.1 THE GENERAL GEOGRAPHY OF GOVERNANCE

Overall, there seems to be little doubt that institutional distance influences specialty retailers’ choice of governance mode for the buyer-supplier relationships in their GVCs. Different types of institutional barriers seem to be at play in different geographic regions, even when comparing countries with similar low labor rates or levels of economic development as in the case of India in comparison to Indonesia or Vietnam. The top five Asian apparel exporters in Asia countries, Bangladesh, China, India, Indonesia, and Vietnam, which account for over 60% of all US apparel imports into the US (OTEXA 2016), appear to grouped in three distinct areas when it comes to governance: China, Southeast Asia and South Asia. Although, because of their dominance, these five countries have been the focus of the responses of most participants, their reference to less important
exporters such as Pakistan for South Asia, or the Philippines, Malaysia and Thailand for Southeast Asia tend to confirm the characteristics of each region. The distinction is not so much geographic in terms of logistical differences, but rather institutional, with each region posing a different set of governance challenges, linked to informal institutional factors such as cultural-cognitive differences business and social norms, as well as more formal barriers due to the general regulatory environment, trade policy and the country’s export orientation. The importance of the latter is further confirmed by within region comparison of country performance.

Retailers with a strong preference for direct governance appear to be geographically bound, with China taking the lion share of all sourcing, accounting in most cases for over 50% of their outsourced production; the largest number of direct buyer-supplier for US retailers appears to be with Chinese suppliers, especially from the Pearl River Delta region, and from the Shanghai area, which have the highest level of manufacturing and trade maturity. This subnational qualification highlights the risk inherent with treating a complex, large country like China as a single institutional entity.

In the words of one Hong Kong based agent:

**AGE2**: “… going to Chongqing, or going up into the northern provinces, even just going to Henan [province] which is a six-hour drive from Shanghai, opens up manufacturing organizations that have never done exporting, and they just don’t understand what’s needed, whether that would be from the technical specification or from a logistics, documentation, export licensing perspective, or indeed me just saying to
them: “The client requires A, B and C” ... “Why? Why do they need that?” or “We won’t do that; this is the way we do it”, with a take-it-or-leave-it kind of attitude. They are not used to working on different requirements that are not quite the fixed standardized ways, in certain locations. Just for a lack of exposure.”

The governance challenges associated with sourcing in these more remote regions of China are generally resolved by Hong Kong based agents and intermediaries, who still play a major role in China, and in about one third of the cases (KSA 2016), by the retailers’ own Hong Kong buying offices. Hong Kong based manufacturing multinationals like TAL or Esquel, that own manufacturing assets in China, are also an important player in this domain, dealing direct with buyers from their Hong Kong headquarters, and then manufacturing in various areas of mainland China.

The latter are part of a broader group of large apparel manufacturing MNCs headquartered in South Korea, Taiwan and Hong Kong, that ceased to manufacture in their own countries in the 70s and 80s, setting up factories in lower cost export oriented Southeast Asian countries like Indonesia, Malaysia, the Philippines, Thailand and subsequently into Vietnam. This set of firms, headquartered in industrialized East Asia, will deal direct with US buyers and manufacture in Southeast Asia, internalizing part of the institutional distance that would be in effect in a direct interface between a US retailer and a manufacturer in Indonesia or Vietnam. In fact, these arrangements represent the only significant instance of direct governance between US buyers and factories in
Southeast Asia; for the rest, using sourcing agents, many of them headquartered in Hong Kong, seems to be the preferred governance choice for specialty retailers sourcing in Vietnam and Indonesia. For most retailers, southeast Asia is the first choice in their quest to diversify from a China-centric sourcing base, perceived to be more difficult than China on a cognitive basis, especially because of linguistic and cultural distance, and education level of the work force. In spite of the reputational legacy of past labor violations by Nike suppliers (Locke 2003), and the endemic corruption, the regulative distance with both Vietnam and Indonesia appears to be more a nuisance than a concern that would lead retailers to distance themselves from manufacturing.

Corruption, compliance with labor and safety regulations, and a variety of real and perceived barriers to trade have a greater impact in South Asia, leading several suppliers to avoid the region altogether, or to distance themselves from the suppliers by means of local trade intermediaries, such as the Delhi based Triburg or the large trade intermediaries as Li & Fung. By relying on trade intermediaries, the retailers seek both a greater level of trade facilitation, to overcome the structural weaknesses of the regional manufacturing ecosystem and a degree of plausible deniability in the event of labor law violations or factory incidents. Surprisingly in the case of India, the potential advantage of an English-speaking workforce, appears to be more than offset by an unyielding cultural resistance to the kind of service orientation found in China and in Southeast Asia., and expected by buyers:
**RET1:** [in India] I have had both local agent, or regional agents managing the factories in the country. There are, sometimes, some good factories, that make a good product but they want to make it their way and that’s it. They don’t want to embrace some of the customers’ requirement; the agent is supposed to help them understand this is what the customer wants, you have to do what the customer wants, but I have seen a lot of resistance from Indian factories where it’s their way or the highway.

The broad governance trends across the three regions lend strong support to Proposition 1, which posits that lead buyers would seek to externalize the buyer-supplier interface in their GVCs as institutional distance increases. While in the case of FDI, entrants in markets characterized with greater distance privilege governance modes that internalize distance, enhancing the firm’s control with wholly owned subsidiaries, for apparel GVCs the trend seems to run in the opposite direction: lead buyers distance themselves from distance, and outsource outsourcing.

**5.4.2 HIGH TRANSACTIONAL DISTANCE**

Apparel sourcing in South Asia seems to be affected by the most serious distance barriers, whereby US lead buyers see the greatest institutional distance, and transactions require the highest level of facilitation, as is typically provided by trading companies. Bureaucracy, regulatory complexity and in India’s case the legacy of protectionism significantly complicate transactions, not only for the buyers but for suppliers as well. Large trading companies have the depth in the supply chain to overcome some of these obstacles:
"The problem is that when we bring Wal-Mart into a factory in Bangladesh “Here is Wal-Mart, they want to pay 4 dollars for that pant.” The first thing the factory does, he turns to our guy and asks “Can you source fabric for me?”. In order to meet that 4-dollar price, I need $ 1.20/yard fabric. OK? They don’t have the resources to do it."

Despite the profit potential from this trade facilitation, some intermediaries blame the regulatory environment, in particular in India, for their inability and unwillingness to do business in certain South Asian countries. A former principal of the largest US based intermediary pointed at the long-lived limits on foreign ownership to 49% as a legacy that persists even after the limited was lifted, institutionalized in the country’s business culture: “We still can’t buy a free lunch in India.” The challenges for US buyers doing business in India surprise many executives who would expect Indian suppliers to have a language advantage over Southeast Asian suppliers; this advantage is offset by taller business barriers:

"It’s certainly baffling in India for example, where the language barrier does not exist: just making things happen in India is so problematic. You have a lot of surprises; you can’t predict."

One of the challenges, linked to regulatory deficiencies is the import of inputs of production (fabric and trim). Another retailer (RET2) lamented that practical trade barriers that forced his firm to source raw materials domestically when producing in India
RET2: “We just know that is something that we just avoid because it is too complicated: there are trade laws but then there is reality, and everybody is paying somebody off to get a box in the country.”

While the Indian regulatory system seems to be the barrier that hampers export business in the country, limiting its success as an exporter to the US, Bangladesh has had greater success in developing a thriving apparel. Duty free status with the European Union and an abundant young and inexpensive workforce created the premises for the development of a vibrant garment industry, with good institutional support from the government. However, poorly defined labor laws, weak enforcement and widespread corruption make compliance a greater problem:

RET3: “With Bangladesh, there are different issues: even if you see the factory, you don’t know that your product is going to be manufactured there. There is a lot of underhand stuff going on over there, and having an agent, I don’t think is going to necessarily safeguard your product in terms of where it is being placed ultimately. So. that is a problem for the brand.”

RET5: “I would be very concerned [Sourcing in Bangladesh] and would make sure I have a very clear view of my supply chain, down to the factory itself, and be very diligent and vigilant with factory audits: who is doing the factory audit? what are they looking for? who else are they making product for? and would probably ramp up the compliance of the factory, for obvious reasons, with all the tragedy that has taken place with fires and building
collapses and child labor. My preference would be to just stay away because there is such a high probability that something awful could happen. There are certain products that are appropriate for Bangladesh, certain basic products, and it can be very cost effective, but you gotta be extremely careful with your due diligence.”

As these testimonies suggest, the governance problem in South Asia seems to be preceded by the question of whether to source there in the first place, and several retailers have indicated an unwillingness to engage suppliers in India, Bangladesh and Pakistan with principal to principal relationships, due to the institutional weakness of the region. The use of large trade intermediaries in these countries gives the retailers a solvent counterpart to assume the country risk, and plausible deniability in the event of incidents in which serious labor law and safety rules violations occur. As one US intermediary reported, the institutional challenges are so grave in the case of Pakistan, the world’s fourth largest cotton producer (USDA 2015) that local suppliers have begun to migrate to other countries like Turkey and Bahrain to continue to serve their customers (RET2). In general, when the retailers must source in India because of the country’s specialization in certain embroidered, more boutique-like styles, they to work through an experienced local middleman, but not without reservations. Much to my surprise, a top US retail executives described even India’s largest and best known sourcing intermediary as untrustworthy. Another US retail executive described the relationship as a no-win situation:
**RET3:** “I think in India there is some level of corruption in the industry for sure. There is corruption in every industry, but I think the apparel industry is especially fraught and I believe the agents are the biggest problem, because they will place your orders based on which factories they favor, with which owners they have the best relationship. The order will go to them, and the agent will get some kickbacks for sure. So, they get 6% from the US retailer they are working for, and maybe another 6% from the Indian factory.”

One Hong Kong based manufacturer, of Indian ancestry, ascribed his own failed attempts to establish a manufacturing base in India to a lack of work ethic and to the country's business culture; this was confirmed by a UK agent based in Hong Kong with extensive experience in India who also highlighted the contrast in management styles between the UK, and by extension the US, and India in these terms:

**AGE2:** “In India ... the challenge that I faced ... I am a very hands-on/lead by example kind of individual and that is not there in the culture for Indian management. Indian management style is “I say it - you do it” and that can lead to a lot of confusion and finger pointing when things go wrong, maybe a lack of ‘ownership’ in those Indian organization. And because I was hands-on and wanting to find resolutions as quickly as possible and bring solutions to the table, I wasn’t necessarily seen to be a senior manager,
because the other Indian senior managers were not necessarily as proactive as I was. Their mentality was more about “Well, I am the boss so I don’t do the work.” This caused frustration from my side, because I felt they should be more involved.”

Cultural difference in relation to timeliness of deliveries, considered by US managers fatal lack of responsiveness to their needs, and even regarding product quality, what a product should look like, what is or isn’t a defect, is interpreted by US buyers as a stubborn cognitive resistance to US buyers’ quality standards regarding product uniformity. In one telling episode, a Chinese factory, much more attuned with US quality standards, preemptively rejected a million-dollar shipment of fine Indian silk fabric it had ordered for a US retailer, because the high number of slubs (clots of fiber with a wider diameter compared to normal spun yarn) made it off-spec. As retailer involved in this debacle recalls, in the ensuing discussions, the Indian silk mill defended his shipment because it was “a beautiful fabric”, while the Chinese factory, steadfastly claimed that it was not what they ordered. The defective fabric was eventually disposed of by a trade intermediary, who placed it in production for a European buyer more acceptant of the silk fabric’s natural flaws. Because of the frequency of this type of business culture clashes

**RET6:** “There is almost an immediate lack of trust on the part of the Indian vendor [supplier] to the retailer and from the retailer to the vendor [supplier]; it is fraught with a legacy of parties abusing each other. It seems
to have moved to a different place in other countries, but in India direct
[sourcing] doesn’t work very well.”

Overall, the participants confirm that lead buyers will externalize the buyer
supplier interface to third party firms when institutional distance is greatest but also that
in countries where weak formal institutions, and incompatible business cultures raise
fundamental transactional barriers, the lead buyer will either not source in the country
or will source through trade intermediaries, lending support to Proposition 2. Opening
trade in low wage countries with the highest level of institutional distance between US
buyers and local suppliers is in fact one of the competitive strengths of the trade
intermediaries like Li & Fung. One caveat regarding this preference is that it is much
stronger in the case of US buyers; buyers for European retailers and brands appear to be
more tolerant of hurdles on the ground and have greater success sourcing directly in
South Asia. This was brought to my attention by one NY based intermediary whose
suppliers all over Asia work directly with European buyer but only through intermediaries
with the US market, raising the question whether institutional distance instantiated at the
buyer-supplier interface is as much a by-product of US ethnocentric business culture as it
is of objective hurdles on the ground in the host countries.

5.4.3 HIGH RELATIONAL DISTANCE

Countries in which the transactional institutional barriers are especially high such as India
or Bangladesh make deeper partnerships with suppliers difficult. For the clear majority of
US specialty retailers, India is only one country of several countries in a highly modularized
global value chain, and given the institutional barriers, exchanges remain transactional, with the buyers distancing themselves from manufacturing. Among the retailers interviewed only one had a significant reliance on Indian suppliers largely due to brand’s embroidered styles and more handmade, boutique-like styles for which India is often the only source. Because of its critical dependence on Indian manufacturing, this retailer differed in governance from the other retailers, seeking direct control over its Indian sourcing, with a liaison office in Delhi.

For the most part given the marketing demand for novelty and “newness” specialty retailers can ill afford distancing themselves entirely from their suppliers. According to the CEO of the of largest sourcing intermediary in New York (ITI1), specialty apparel retailers are constantly chasing the chaotic signals of fashion in a reactive manner because of the length of their development calendar (most are still working on a 40 to 50-week calendar), and as a result of this chase, they are constantly changing designs and quantities for each style, testing the suppliers’ ability to understand requirements and execute according to specification, and increasing uncertainty along the whole supply chain. Operating under this level of apparent dysfunction requires a higher level of cognitive and cultural alignment between buyer and supplier, but above a suitable mechanism to establish a working level of trust, considering the diverging needs of buyers, seeking maximum flexibility and the suppliers, who seek to reduce commercial uncertainty. Trust development, of course, takes time and is ultimately based on performance; paradoxically, it can be hampered by losing sight of key transactional
factors in supplier selection on the part of buyers and in seeking orders, on the suppliers’ end:

**AGE1:** “I think both sides can be too trusting, it can go too far that way: the factories can become too trusting when blinded by an opportunity, a big order. They don’t do enough homework to protect themselves, they go in over their head before determining whether this is a reliable buyer, do they stay on calendar, do they make rational decisions, do they pay on time. And I think that buyers, especially when you get outside of sourcing professionals, and you get into merchants or you get into design creative, or product development people: they will make decisions on placement based on something very superficial. They will put the trust in a factory because of a beautiful sample or because of a price that is exactly what they wanted, and will not look at all the other factors.”

This is where a knowledgeable and trustworthy agent can fill the gaps, starting from the search barriers associated with supplier selection across great distance, to the establishment of trust supporting business practices between the buyer and the supplier. In countries like Vietnam and Indonesia more export oriented policies have lowered some of the regulative barriers that hamper Bangladesh and India, and local firms show a greater customer-centric service orientation in their relations with US retailers. Significant barriers to direct buyer-supplier governance persist, however, starting from significant cognitive and cultural barriers. The most obvious and persistent barrier is still
the language barrier and as one retail executive stated (RET1) still the primary reason for using local agents. Language barriers make it exceedingly costly to identify and verify suppliers and their capabilities remotely, as much information beyond company brochures used by the salespeople is not available in English. Past the search barriers, there are more serious language and cognitive barriers in terms of understanding and shared meaning that limit the ability of US buyers and suppliers in countries like Vietnam and Indonesia to deal directly. With few exceptions, English is a second language, if not a third language, learned in school and through trade, and although, as most interviewees confirmed, the level of English proficiency of industry professionals in these countries is fairly good, there are clear limits to their expression range and their true understanding of information and instructions as communicated by the buyers. This linguistic distance is exacerbated by the behaviors and assumptions of US buyers, who often remain culturally insensitive to these barriers:

**AGE1**: “My position many times is that of a cultural anthropologist that is trying to explain these crazy Americans to the Indonesian factories, and I try to explain to the Americans what the factories are trying to get across, and what their aims are. It is not immediately apparent because the Americans, less in the sourcing staff but in product development, have miserable writing skills: when they write, they tend to use a lot of shorthand, a lot of idioms that even in a country like Indonesia where the English skills can be quite good, but it’s classical book learning ... when they hear for example “take it with a grain of salt” – they don’t have a clue!!
[laughing] what does this person want me to do??!! and I can give you so many examples that become increasingly absurd.”

Beyond pure semantics, there are deeper cultural barriers to a good mutual understanding especially when it comes to the nuances that might distinguish one brand from another and that might determine buyer demands that are not intuitively clear to the supplier. One agent (ITI2) described her hour-long struggle to explain the differences between the Aeropostale brand and other known teen brands to a supplier in Vietnam, only to hear the supplier comment, at the end of the meeting “Ah, like Abercrombie.” Local agents, typically staffed by a combination of American or British, and local management play an essential role in smoothing some of these cultural barrier, and an even more important role in monitoring operations once a supplier is selected for a program. Sampling, fit approval and finalization of orders are very time consuming, involving intensive back and forth between communication from the factories to the buyer, with errors and misunderstandings at any step of these process inevitably affecting final product quality, and delays in finalization leading to production delays. A locally embedded agent is essential in monitoring progress and in early detection and resolution of problems along the way because differences in business culture, many of them generalizable across the region would make both problem detection and resolution arduous relying on direct buyer-supplier communication. The level of employee empowerment in Southeast Asian countries is much lower than in US firms; in fact, as the sourcing agent I interviewed in Bali emphasized, workers in Indonesia are very diligent but they will typically wait for their bosses to tell them what to do rather than try to
resolve minor issues themselves. As a result, even small problems need to be elevated to senior ranks or ownership in the company, resulting in critical production delays. Visibility at the top also exacerbates the effects of another well-known cultural phenomenon seen in most Southeast Asian and East Asian countries: the need to save face, and the reticence that it engenders when problems inevitably arise. Only a local agent will have the fine-grained awareness of the inner working at the suppliers and preempt the escalation of conflict between the buyer and the supplier.

**AGE1:** “Asian workers have a very hard time dealing with, accepting that they are at fault: they would rationalize it come up with an excuse, and do anything to avoid say we were really wrong here. At all levels, even the most senior people, the senior managers – and I would really have to sit them down privately, quietly and go through it with them: what did we do wrong, what do we wish were had accomplished, let’s learn from this and try to fix it. Let’s not try to push back and say it’s not our fault, we didn’t do it, because that is a very common reaction that inflames the relationship further.”

Although sourcing agents are paid by the buyer, they are embedded in the local environment and attuned with its business culture, allowing them to be perceived as trusted partners by the factories as well, not only because they bring them business, but also because of their essential role as interpreters and mediators between two distant parties, and as problem solvers. Beyond the transactional brokerage, they perform on
behalf of the lead buyers, agents are true brokers of trust, the missing ingredient in the direct interface between buyer and suppliers. Trust gaps in the global value chain emerged in most interviews as the most powerful impediment to the alignment of goals and coordination of economic exchange, limiting the potential for partnering between parties that are otherwise as mutually dependent such as lead buyers on one end and suppliers on the other. Buyers and supplier struggle because buyers don’t understand factories very well, and the factories don’t understand what the buyers are trying to say. Then, there can’t be trust (MFG2). This is where the sourcing agents fit in:

**AGE3:** “I can give you our perspective of buyer and suppliers: what they are afraid of is a function of what they want. So, what the buyer desires is that product delivered. As you know, this varies, based on their orientation towards life, their orientation towards social compliance, quality price and all that. Let’s say they want the product, they want performance, they want what they ordered on time at the quality and price level that they have agreed to. That’s what a buyer wants. Most of our clients [US specialty apparel brands] take it a step further: they want it done in a manner, at least the ones that hire us, in a socially compliant ethical manner. Not everybody does in the world but our clients do. So, that’s what the client wants: they want to source ethically on time at the price they agreed to. What the suppliers want, what they are afraid of is that they won’t get paid, or that the product gets rejected. Our trust [role] is that we make sure that those two parties’ needs are met.”
The dynamics of trust itself differ between from buyers to suppliers due to their different position in the GVC. The buyers’ top concern is having to make the decision to place trust in the competence of suppliers and their ability to perform, with imperfect information and the search barriers associated with distance. Suppliers, on the other end, fear buyer opportunism: orders being cut or cancelled, as well as bogus quality claims resulting in the reduction of payments due, a practice called charge-back, because of poor retail results rather than a legitimate issue of supplier performance.

**AGE1:** “The supplier is afraid of not getting paid: as I mentioned, it can be millions of dollars and it’s incremental: they keep buying fabric, they keep making goods but in the course of six months it can be a lot of money, and there is no protection other than sheer trust, and performance. If the buyer has paid on time in the past you can safely assume that it will happen again. Sometimes that doesn’t happen, sometimes there are financial problems that you can’t see from the outside."

Suppliers will often question the motives of lead buyers’ quality claims, asking agents whether the retailer’s business is slow when quality claims are brought up, or goods are rejected (AGE1). Evidence of buyer opportunism also increases the suppliers’ distrust of the retailers’ own competence in making product decisions, and in understanding the impact that their product development practices and demands have on the suppliers’ businesses.
AGE1: “Then it’s a cycle of distrust, which leads to lost opportunity, and that’s where an agent with a cool head and judgment can come into it. What I have found is that with my years and years of experience, and the grey hair that comes with it, my opinion was trusted by both sides, so that when I would get on the phone with the [retailers’ sourcing executives]; I would say look this is the best you are going to get, or these are your choices, don’t try to go in that direction because this is the direction you need to go, and they could trust my judgment on it. And the same thing with the factory: I could tell them ‘you may not want to do this but you need to do it’, and they would trust me, because they had been through it with me and they knew it would come out ok in the end, or it would be the least of many worse choices.”

For lead buyers in the specialty apparel space seeking to establish a strong alternative sourcing base outside of China, export-oriented economies like Vietnam and Indonesia are the first choices, one step above South Asian countries in terms of overall ease of doing business in terms of transactional effectiveness. Regulative barriers are lower than in Bangladesh and India, especially in the area of labor laws (Verma 2016) and worker safety, and an effective agent can be the buyers’ ears and eyes, and their boots on the ground, to ensure compliance, as well as performance. Because of their cross-cultural savvy, and reputation-driven business model, sourcing agents effectively broker the buyer-supplier relationship past the cognitive and cultural distance barriers, and play a vital role in bridging the trust gaps between distrusting parties. As suggested by one
Hong Kong manufacturer with factories in Southeast Asia (MFG2), a potential contributor to the special role that Hong Kong-based agencies have in managing business in Southeast Asia is the dominant role of ethnic Chinese in the region’s garment industry, which minimizes intraregional distance challenges, a factor indirectly corroborated by the struggles faced when the same agents move from the culturally friendly Southeast Asian region, and attempt to manage production in South Asia, on behalf of the same retailers (RET1, AGE1). As several retailers indicated in the interviews, sourcing through agents is the dominant governance mode in Vietnam and Indonesia (and in the past Thailand, now a minor exporter) where the barriers to exchange are primarily relational, lending support to Proposition 3.

5.4.4 GOING DIRECT IN EAST ASIA

China, Hong Kong, S. Korea and Taiwan a group of countries where the benefits of direct buyer to supplier relationships can outweigh the governance costs. In reality, we are talking about two distinct set of countries based on their institutional and economic characteristics: Hong Kong, S. Korea and Taiwan on one hand, and mainland China. The Asian Tigers are now high income, highly developed nations, with well-developed institutions and established rule of law that were the original host countries of garment production. Some of their most successful garment manufacturers were also pioneers in country migration when domestic labor costs became unsustainable as a result of their rapid economic growth in the 70s and 80s. Hong Kong, Korean and Taiwanese garment suppliers invested aggressively in southeast Asian setting up factories in Malaysia, Thailand, the Philippines, Indonesia and subsequently in Vietnam, while retaining
commercial control of the relationship with global buyers at their original headquarters.

As my host at Li & Fung illustrated in the management presentation that I was invited to attend, Hong Kong firms naturally privileged expansion into China, establishing manufacturing in the nine provinces of the Pearl River Delta. This special class of mega suppliers like Tai Nan Enterprises, the TAL group, Esquel ranging in size between US$ 300 MM to over US$ 1 billion.

RET4: “The guys [suppliers] that we invite over to brainstorm and do problem solving in [key vendor meetings], are not coming off the factory floor and sitting down with us … these are very educated owners, a lot of them very westernized. They all know what we are talking about – and they know their business better than anybody else.”

China, which has opened its economy in the late 70s and facilitated the development of a dominant garment manufacturing sector in its special economic zones, especially in the Guangdong province, in the municipalities of Guangzhou, Shenzhen and Dongguan. China’s immediate success in the apparel industry was the result of a combination of abundant disciplined, low wage labor, government policy and the strength of Hong Kong intermediaries and their entrepôt trade. When China opened to the world as a provider of cheap labor for offshored and outsourced manufacturing, retailers from the US rushed to establish liaison offices and fully staffed sourcing offices to take advantage of the sourcing opportunity, creating an intensity of direct and mediated exchanges between US buyers and Chinese factories. One of the retail executives interviewed (RET1) shared her experience in the early 80s, when as a 24-year-old manager
she was given the opportunity to live in Hong Kong for almost a year, and manage her employer’s production in China, dealing with Hong Kong agents and directly with Chinese factories, shuttling back and forth between Kowloon and factories in Guangzhou, driving on dirt roads still filled with bicycles and ox-drawn carts.

Frequency of travel to Hong Kong and into China, and sheer length of stay created a generation of sourcing executives in the US comfortable doing business in China, and a management class both in China and Hong Kong prepared to take the challenge head-on. In addition to an ecosystem that facilitated exchange, thanks in part to trade through Hong Kong, and to government policies in China aimed at transforming China into an industrial powerhouse, the most enterprising Chinese suppliers were forced early on to upgrade their service capabilities to overcome the quota limitation imposed by the Multi Fibre Agreement. Companies like the Limited working initially with Li & Fung (Fung, Fung et al. 2007), and subsequently through its own sourcing company MAST Industries, experimented in transferring more ancillary and service functions to the low cost factories that were manufacturing their garments (RET2). By the time quotas were eliminated in 2005, the Chinese apparel industry as a whole had established itself as the “easy button” of apparel sourcing. These superior service capabilities, institutional support in trade financing, infrastructural development and relatively efficient goods markets facilitated the emergence of a whole class of suppliers with whom retailers can work directly, either form headquarters or through Hong Kong sourcing offices. While the traditional Hong Kong office have become expensive to maintain and overall ineffective is serving the lead buyers’ broader sourcing geography, they still serve an important function managing a
China-centric sourcing strategy; the retailers with a strong preference for direct sourcing source over 60% of their product in China and still maintain large Hong Kong offices, in what becomes a self-perpetuating cycle:

**AGE1:** “The buying offices ... again, it depends on how much they are willing to put into it, but there are some excellent people there [in Hong Kong]. The problems start when you leave Hong Kong and China: it’s almost a self-fulfilling prophecy. The retailers put weak people in the offshore [peripheral] offices, they put the communication through Hong Kong, and sometime they get around to passing the information to the offshore office in the middle of the afternoon and things [fall through the cracks] - and guess what ... “we can’t work in Indonesia, Sri Lanka is hopeless, forget about Bangladesh ... let’s just go back to China!” And everybody is happy again – except the sourcing manager who is trying to diversify! It’s really an uphill battle.”

Cultural barriers persist, and both the opacity of close Chinese trust networks and the reticence in Chinese communication styles clash with US direct and low context communication style:

**RETS:** “I found that in general transparency is a challenge in China, not only with vendors but also with agents, and suppliers; it’s almost like a cultural element of mystery of and half-truth.”
However, Chinese business people show some sophistication in using this to their advantage, helping overcome the cross-cultural gaps between them and US buyers, especially when the latter become overly analytical and data-driven in their negotiations:

**AGE1:** “The Chinese are the consummate diplomats: they can manage to get things done without offending anyone. This is where the Chinese excel: they understand that they have to figure out a way to make things happen; they have to figure out a way to make it look like they are compromising.

For example, on pricing, as the brands [lead buyers] have become more sophisticated, they have become more granular in the way they look at pricing: they look at the cuts and make, they look at the buttons and they add it all up and they come up with a figure that they think is fair. And the [Chinese] factory knows that and then starts to manipulate it – because it doesn’t really matter to the factory: they want to get to 10 dollars per unit and they don’t care if it’s four in labor and six in fabric. So, a skilled merchandiser at a factory will finesse these numbers to get to the buyer’s target. The buyer walks away feeling happy because they achieved what they need, and the factory walks away happy because they stayed within their range. But it isn’t necessarily as precise as the buyer thinks it is…”

While all three governance modes have pros and cons, virtually all specialty apparel retailers I interviewed have expressed a desire to retain a degree of direct control over their production, and seek some direct buyer supplier relationships. The retailer who
expressed the strongest preference for direct control over sourcing (RET4) find itself in fact limited to sourcing from the “super vendors” based in Korea, Taiwan and Hong Kong, and from a handful of large full-service factories in China, a key vendor strategy that allocates 75-80% of the production in dollar value to 10-15 key suppliers based in these East Asian countries. For most other retailers who pursue a more hybrid sourcing strategy, the governance in China is more of a mix between agent-managed and direct sourcing, with the latter prevalent in Southern China (RET1). Overall industrial maturity, an educated and experienced work force, and institutional development in Korea, Taiwan, Hong Kong and in coastal China lower the transactional and relational barriers for US lead buyers, making the direct governance mode relatively frequent. While the overall governance in China remains a hybrid, with plenty of relationships buyer-supplier relationships managed through intermediaries, China, Hong Kong, Korea and Taiwan constitute the only Asian region in which a direct sourcing strategy can be successfully implemented, lending support to Proposition 4.

5.5 SUPPLIER CAPABILITIES

The second research question of this study concerns the influence of supplier capabilities on the governance choice. The extant literature (Gereffi, Humphrey et al. 2005) on GVC looks at suppliers’ capabilities primarily in terms of control: the lower the supplier capabilities, the greater the level of control that the lead buyer seeks to exercise, primarily through hierarchical governance through direct investment, or captive contract manufacturing arrangements. While these may be a viable governance forms in the
sectors like consumer electronics or auto parts sector, in which fewer, more specification driven products with tighter tolerances are offshored in the case of the specialty apparel industry, as discussed previously, because of the sheer number of distinct SKUs and the constant changes in style, direct investment is virtually non-existent, and captive governance undesirable for both buyers and suppliers. Since all production is outsourced offshore to third party suppliers, I look at governance from a different perspective: the degree of internalization of the cross-border buyer-supplier interface. From this perspective, I propose that suppliers with better production and service capabilities have greater strategic value for the lead-buyer, who capture it by internalizing the interface, through direct sourcing. Suppliers with less valuable capabilities are used solely or primarily for their production capacity, they have less strategic value, and the interface is more commonly outsourced to specialized middlemen, either sourcing agents or trade intermediaries.

The general pattern that I seek to verify is a positive correlation between supplier capabilities and the lead buyers’ internalization of the buyer-supplier interface. To do so, it is necessary to identify a continuum of supplier capabilities that can be correlated with the degree of internalization of the governance. In consideration of the highly transactional and relational nature of the apparel GVC, and in parallel to the analysis applied to institutional distance, I look at suppliers’ transactional and relational capabilities, trying to assess how the capability sets cluster in the apparel global value chain. If these clusters create a hierarchy of suppliers along a capabilities continuum, it is
It is possible to correlate each cluster with a predominant governance mode, and possibly one in which the lead-buyer’s governance preference matches that of the supplier.

Supplier selection hinges on the priority each retailer places on price, quality and speed, and the trade-offs that the retailer is willing to make among them; as one industry veteran emphasized (AGE1), compliance has now become a non-negotiable fourth factor in the sourcing decision. To ensure the appropriate supplier mix, suppliers undergo a length approval process either directly or through the buyers’ agents, and their performance monitored and routinely assessed in supplier scorecards; the workload imposed by these practices is such that the use of agents, and limiting the number of interfaces through supplier consolidation are often necessary:

**RET6:** “An important tenet of how we approach our supply chain is that, as we go through each one of our product categories, we want to be more important to fewer suppliers [includes MGF, and intermediary]. At the same time, we want to make sure that the supplier is relevant to the category, so we go through each of our product categories, and for each category we have anywhere between three and five suppliers, it’s not broad, and that may make up 70-80% of the business, and then there are a couple of ancillary suppliers that fill in as needed from the trend standpoint.”

Virtually all specialty apparel retail executives interviewed stressed the value of maintaining a direct interface with quality suppliers, compatibly with their sourcing
budgets; if we look at the coding map for the supplier capabilities portion of the interviews (Figure 5.7), to high capability suppliers with whom direct sourcing is possible receive much greater attention than lower capabilities suppliers, for whom the interface is outsourced. This interest does not necessarily correspond to a greater volume of trade, as agents and intermediaries still manage significant portions of the supplier relationships, but it reflects the strategic importance for the retailer not to distance themselves entirely from production.

![Coding Map for Supplier Capabilities](image)

Part of this strategic interest rests on the need to focus on core activities, which for specialty apparel retailers are first and foremost in design, brand development and retailing, especially as they expand into multi-channel marketing, with outlet stores,
factory stores, and e-tailing. Multi-channel retailing increases the complexity of the supply chain and its associated management costs, and makes the retailers critically dependent on outsourced services, even in core activities that define the brand.

**RET1**: “We usually look for vendors and factories with some R&D design capabilities. Even though we have our own design team for apparel, we still want our supplier to provide design support, to be able to either reinterpret concepts, or come up with concepts. That is very important, so if it’s just a good factory that makes fine clothing good quality clothing, that’s not enough for us.”

**RET6**: “As a business, we’ve got to be plugged into newness. If a supplier has a new manufacturing capability, whether in apparel, or in jewelry, or footwear or whatever it is, we have to be able to plug into that, because that’s where the trend is from the business standpoint.”

There is little doubt that the governance mode choice is heavily influenced by the supplier capabilities; not only are retailers quite explicit about their desire to transfer greater service responsibilities onto capable suppliers in a direct buyer-supplier relationship, but the suppliers themselves who invest heavily in the desired design, production and service capabilities do so with the expressed intent to cut off the intermediary, wherever possible. This expressed preference is not so much driven by transactional economics, since the cost of these investments in capabilities eventually works its way into the garment price, but rather by the benefits of tighter coordination
and coordination, the reduction of business uncertainty and avoiding the “loss in translation” and the information asymmetry which characterize mediated exchanges. Moving down the ladder of capabilities, suppliers enlist the support of agents and trade intermediaries, distancing themselves from suppliers with limited or no strategic value beyond production capacity. The behaviors, strategies and expressed views of virtually all participants suggest that lead buyers will seek to internalize the buyer-supplier interface as supplier capabilities increase lending strong support to Proposition 5.

5.5.1 SUPPLIER TRANSACTIONAL CAPABILITIES

Outsourced garment production started as a low labor cost chase: because it is still a labor-intensive production, in the 60s US retailers and apparel brands began to outsource in low-wage, non-unionized developing economies, like Taiwan, Hong Kong and S. Korea. The original form of contract manufacturing involved buyer purchasing fabric and trim that would be cut and made into garments in offshore factories, according to the buyer’s specification. In this type of arrangement, known as CM (Cut & Make) or CMT (Cut Make & Trim), the factory’s capabilities might be limited to cutting and sewing, with the buyer supplying the raw materials, and then picking up the goods at the factory and arranging for their shipment. Over the years CMT suppliers have evolved and in general they will now purchase fabric and trim, make the garments and load them in a container for shipment, relieving the buyer from much of the micro-management of their orders. Outside of small subcontractors used by some suppliers to manage their order overflows, strict CMT suppliers are a thing of the past:
**RET1**: “In Asia to my knowledge there aren’t really any factories that are working on a CM basis: they are all full package. In North Africa, there are still some, and the agent will manage them.”

**Full package suppliers** represent the lower end of the spectrum of transactional capabilities in the specialty apparel GVC, offering basic value for a low price. Virtually no specialty apparel retailer works directly with full package suppliers, but they all tap on them for production capacity through intermediaries, as part of their modular supply base. Trade intermediaries reduce marketing costs and mitigate commercial risk for these suppliers who would be otherwise at the mercy of buyer opportunism, they manage the inbound logistics of raw materials and the shipment and delivery of the goods; on occasion, trade intermediaries like Li & Fung will also act as lenders of last resort. Large manufacturing MNCs, the mega-suppliers, also tap on the manufacturing capacity of basic full package suppliers to manage order overflow, or to meet particularly tight price targets; in these instance these MNCs function more as intermediaries than as manufacturers.

**MGF1**: “[on contract work] we are almost working on a CMT basis because we would nominate the mill, and place the yarn order for them. Them having an international scope? I don’t want that; I don’t want competitors. I don’t want [factories] that are focusing their effort on things we can do. I want them to focus their efforts on things we cannot do.”
From the transactional capabilities perspective, a separate class of suppliers has evolved in Asia, upgrading their product and service capabilities to meet the increasing requirement of US specialty retailers: the **full-service supplier**. Virtually all lead buyers at US specialty retailers have explicitly indicated a set of high expectations from full service suppliers, looking at them for both complementary and supplementary capabilities, as summarized by one veteran sourcing executive, with experience at five different Top 50 retailers:

**RET1**: “Full service means: [product] development, creative design, fabric research, trim (raw material research, as we call it), and then they produce it for you. So, ideally we are looking for that end-to-end capability, with speed and flexibility. How quickly they can create and produce a product, develop a product? Do they have a compatible mentality with our business model? Are they innovative? Are they constantly looking for new ways to work? That’s really important to us, that continuous improvement mindset, that they are constantly reinventing their business, not standing still, not becoming stagnant.”

Although East Asia may have a larger number of full service suppliers, these capabilities are sufficiently distributed across the sourcing regions; as one retail executive confirmed (RET5), there full service suppliers for each product category in multiple countries, in more than one region, as result of the buying activities of US retailers but
also of European brands, whose sourcing has a different geographic distribution, with a stronger presence in India and Bangladesh.

5.5.2 SUPPLIER RELATIONAL CAPABILITIES

Besides the basic manufacturing and service capabilities, suppliers can be distinguished based on the geographic scope of their business social capital and its global reach. Given the relatively low capital intensity of garment production, there will be a significant number of local entrepreneurs setting up garment factories in China, Southeast Asia and South Asia. As the CEO of the world’s largest shirt manufacturer (MFG2) explained, a Juki sewing machine, one the industry standard piece of equipment, will cost between one and two thousand dollars depending on its specifications, and a basic mid-size factory with three hundred sewing machines can produce 40-50,000 units a week, enough to fulfil sizeable orders from global buyers and possibly add capacity. These factories tend to be embedded in local business networks, and don’t have great depth in the supply chain, with limited access to suppliers of raw materials and to trade finance. In the experience of several sourcing executives, these factories may be owned by people who have limited international experience, uncomfortable speaking English making business with overseas buyers difficult. These locally embedded suppliers are not necessarily small in size and scope of business; as one Indonesian sourcing agent noted:

AGE1: “In Indonesia, the factories were always big; Indonesia never had that workshop mentality. The factories are minimum one thousand workers, up to ten thousand workers. That’s how they operated; what the
Indonesians didn’t have was the marketing, so they were really depending on the agents and the buying offices to get them the orders.”

Locally embedded factories of this scale may upgrade their transactional capabilities, whereby they are capable of doing fabric research, and of providing product development and technical design support to their clients, thus offering full service capabilities, but in many cases they fail to develop strong connections with global fabric and trim suppliers, and to invest in the quality of staff necessary to work independently as a global supplier. Other firms have made that qualitative leap, becoming globally integrated suppliers, pursuing deliberate strategies to become globally integrated in raw materials markets, in fashion trends, in production technology, and in marketing. One large sweater manufacturer highlighted the scope and expense associated with this strategy:

**MFG1:** “We have an office in New York; it’s a small office, of course we are very concerned with the cost. Our strategy is we want whatever job needs to be done we want to make sure it’s done right, but also at the lowest cost. So we are in China, Hong Kong and in the States. In the States it’s 5 people managing 150 MM dollars in business. They are very focused: they are the interface with part of it. But some of the interface is direct with Hong Kong [retailers travel], and part of it we’ll be moving direct to China, in time; we are training that skill set now.”
While the largest manufacturing MNCs are all globally integrated suppliers, size is not the only determinant of global integration; retailers have given several examples during the interviews of relatively small firms that are well plugged in with suppliers, that keep abreast with global fashion trends and stay technologically current. As much as size, specialization and firm leadership seem to be the driving forces behind strategies of global integration.

5.5.3 SUPPLIER CAPABILITIES AND GOVERNANCE

Interviews with sourcing executives in all roles seem to confirm the model’s assumption on clustering of supplier capabilities and that suppliers can be divided into three broad classes based on their transactional and relational capabilities, ordered here from lower to higher:

1. Locally embedded full package suppliers
2. Locally embedded full service suppliers
3. Globally integrated full service suppliers

The key question that this research needs to answer is whether these three clusters are sufficiently distinct in their characteristics and their competitive advantage to engender different governance preferences. The evidence points at a strategic convergence of suppliers, intermediaries and lead buyers in terms governance modes, whereby the lead buyers’ preference matches the suppliers’ preference, with the intermediary firms specializing to operate in the governance space defined by this set of preferences.
5.5.3.1 LOCALLY EMBEDDED - FULL PACKAGE SUPPLIERS

This first set of firms bring production capacity to the market, and have a cost competitive advantage due to their limited investment in other capabilities. There are many of these suppliers in every sourcing country, and due to their sheer number and their limited value added, they are typically managed by third party firms:

RET1: “Just the cut and make? That’s really a model that has largely gone away in our area, in our industry, where you would just contract with a factory to cut the fabric and sew it. Now they expect the [middleman] and factory relationship to manage the whole thing purchase the raw material on our behalf, finance it, purchase the trim finance the trim and really manage it end-to-end, with all the resources need to do that, including technical resources, and then ship it. So that we don’t have to hire those people to do it.”

These full package suppliers themselves have limited capabilities to fend for themselves in the global markets and rely on trade intermediaries for orders. Not all the full package suppliers are small, but the large ones are typically larger in scale but narrow in scope, focusing on capacity expansion rather than service extension. This narrow focus of production capacity can lead to issues in compliance with labor and safety laws, leading US lead buyers to distance themselves from the supplier, transferring the reputational risk onto the large
trade intermediary firms (MFG1) like Li & Fung that specialize in managing production in this environment, and bring to market an extensive network of full package suppliers. Virtually all retailers have expressed little interest in establishing relationships in the full package manufacturing space, and seek to distance themselves completely from direct contact with the supplier; the frequency of references to the CMT/Full package suppliers in the coding map (Figure 5.7) is in large part due to my prompting in seeking to define suppliers’ characteristics, and to references to the past. Overall, interviews with both retailers and intermediaries show that full package suppliers are best managed through trade intermediaries, lending strong support to Proposition 6.

5.5.3.2 LOCALLY EMBEDDED - FULL SERVICE SUPPLIERS

A smaller number of factories which accounts however for a significant portion of total supply have upgraded their manufacturing quality as well as the scope of their service capabilities in terms of design support, fit approval process, and fabric development. Some of them specialize in a single product category and pride themselves with their manufacturing quality and technological leadership, but in many instances they remain owner managed, locally embedded, lacking the organizational depth necessary to establish and maintain a direct connection with the lead buyers. While their manufacturing capabilities make them strategically important for the lead buyers, who may book critical programs with them, these firms lack the international business connections, and can’t contribute a sophisticated perspective on global trends that would be of strategic value to the lead buyers. Although they have evolved into full service
facilities, they are still contract manufacturers at heart. This is best exemplified by

a description that one retailer offered of a multimillion-dollar linen program produced in a

Thai factory:

**RETS:** “[The agent] he brokered the fabric transaction, all the negotiation

and all the arrangements, it was not the factory. And not that the factory

was not potentially capable of doing it, but it was an established

relationship with one of the better linen weavers in Northern Ireland and

the owner of the agency was in Ireland a lot, six to eight times a year. He

was there all the time following up on our business because there was so

much yardage we committed to in the course of the year, that it was

important for him to be personally present, troubleshooting and making

sure that nothing was going to go amiss in the delivery.”

This highlighted lack of global connections with fabric suppliers, as well as an

overall limited ‘ownership’ of the overall sourcing process limits the value of direct

relationships for the lead buyer. This is the domain in which agents excel, supplementing

and complementing the suppliers’ capabilities, linking buyers and suppliers in a triangular

relationship, mediating between the two parties and monitoring and managing

production with ‘boots on the ground’ (RET1). These suppliers are quite valuable to the

buyers because of their product quality and overall service capabilities, but the interface

remains difficult, and is best managed by sourcing agents like Hong Kong based W.E.

Connor; their economic importance is underscored by the willingness of many of the

largest trade intermediaries like Li & Fung, MGF and New Times to act as commission
agents with these suppliers. With few exceptions, the lead buyers will not pursue direct governance; at the same time neither the suppliers nor the buyers will accept complete separation, making sourcing through agent the preferred governance mode, lending support to Proposition 7.

5.5.3.3 GLOBALLY INTEGRATED - FULL SERVICE SUPPLIERS

Over the past few decades several world class garment suppliers emerged primarily as the result of two separate drivers. Some Chinese suppliers that integrate textile and garment operations, whether state or privately owned, have reached a very large scale and sophisticated production capabilities, with strong institutional support at central and provincial level; although a number of these companies are classified as “self-exporting” by their trade association, the China National Garment Association, in many cases they still work through affiliated trading companies or through agents because of service gaps and because of their local embeddedness in Chinese business networks. Technology and scale are not the only requirements to become a direct supplier and the most successful firms have grown organically adding capacity and gaining greater global business sophistication over time: many of them are the heirs of the original contract manufacturers in South Korea, Taiwan and Hong Kong who have established productive facilities in China, and Southeast Asia becoming true garment manufacturing MNCs. Second generation owners were often educated at top UK and US universities, bringing modern management practices to their firms, along with a sophisticated understanding of the global retail and fashion business, and of the global buyers’ product and service needs. Companies like Esquel Group and Tal Apparel have not only perfected
manufacturing technology, and become trusted suppliers with leadership role in corporate social responsibility and compliance, but they have invested in ICT, introducing buyer-supplier interfaces to reduce interface human errors such as fully developed EDI (MFG1), and to minimize the bullwhip effect (MFG2) such as Vendor Managed Inventory (WMI). Besides the valuable systems integration, these firms have become the ‘easy button’ in sourcing for their categories, thanks to their superior production capabilities, their innovation and knowledge of markets and trends:

**RET2:** “Full service suppliers have a front of the house that can design for you, but for them to do that they are going to either need operations in the US or travel a lot to the US to interact directly with the buyers, not so much with the sourcing people, but with the buyers and the merchants, through the retailers’ sourcing people, because the sourcing people are like the quarterback of the transaction. Full service factories now have people who can do all that.”

**RET6:** “They develop in their own factories. We co-source fabrics, but sometime they bring their own developments to the table, but they perform a very similar function to that of MGF (a major sourcing agent and intermediary) but only for one product category. We have a similar vendor in dresses, and in knit tops. Our LDP (landed duty paid) suppliers are those that fall in this realm of suppliers who can deliver a full package, including development, into our distribution center.”
Supplier evolution driven in part by the desire of both buyers and suppliers to cut the middleman, and by developing superior relational capabilities these global suppliers eliminate their dependency on third-party firms for placement, and equally important to the buyer eliminate the loss in translation that characterizes all mediated exchanges:

RET3: “Some large factories have become more like agents over time. When I was working on the collection for [large womenswear brand], I used to work with two factories in Korea that were cut and sewn knits; one of them had become so large and so capable that we started working directly with them. They placed a product development (PD) team for us in-house, they bought two or three knit mills so that they could service us right from the beginning with the fabric development from the mill: if we wanted a certain type of knit fabric, they would make it for us. The PD got to a very sophisticated level where their people would go to Pitti Filati [a yarn trade show in Europe] and other shows, and bring back development and then develop things for us. It cut back our cycle time, and they took on a large expense in developing for us.”

Sourcing agents feel the sting of competition as they face the loss of suppliers that might have worked through them in the past but have now upgraded to direct sourcing:

AGE1:” The big multinational factory groups, or trading companies like the Korean, the Taiwanese, TAL, Esquel [HK based Esquel Group], some Singaporean groups, some Indian groups, like Triburg, they are
manufacturing all over the world so ... are they factories? are they agents? are they trading companies? 
They are falling into a hybrid role, and that results in a lot of turf wars.”

MFG2, the CEO of a Hong Kong based manufacturing MNC with factories in China, Thailand, Indonesia, Vietnam, and Malaysia, has invested significant resources in upgrading his quality systems and in becoming a full-service supplier to many of the top global apparel brands, and now 95% of his business is direct and only 5% through agents or intermediaries. He emphasizes the potential gains from positioning himself as a direct supplier:

**MFG2:** “Customers [lead buyers] look at quality and say “I am really going to reward factories for having certain quality standards, and below a certain level I don’t care if they are cheap I am going to move away from them.” They give a strategic plan to manufacturers and say “I am trying to rout, to kick out the cost of inspection. I want ‘right-first-time’, I am going to reduce my inspection costs, I am going to vet the suppliers; it might cost me more money upfront, but you know what? all that back-end trouble I face, all the inspection costs, all the issues when the goods get to the US? All gone.” So, people who have that strategy I find manage to reduce their overall costs. It doesn’t matter in what country they manufacture: they overall cost comes down. And that strategy can only happen, in my mind, when you work directly with your suppliers, not through an agent.”
For retailers and brands with a strong global preference for direct buyer-supplier governance, there is a sufficient number of globally integrated full service suppliers in most product categories to make it possible; one such buyer, who unabashedly describes her company, a US$ 2 billion US womenswear brand, as a “tough first date” and with an industry reputation as a “difficult” buyer, places the lion share of its production directly with a group key suppliers with facilities in China, Vietnam and Indonesia:

**RET4:** “Our top 15 suppliers produce about 75% of our goods. These are our partners: they know they are going to get business from us so they are willing to work with us. Are you opening a new facility? You are going to undergo the same rigor and audits, but we know you well enough, you are not Alex coming in with his earrings from his factory on Broadway. So, we focus so much on that relations, the top 15 are hugely important for us. We know everything about them, they’ll do work for us, they’ll develop, they really partner with us. They know they are going to get business from us.”

As these comments highlight, lead buyers and these globally integrated full service suppliers seek a direct governance mode for their interface strongly supporting Proposition 8.

### 5.6 INSTITUTIONAL BROKERAGE

The third research question in this study concerns lead buyers’ agency, the different forms it takes depending on the strategic views of the supply chain, and its effect on the
governance of the global value chains. In my theoretical model, institutional brokerage is the strategic response of lead buyers bridging the transactional and relational barriers to exchange imposed by institutional distance, and because institutional distance is instantiated at the individual buyer-supplier interface, it is simultaneously a response to bridge supplier capability gaps. From the methodological perspective one of the greatest challenges in the interviews presented itself in trying to distinguish country level activities and capabilities associated with institutional brokerage from those that operate strictly at the buyer-supplier interface. Separating the two proved impervious because the dyadic buyer-supplier dynamic is operationally much more salient to buyers, suppliers and intermediaries than cross-country dynamics; this was also reflected in the tally of nodes directly addressing the three propositions related to institutional brokerage, whereby only proposition 10, concerning the reinforcing effect of institutional brokerage on supplier capabilities registered a significant response level.

From the analytical perspective, dividing institutional brokerage into its transactional and relational components, to parallel the treatment afforded to institutional distance and supplier capabilities, provides insights into its distinct effects at country level and at supplier level as a matter of strategic choice. Although one can conceive the level of lead buyer’s investment in institutional brokerage activities and capabilities along a continuum, strategic choices with regard to the role of the global value chain and the allocation of costs to it, tend to cluster lead buyers in three main camps: firms with low investment, lead buyers focused on transactional institutional brokerage, and lead buyers engaged in relational institutional brokerage. All retail sourcing
executives interviewed fall into one of the latter two camps, but there are brands like Tommy Hilfiger that have chosen to simplify their global value chains to a single interface with intermediary powerhouses like Li & Fung, avoiding much of the complexity and expense involved in interfacing with suppliers.

In broad terms, lead buyers engaged in transactional institutional brokerage seem to have choses a strategy that resolves the challenges imposed by cognitive and business culture distance at the supplier level, following a systems based, more traditional supply chain management approach of minimizing transaction costs, including supplier rationalization. The routines and practices used and skills set developed, fall in the traditional contract manufacturing management, and tend to be more directional and more punitive to suppliers in the event of quality problems or shipment delays. The transactional focus seems to come at the expense of activities and capabilities that lower country level cognitive and normative distance barriers, thus opening up a broader supplier base. This country level skill set is the focus of relational institutional brokerage, which represents a significant investment in human capital on the part of the lead buyer to create a sourcing team and a corporate business culture that facilitates tapping on the capabilities of suppliers in a wider arange of countries.

5.6.1 TRANSACTIONAL INSTITUTIONAL BROKERAGE

Any dismissal of institutional distance as a key factor in the apparel global value chain, is belied by the organizational complexity and by the cost incurred in overcoming it. This is exemplified by one specialty retailer with strong preference for direct sourcing (RET4),
that at the time of the interview, had 270 people working in its Hong Kong sourcing office, and a little over 80 sourcing managers and executives in their New York office to manage the flow of over two-thousand orders a year, at an estimated fixed cost greater than US$ 50 MM, about 5% of the cost of goods sold. This number does not include the cost of two other critical groups of managers and executives who are also involved in the transactions and in the relationships with suppliers, directly and through the Hong Kong office: the merchant teams for each division and the creative and technical designers, who are also involved in the transactions and in the relationships with suppliers. As discussed previously, institutional distance in the GVC has a transactional and a relational dimension; correspondingly, the lead buyers’ strategic response to it can focus on either one of these dimensions, with distinct governance and performance outcomes. We could characterize transactional institutional brokerage as a systems-oriented solution focused on fool- and fail-proofing the transactions; this focus appears to be highly desired by the most capable suppliers for whom the accuracy and detail of the purchase order is essential. Transactional institutional brokerage tends to be a systems-based approach to overcome the costs imposed by institutional distance and by supplier capability gaps, and in this sense, it is related to traditional supply chain management solutions. In this study, I try to break it down in some of its components and to analyze the impact that investment or lack thereof, and reliance on it can have in the lead buyers’ choice of governance mode for their GVCs.
5.6.1.1 CONTRACTS AND IT SYSTEMS

In the development of my theoretical model I have identified a few key transactional factors that can influence governance: systems and technology, routines and standard operating procedures (SOPs), order processing and contracts. During the interviews, it became clear that these factors are not perceived as equally important; not surprisingly, given the transactional pressure on participants in the apparel GVC, the attention of lead buyers, intermediaries and manufacturers appears to be more focused on factors that help move individual transaction forward, and the approach to the buyer-supplier interface more reactive than proactive. This may be due in part with somewhat crystallized perceptions of institutional distance as sticky and pervasive; although suppliers in most of the GVC host countries have matured in their ability to do business with US companies, some of the institutional barriers to conducting business in the host countries, such as the rule of law, and law enforcement have not evolved at the same pace, while demands and expectations from US lead buyers have increased. The hurdles to doing business with suppliers in all three regions cannot in general be overcome with contracts, a reflection of shakier rule of law and uneven law enforcement, that feeds into a business culture dominated by informal agreements.
Contracts could facilitate direct sourcing, but end up being more important between US lead buyers and agents or intermediaries based in Hong Kong, where the common law legal system supports them, and much more infrequent in the relationship with suppliers in the various Asian host countries. A Hong Kong based sourcing agent indicated that references and experience of his staff are his primary tools to limit risk when starting new business relationships:

**AGE3:** “A third tool that we use is contracts. We contract what we verbally say we are going to do in a legally binding contract, which works more with the American firms, with Australians, and with the UK – I guess western, if that’s the word we want to use: the majority of our clients are western
retailers or brands. That contractual tool is uncommonly used in China; of course, there are some sophisticated businesses in China, but they typically go direct with that model [contracts].”

Law enforcement and legal remedies remain a great concern when the jurisdiction is in a country with a weak judicial system, and discriminatory application of the law, as agents and several buyers with extensive regional experience suggest is still the case in China and in Southeast Asia. Overall, any insistence of lead buyers on using contracts seems to be more symptomatic of a desire to separate themselves from production and their GVC than it is an effective solution to institutional distance or to supplier capabilities gaps.

The use of information systems and technology to lower transactional barriers and to facilitate exchanges of information with suppliers is another supply chain management approach that somewhat surprisingly does not receive great attention from US retailers. The development of fool proof systems for the transfer of production specification and for real-time tracking of the progress of production programs should favor direct buyer-supplier interfaces but they have only been embraced by retailers at the product level, with systems designed to codify and transfer product specifications. For the rest, most US lead buyers report that retailers’ information systems tend to serve internal management functions in critical areas of financial and retail control, rather than being relational, providing seamless interfaces with direct suppliers and with the intermediaries that manage the other supplier relationships in their GVC. In a sentiment echoed in industry
reports published in the trade press (KSA 2016), some retail executives were outright dismissive of the value of investment in interface systems:

\textit{RET4}: “Investment in supply chain technology is not going to generate sales. You can make an argument for it that, it will save costs and headcount, but you must be really well-planned to implement it, and you are never increasing sales with it.”

Not surprisingly, investment in interface EDI and middleware to communicate across platforms is more extensive on the part of trade intermediaries, as exemplified by proprietary systems developed by Li & Fung to interface with over 12,000 suppliers in 41 countries and with hundreds of buyers in the US and in the EU (ITI3), and at the level of the large manufacturing MNCs, who invest in the necessary technologies to cut the middleman (MFG1, MFG2). One large sweater manufacturer lamented the lack of adequate EDI systems at one of the US top 3 big box retailers as the reason that made direct governance unmanageable:

\textit{MFG1}: “So, we spoke to [Big Box retailer] and they said, if you want to go direct with us that’s fine. It was the biggest nightmare because they are not set up to do it. I remember just setting up EDI – I was up every night two hours a night for a month with someone setting up EDI, while if that had been [ITI3], it would have been half a day. Because they just don’t know ... it’s such a big organization, and I feel that [ITI3] is holding it all together: all these departments. We worked with them direct for two years: we have
done a million dollars with them the first year, a million dollars with them the second year. The third year, we made a decision that we’d work through [ITI3], and we went from 1 to 12 Million. In a year!”

The lack of adequate interface systems at the lead buyer’s end limits the number of suppliers with whom direct governance is feasible to a handful of top tier global suppliers that have invested in these missing capabilities, giving the incumbents a great advantage over potential competitors. The above-mentioned retailer (RET4) has reportedly sourced about 70% of all its production directly from the same 15 key top tier global suppliers headquartered in Seoul, Taipei and Hong Kong, with manufacturing in China and Southeast Asia, for the last 10 years. Over the same period, sourcing in India, which represent about 20% of the total has continued to be channeled through the same trade intermediary, primarily because of the difficulties dealing with barriers to trade and the business culture (RET4).

5.6.1.2 ROUTINES, SOPs AND ORDER PROCESSING

From the transactional perspective, routines and standard operating procedures (SOPs) reduce business uncertainty by establishing and communicating buyer expectations to the suppliers; often translated into checklists, they are helpful in overcoming cognitive barriers that impede unequivocal understanding and execution of instructions in the host countries. Routines and SOPs also help establish clearer inter-organizational interfaces, facilitating project management, peer-to-peer mentoring and problem resolution. For the
most part, these operating routines and SOPs are basic supply chain management tools that are rather commonplace in US businesses, but their implementation overseas is constrained by the transactional aspects of distance, as they are not typical in emerging markets; even in countries like China that have seen significant upgrades in their capabilities, it would be a fateful decision to assume that basic instructions are understood, transmitted internally further away from the interface and then executed correctly. Business cultures seem to truly collide when instructions are misunderstood, misinterpreted or ignored and result in a production problem. As several retailers and agents pointed out, there is a general reticence across East and Southeast Asian business, and an unwillingness of suppliers’ staff to recognize their own mistakes, or acknowledge fault, due in part to distrust in the retailers’ fairness but also to fear of personal repercussions within their own organizations, if they shine a light on a potential problem. Thus, problems that could be resolved if addressed in a timely manner tend to escalate, out of sight, until it is too late to remedy, at significant cost to the retailer and the supplier.

While one could not say that an intense managerial focus on routines and SOPs is sufficient to promote direct buyer-supplier interface, it appears from all sources that it is a necessary condition, and that where lead buyers fall short, it is the service proposition of agents and trade intermediaries to step in with their local staff. While all the agents and intermediaries interviewed have indicated that they make extensive use of checklists and monitor production progress very closely, retailers that consider suppliers’ tacit knowledge and capabilities a valuable resource see a serious limitation in ‘management by checklist’:
RET1: “[SOPs and checklists] have been extremely important for us, but you reach a point where it can be too much, where people stop thinking with their own head because everything is so defined. We see that sometimes people just stop using their head, so we are walking a fine line.”

Q: Could you give an example of a situation in which this happens?

RET1: “I think in the case of quality problems: when we have a quality problem in manufacturing there is a list of things we must do, but the menu doesn’t always apply to the situation. In some cases, you must think beyond it because the solution is not going to be in that checklist. In the countries in which we work, the suppliers appreciate, to some extent, being told what to do, and the checklist really helps when they try to solve problems on their own, so that fewer problems come to us. But sometimes they may have other solutions that they will not bring to the table because they are in that robotic state, and they stop thinking outside the box.”

From the perspective of direct suppliers, the most important checklist is the actual purchase order, which should contain all the information necessary for production, once the order is finalized. Viewed from the perspective of a large multinational supplier, lack investment in order processing capabilities and staff on the part of the buyer is possibly the biggest hurdle to direct sourcing:
MFG2: “At the most transactional level, issuing a P.O. is a quite a detailed, cumbersome process, and retailers that don’t want their US staff, in their US offices, with high wages doing that, find it very hard to do direct, because that’s what we take direction from: the official purchase orders.

Q: So, they are giving up on contractual clarity …

MFG2: “They are giving up on the detail level of managing all the P.O.s, and having that agent manage the P.O.s for them. It definitely saves manpower on the retailer side: you are giving all that transactional stuff off to the agent and you think it saves cost. It does, but it prevents you from having the capability to deal directly with the manufacturer. You need to be able to handle the O.s, in order to go direct.”

Q: You are putting a certain amount of emphasis on contract – what is the thing you would be most afraid of with a retailer?

MFG2: “It’s not so much contract – it’s the P.O. details, because in the P.O. you have the quantity, the style, the specs, the details, the delivery date, the FOB accuracy and that’s all agreed beforehand, the accuracy of data, that kind of detail. The contractual we couldn’t care less: we sign a master service agreement sign once we start working together. It’s not the contractual issue I am worried about, it’s the level of detail, the transaction details that you must go through, and a lot of US retailers say it’s too much
detail, I don’t need to handle it: I’ll let my Hong Kong team which is a lot cheaper, on wages and benefits, and then let my China team do it, and let me focus on something else. When you do that, you are out of the game, you can’t deal directly. If you want to deal directly you don’t have someone else do your work for you: you are going to have to do your work! If they want to go direct they must handle the P.O. issuing, which retailers sometimes don’t want to do because it takes a lot of manpower: you are talking about teams of 20-30 people that just manage P.O.s.”

These comments highlight that the lead buyers’ governance choice is at least in part a function of their investment in order processing capabilities, a fixed cost if internalized and a variable cost if transferred to agents or trade intermediaries. While scale plays a role in the choice between fixed and variable cost, so that at the high end of volume we see the three main brands of GAP Inc. internalizing the function, for companies like Chico’s and Ann Taylor who occupy the one to two billion-dollar specialty apparel space, it is not scale that drives the decision between fixed costs and intermediation, but rather a philosophy of the role and value of supplier relationships. Overall, the activities that constitute transactional institutional brokerage, as highlighted by the interview participants, contribute to moderate the effect of transactional barriers associated with institutional distance, supporting Proposition 9. Regarding supplier capabilities, there is some direct evidence from retailers that lead buyer transactional institutional brokerage activities enhance supplier capabilities, facilitating a more direct interface. The suppliers themselves place greater emphasis on the lack of lead buyer
investment in transactional brokerage as a key impediment to direct sourcing. Both viewpoints lend support to Proposition 10.

5.6.2 RELATIONAL INSTITUTIONAL BROKERAGE

One of the strongest findings in this research is the prevalence of trust barriers associated with cognitive and normative distance in the cross-border buyer-supplier interface; these trust barriers operate at the interpersonal and at the inter-firm level, making transfers of knowledge and practices more difficult, adding to coordination costs. While the existence of these barriers to trust-development is not in general questioned by any of the interview participants, there are some striking differences in views among lead buyers regarding the extent to which they should be tackled by the buyer, the best strategies to address them in practice, and whether the different strategies truly result in different outcomes (ITI1). One camp, best represented by RET4 takes a more adversarial and transactional approach to the governance of its value chain, seeks to avoid engagement with the complexities of bridging the gaps created by institutional distance, preferring principal to principal relationships with suppliers who internalize institutional distance and are adept at transacting in the mode preferred by a traditional US buying organization. There are only two types of organizations with this type of capabilities: the large manufacturing MNCs based in Taiwan, Korea and Hong Kong with factories in China and Southeast Asia, and trade intermediaries like Hong Kong based Li & Fung or Delhi based Triburg. The sourcing strategy of RET4 reflects this reality with 75% of all production outsourced to 15 key vendors, each of them a manufacturing MNC, with an average of three approved
factories in China and Southeast Asia, whereas production in India being entirely sourced through one trading intermediary. Transactional brokerage is essential to the success of this strategy because, at the end of the day, in the words of one direct supplier (MFG2): “The purchase order is king.”

On the other end of the spectrum we find lead buyers (e.g. RET1) who truly believe that engaging a broader range of suppliers adds value and product capabilities to the firm, because nowadays these capabilities reside at industry and cluster level, rather than at the retailer level; not only are there more suppliers with valuable capabilities than the handful of manufacturing MNCs used by RET4, but also agents and intermediaries acting as agents have economies of scale and scope in the aggregation of these supply capabilities that no retailer can match. To tap on the supplier resources in a wider range of countries, lead buyers need to make a substantial investment in relationship building in the GVC, starting from selection and training of staff, engaging in activities that develop cultural intelligence and cross-cultural communication skills (Figure 5.7), supported by corporate culture seeking a flexible approach to the governance of each buyer-supplier relationship. The underlying idea behind relational institutional brokerage is that idea is that suppliers are essential contributors of value, that a strategy aimed at maximizing the firm’s social capital in the global value chain is a topline contributor and that the governance costs associated with what could be described as a hybrid, ad hoc approach to GVC governance are more than offset by the contribution to sales from product capability gains and access to supplier resources.
A sourcing strategy founded on relational institutional brokerage has high fixed costs because it engages the retailer with its direct suppliers, as well as in triangular relationships among the lead buyer, agents with local offices in the host countries, and the suppliers. Lead buyers does not only incur high overhead costs to manage so many cross-border interfaces; they also incur substantial costs in developing a corporate culture that is capable of sustaining trust development across borders consistently. Whereas the transactional lead buyer can reduce the sourcing equation to the simplest terms “Here is my detailed order, you will make nothing else than what is on my order, you’ll deliver it by the agreed upon date, and we’ll pay you 60 days after delivery.” the relational buyer needs to make a significant organizational investment in the selection, training and
support of managerial and executive staff to ensure their ability to develop and maintain strong and effective relationships with overseas suppliers and agents.

5.6.2.1 CULTURAL INTELLIGENCE

A key ingredient for the development of cross-border buyer-supplier relationships, whether direct or mediated through agents, is cultural intelligence. Although this might sound commonplace, even in the limited cross-section of specialty retailers interviewed in this study, cross-cultural intelligence is not truly valued or cultivated by all lead-buyers: the more transactional buyers take a more directive, normative approach to their interactions with suppliers, and a quite ethnocentric view of the management challenges in their value chains. The words of one such retailer (RET4) sums up this attitude in discussing her approach to relations with suppliers: “...we are tough first date and, in general, we don’t really care what everyone else is doing.” On the other end of the spectrum, lead buyers who engage in relational institutional brokerage, as well as some key suppliers and agents agree on the importance of a corporate culture that values the kind of cultural intelligence to develop lasting trust-based relationships with remote suppliers based in institutionally distant regions.

Relational oriented lead buyers focus a significant amount of attention to recruitment, and while product knowledge and experience sourcing overseas are important (ITI1), they are not the key determinants in the hiring decision, and once recruited aggressiveness in pursuing financial goals is not a key to internal promotion. Hiring executives seek to probe a potential candidate cultural intelligence with business
scenarios and through extensive interview processes extending over several weeks and multiple meetings to ensure a good initial cultural fit. This effort is mirrored by the hiring practices of the lead buyers’ agents:

**AGE3:** “We have so many scars, so I have some scenarios [in the interview process] that I’d want to see how this individual would react, whether it is a corruption issue or more importantly a product-client confrontation or interaction issue, for example with this vendor from Korea with a factory in Indonesia, a client based in the United States with and office here in Hong Kong. In this context, a manager’s compensation in Indonesia is a fraction of what it is in Korea and the individual found out. How would you resolve a situation like that? And you know how it is, an ethnocentric response “that’s how it is in America” is not appropriate ...

The percentage of people who have [cultural intelligence] is not that great. How you give it to them is tough: some people are born leaders, some people are born mathematicians, and then you enhance it. It’s very hard to teach someone cultural sensitivity, if they don’t have it. We typically look for someone with a more global perspective when we are recruiting, and that could be from anywhere from Pakistan, from China or from America. Have they had more sophisticated global experiences in life: have they gone to school in America, have they studied foreign languages ...”
Lack of cultural intelligence can lead to costly mistakes that then get exacerbated by the typical cross-cultural barriers that characterize communications between US and east Asian staff. One trade intermediary (ITI1) with a past as a retail sourcing executive recalled an incident from his days at a very large US retail chain that illustrates how the effects of an ethnocentric approach to cross-cultural challenges can snowball:

**ITI1**: “Years ago, I had this woman working for me in Hong Kong, a real dragon lady ... and she wanted to hire a designer for our brand. I said fine, so she hired this Japanese guy who was interesting, but had trouble with the American market. This went on for about 6 months and it wasn’t working, I started talking about it “this isn’t working” ... and I couldn’t get her to budge about doing something with this guy. It was a mess. The biggest thing was that culturally, this was back in the 90s, he was too ahead of the American market in fashion: he just wasn’t connecting with our brand, and his communication skills were not great either ... it just wasn’t working. And I looked at her and said, why don’t we put him on contract? As opposed to putting him in full time, put him on a contract, that will free up the headcount. Problem solved. She goes ahead, puts him on contract and two days later he resigns. And it finally occurred to me what I was up against: she had “face”, she didn’t want to give up on her concept of having a designer, and for her to fire him would have been a loss of face. He, being Japanese, thought when you got a job with a company, you got a job with the company – for life – you are not going anywhere – and
nobody fired Japanese people ... so when he got the message that he was
going to be on a contract as opposed to full time – he resigned.”

Beyond careful selection in recruiting, relationally oriented lead buyers adopt a
number of formalized and informal means of developing the cultural intelligence in their
sourcing staff, and of management at large; several retailers and their suppliers have
developed internal training programs, and encourage academic development of their
staff with scholarships and tuition support, but the most useful training, and the least
disruptive to work schedules, comes in the form of ‘embedding’, which consists in
sourcing managers, the technical people, and sometimes merchants spending several
weeks embedded at a key supplier’s factory, or at an agent’s office overseas, shadowing
their transactional counterparts, as well as hosting suppliers and agents at corporate
headquarters for periods of comparable length:

**RET1:** “One of the greatest advantages is that it builds a new enthusiasm
in what they are doing; they develop an appreciation for what the suppliers
are doing and they come back and they share with the team. They are much
more vocal about what goes on over there: the culture, the experience, the
actual manufacturing and technical process. We see them sharing the
knowledge more, and seeing the vendor and the country less as the ‘other’
but more part of the team. It builds that cultural understanding and sense
of partnership – that they are just an extension of us – that is probably the
greatest difference. You just hear it in the way they speak about the
suppliers: they talk to others about them. and they explain things more in
detail to other members of their cross functional teams, because they
understand the ‘why’ behind certain things. They’ll explain to the merchant
who hasn’t been there, and might want a supplier to do certain things -
that it can be done, but it will slow down productivity and here is why.”

Embedding develops a strong connection between the lead buyer’s organization
and the key suppliers, and when sourcing is managed indirectly with the agents, and
provides an excellent on the job ‘onboarding’ for new recruits, shadowing their supervisor
in some of these extended visits. Embedding exposes managers to the host country’s
culture and humanizes the relationship, effectively reducing communication barriers and
promoting interpersonal trust. This interpersonal trust also projects at the firm to firm
level because the experience translates into greater trust in the suppliers’ systems,
preventing conflict escalation and facilitating problem solving and dispute resolution,
with greater equity, and in a manner conducive to business continuity. More forward
thinking retailers also emphasize overseas travel of senior executives to reinforce trust in
their commitment to the relationship with suppliers and agents. The trust established
through these frequent exchanges and direct in person interface has a measurable impact
on suppliers’ performance, and in their willingness to accommodate the needs of lead
buyers who invest in their relational capabilities:

**MFG1:** “Aeropostale wanted to launch a whole new product line last year.
They wanted us to deliver goods in 45 days from first drawing. It’s unheard
of in this business: we were flying it [shipping by air rather than by ocean],
but you still have to dye the yarn, you have to produce, and it was in the
middle of peak season. We did it because of that relationship If somebody
else asked us to do the same, I would have said no.”

The investment in embedding staff is often reciprocated by suppliers and agent,
farther reinforcing the buyer-supplier bond; one supplier (MFG1) mentioned travelling to
the US with management from his factories during Thanksgiving, to give them first-hand
experience of “black Friday”, for them to understand the devastating business effect of
missed product deliveries in that critical holiday season.

5.6.2.2 CROSS-CULTURAL COMMUNICATIONS

As can be inferred by the preceding discussion, cross-cultural communications are one of
the most significant barriers to exchange associated with institutional distance, and in no
industry is this more apparent than in the specialty apparel industry, with its transaction
frequency and with the level of detail involved with each transaction. Cross-cultural
communication barriers will naturally affect the proper execution of individual orders
with an adverse effect on buyers’ trust of suppliers’ competence, and lack of adequate
communication skills will hinder the development of interpersonal and inter-
organizational trust necessary for the desired level of cooperation and coordination. One
solution to the problem is avoidance, which can be achieved by limiting the supplier
interface to the globally integrated manufacturing MNCs or by using specialized trade
intermediaries; both types of firm specialize in resolving the cross-cultural
communication issues for their clients by shielding them. Avoidance creates however information asymmetries that give incumbent suppliers and trade intermediaries greater power in the relationship, resulting eventually in the erosion of the competitive advantage derived from supplier consolidation. This type of concern drives several retailers to pursue sourcing strategies that maximize access to a broader range of suppliers’ capabilities, beyond manufacturing capacity, and that actively seek their contribution to the topline as extensions to the firm. Many executives at these firms have previously worked for some of the more transactional and adversarial retailers and chosen to expand their supplier base to a larger number of suppliers, in more host countries. While the best example of a strongly transactional supply chain among the interview participants (RET4) sources over 90% of its production from 15 key suppliers and one intermediary, with the lion share of the business in China, some of its most direct competitors (RET1, RET5) regularly work with over 50 suppliers in four or five countries, and with close to a hundred when considering all the ancillary factories that may supply one item per season. In order to work effectively with such a variety of suppliers and across different regions, these retailers make a conscious investment in their managers’ cultural intelligence and in the associated soft skills that are the foundation of relational institutional brokerage. As echoed by many of these retailers and by the agents who work with them, leadership sets the tone for sourcing management and staff, starting with weeding out successful but more adversarial and potentially “toxic” hires when recruiting.

RET5: “Depending on the size of the company, of course with a bigger company it’s harder, but if I am in a leadership position, when I meet my
team, I am driving that theme home. When I interview somebody for a position, I make sure that [cross-cultural communications] are a big part of the conversation. I mean written communication, the awareness that if you are importing from overseas, you are communicating with people for whom English is their second language, and you gotta be careful about using slang and colloquialisms: it can’t be conversational, it has to be very professional.”

The importance of strong sourcing team leadership is echoed by agents with experience working with US retailers in the host countries:

**AGE1:** “It’s not a formal training process but it’s a training process by example. When you have a good person at the top in a sourcing organization who is reasonable, and thoughtful and very person-oriented, that person sets the tone.”

The cross-cultural communications barriers are exacerbated by the preferred medium of communication: e-mail, due to time zone difference and to the need to transmit information or details regarding progress or issues in the dozens of steps involved with each transaction. The use of e-mail communication seems to metastasize rapidly because of the ease with which sender will include several recipients on both sides of the ocean, at times out of lack of trust in other parties in the transaction (RET7). As an executive noted, this lack of trust also ensures that no one gets off the recipient list, leading to executives receiving as many as one thousand e-mails a day (RET1, MFG1). The
importance of managing supplier communications is evidenced in a study commissioned by one retailer (RET4) which revealed that managers and executives in the sourcing were spending an average of 55% of their time answering e-mails, a problem that many interviewees attribute to poor communication skills. The problem can be mitigated by a dedicated effort to improve cross-cultural communications across the organization; as one executive noted, leadership can be as simple as gentle mentoring, predicated on a collaborative atmosphere in which the front-line managers feel free to ask for a second opinion:

**RET5**: “It’s really hard to write a manual for this kind of job; companies have done it, but every day is like a new adventure in the sourcing world, a new problem, a new challenge, a new opportunity. There are wrinkles with those daily, so a lot of it [leadership] is hopefully instilling in people the ability to do their work, but also knowing the differences: ‘Ok, I am really not sure what do next, so I’d like to get another opinion before I open my mouth or write another sentence’, or they might draft an e-mail and give it to me to read. I used to love it when they did this, they would draft and e-mail and ask: ‘Is this ok to say? Here’s the scenario ... has the way I have written this come across ok to you, as the reader ... if you got this e-mail, what would you think about the person who sent it to you?’

The challenges with cross-cultural communication in the fast moving context of apparel global value chains have to do with transmitting the necessary content, in the
proper form and using the right medium; there can be some level of academics inside the corporate environment by which the new person you just brought in as assistant purchasing managers receives some training on cross-cultural communication and negotiations training but at the end many participants noted that people tend to follow the culture of the organization, so that leadership by example is crucial. One way leadership can improve the cross-cultural communication outcomes is by providing institutionalized support for travel, so that when e-mails and midnight phone calls have reached the limit of what they can accomplish (RET5), managers can meet in person with suppliers and agents to review issues and resolve them face-to-face. This view is supported by agents as well, who greatly value frequent travel by the buyers and embedding at one another’s location for the benefit of all parties involved. Communicating and negotiating in person at the appropriate time is not only conducive to more harmonious relationships in the global value chain, but it has significant positive impact on economic outcomes for the retailer, a view confirmed by suppliers and agents:

**MFG1**: “Yes ... I get better prices if I am in person! Honestly, customers seem to pay more; if you are there negotiating in person, there is a certain comfort, they lay their cards down, and so do we. And we do the same [give better prices] quite honestly, because we understand where they are coming from: they tell a lot more detail when [the negotiation] is in person, and then we understand. Are they negotiating just because they want to negotiate? Do they have someone else tipping this price? Is there
something coming from senior management, do they need to hit this price?

If you can understand that, you can make better decisions.”

5.6.2.3 CROSS-CULTURAL NEGOTIATIONS

Cultural intelligence and good cross-cultural communication skills are critical when negotiating across borders and the interviews have revealed many scars and failures to develop a working trust with suppliers resulting from unyielding, adversarial negotiation tactics. Some sourcing executives (RET7) have found that the reputational effect from past employment at very large retailers known for their confrontational and punitive style in global sourcing carried over for years after leaving, resulting in suppliers’ complete lack of trust in their fairness and reasonableness, even after they had joined retailers with an excellent reputation in the industry. The contrast in style among UIS lead buyers is such that some executives have indicated, off the record, that they would be inclined not to recruit sourcing professionals from the most adversarial retailers. While, as many interviewees noted, the specific skills and behaviors that make up a good cross-cultural negotiator are intuitive and rather standard fare (AGE2), the sheer number of contracting negotiations and micro-conflicts that arise in the set up and execution of each order amplifies the differences between lead buyers’ corporate cultures, their perspective on the global value chain, of the role and importance of suppliers and intermediary firms. Without a steadfast corporate commitment to developing relationships and trust in the global value chain, each order is rife with opportunities for cross-cultural communication barriers to result in negotiation breakdowns:
**ITI2**: “I have been sitting with the customer many times in price negotiations, and I have seen it happen, even with associates whose English isn’t so good. The customer is sitting there asking questions, and they [the suppliers] get nervous, starting to laugh, to cover their face. The customer takes it as ‘They are nervous, they are laughing at me’, ‘They are silly’, ‘They are hiding something’. How do you broker that?”

The ability to navigate the treacherous waters of cross-cultural negotiations are of course founded on the cultural intelligence of the lead buyer and of their local intermediaries, and are the foundation of the lead buyers’ legitimacy in the eyes of the suppliers. To that effect, cultural intelligence, preparation and a transactional body of knowledge are essential to maintaining reasonable expectations and a degree of fairness and reciprocity in the negotiation:

**RET1**: “[the negotiators] need to know what the labor costs are in that country and understand the different cost components: what are the labor cost in the different countries, what are the efficiencies and the inefficiencies of that particular country? We try to get full cost transparency from our suppliers but we don’t always get it, so they need to really break cost down into each major component to be more effective negotiators, rather than just going in saying I need this price. - the other thing I did not mention is that they need good collaboration skills, really developing that partnership partnering for the long haul rather than
focusing just on that negotiation piece. You may give up 10 cents today but you might really need it tomorrow, so they need to sit back and look at the bigger picture. We deal with a lot of business owners, so we need think of it [the negotiation] from their perspective.”

The reasonable expectations, transparency and reciprocity necessary for good cross-cultural negotiations are clearly the result of a deliberate strategy by the lead buyer, promoted internally, and communicated directly, and through agents to the suppliers. Not surprisingly, the lead buyers that focus on collaborative relationship with suppliers will avail themselves of the help of sourcing agents whose reputation for fairness and integrity is such that even large direct suppliers, who by preference avoid interfacing with agents, make an exception and accept working with them (MFG2). The managing director of one such agent describes his approach to fairness and integrity in negotiations as follows:

AGE3: “If somebody in the chain tries to take more than whatever their piece is worth, it not going to work, or if it works, it’s not going to be sustainable. If that supplier charged too much for that good, he might be able to get one off, but it’s transactional: it’s not sustainable. Or if the agent, which we have never done, is taking more money from them than they are telling the client [e.g. by double dipping], that ultimately is put back in the cost, or quality is taken out. You really can mathematically look at the supply chain; it’s not that complicated. You have a 50-dollar shirt
with an 80% IMU; if there’s more nickeling and diming into that, something must give.”

More relationally oriented lead buyers tend to value a degree of transparency, not only on cost but also on compliance, that can only be achieved with a sustained effort to bridge trust gaps in the global value chain that is fully supported at executive level, working directly with some suppliers and in triangular relationships with suppliers and a reputable agent, who can be essential brokers of trust:

RET3: “When you go through an agent the trust is really between the factory and the agent, and then between us and the agent. If you are not dealing directly with the factory, you don’t really have that contact: you are not communicating daily with the factory. It is really the agent communicating daily with the factory, and you are communicating with the agent, so your trust level and work is really with the agent. (...) So, you hire the agent based on history and on their reputation in the market place, and if they are a well-known agency, the factories trust them.”

It is clear from the preceding discussion that relational institutional brokerage is a costly investment in capabilities and resources that maximize the value of the buyer-supplier relationship as opposed to a simple on minimizing transactional errors. Selecting and training for cultural intelligence reduces the country level cognitive and normative barriers to communication and trust development, facilitating a more direct interface with suppliers in all regions, lending support to Proposition 9. A corporate level focus on
relationship development, with training and in general greater attention to cross-cultural communications and negotiations skills also valorizes supplier capabilities, favoring more direct governance mode. Lead buyers who invest in relational institutional brokerage tend to have direct buyer-supplier relationships in a larger number of countries, establishing triangular relationships through agents with suppliers that more transactional lead buyers will contract through intermediaries, supporting Proposition 10.

5.7 RESOLVING MULTIFINALITY IN GOVERNANCE MODE

The interaction effect of institutional distance and supplier capabilities on the preferred governance mode can be visualized arranging the two variables in a 3x3 matrix (Figure 5.9).

![Figure 5.9 Combined effect of ID and supplier capabilities on governance](image.png)
Although both institutional distance and supplier capabilities are on a continuum they tend to cluster as shown in the matrix for competitive reasons by virtue of their investments in transactional and relational capabilities. While lead buyers have indicated that they can find suppliers with all ranges of capabilities in all the main sourcing regions, in many cases supplier capabilities tend to fit the prevalent governance profile of the country in which they are located, so that there is a greater concentration of high capability suppliers in countries with lower institutional distance, with direct governance, and a greater concentration of suppliers with low relational capabilities in countries for which the preferred governance mode is indirect, through intermediaries. This is represented in the matrix by the boxes along the diagonal in which the governance expected based on supplier capabilities matches those expected for the host country.

Lead buyer institutional brokerage capabilities seems to assist in resolving the governance equation in the two boxes in which the governance is not unequivocally by the two independent variables: different levels of brokerage capabilities, and focus on different types of brokerage seem to lead to different governance options. In broad brushstrokes, retailers who focus their effort on transactional institutional brokerage are more comfortable with principal-to-principal relationships, and will use externalize the interface to trade intermediaries when direct governance is not an option. Lead buyers who invest in relational institutional brokerage on the other hand tend to place value in maintaining an interface with suppliers whether direct or in triangular relationships mediated by an agent, and will opt for governance with agents when in situations where direct governance does not appear viable. Although the interviews have only revealed
anecdotal evidence, namely instances in which sourcing agents have reported competing for manufacturing space with trade intermediaries retained by rival retailers, and from executives who have worked with the same factories for different retailers, the governance logics that emerged from the interviews lend support to Proposition 11.
CHAPTER SIX

DISCUSSION, LIMITATIONS AND RESEARCH AGENDA

The primary objective of this study was to extend the existing theory on the governance of buyer led global value chains to incorporate two determinants of the governance mode that have been largely neglected in global value chains scholarship: host country characteristics and lead buyer agency. To this purpose, I isolated a large subset of the apparel sector, large US specialty apparel retailers, within which transaction complexity and codifiability are relatively invariant, thus controlling for two of the three conventional governance determinants, retaining only supplier capabilities as a variable. I have also discarded three of the five governance modes in the established model, hierarchy, captive and market because they are rarely, if ever, encountered in the specialty apparel retail space, and then redefined the relational and modular governance modes in terms of degree to which the lead buyer internalizes the buyer-supplier interface, in order to exercise direct control, or externalizes it agents or trade intermediaries, in order to avoid some of the costs and the organizational complexity associated with contracting and coordinating production in institutionally distant host countries. By doing so, I have selected governance modes that match actual industry practice, as suggested by preliminary interviews and secondary sources, and confirmed by all participant during the interviews.
6.1 INSTITUTIONAL DISTANCE IN GLOBAL VALUE CHAINS

With governance thus defined, I applied an institutional theory lens, and specifically looked at institutional distance to assess the effect of host country characteristics on the governance of buyer-supplier relationships. Given the high frequency of transactions, the large number of steps involved in each transaction and the need for buyer-supplier cooperation to coordinate production I framed institutional distance in terms of transactional and relational barriers to exchange, anticipating that cognitive, normative and regulative barriers would loosely correspond to interpersonal, inter-firm and country-to-country level barriers. The interviews, as well as other informal conversation that continued with some of the participants, leave very little doubt that institutional distance is a key determinant of the buyer-supplier interface governance, and that industry experience and ongoing assessment of country characteristics divide the five countries from which over two thirds of all US garments are imported into three regions each with its preferred governance mode. The governance choice appears to be a country level decision that bundles suppliers with very different capability level within one specific country level governance mode, because despite frequent claims to the contrary, lead buyers’ perceptions regarding institutional distance barriers trump supplier capabilities, even when they are significantly upgraded. In the world of outsourced apparel manufacturing, higher perceived institutional distance is clearly associated with lead buyers distancing themselves from their manufacturers, externalizing the interface and
therefore outsourcing management of distance barriers to either agents or trade
intermediaries. This seems to contrast with the approach taken in equity entry modes,
where the dominant response to distance is to control its effects through internalization,
establishing wholly owned subsidiaries.

Analyzing cognitive, normative and regulative distance in terms of the
transactional and relational barriers to exchange and cooperation provides a detailed
framework that captures on one hand creeping transaction cost increments that
compound over multiple extended transactions, and on the other, the barriers to
development of trust between buyers and suppliers to a level that would facilitate
knowledge and information flows, as well as legitimize buyers’ demands and
requirements, removing barriers to the acceptance and adoption of lead buyers’
practices. The interviews have clearly indicated that while transactions eventually take
place because of the mutual dependencies of buyers and suppliers in the global value
chain, there is limited trust in the other party’s competence, with buyers failing to
establish the business legitimacy of their demands and of the practices they seek to
impose. This result either in ceremonial adoption, as has often been the case in China
regarding labor working hours and subcontracting, or in actual opposition and resistance
as several interviewees reported in the case of India.

6.2 SUPPLIER CAPABILITIES IN GLOBAL VALUE CHAINS

The importance of supplier capabilities in the governance decisions is intuitive and had
been previously addressed in the GVC literature; contrary however to the conclusions
drawn by Gereffi et al. (2005), low supplier capabilities do not lead to internalization of the buyer-supplier interface as would be the case of captive or hierarchical governance, but rather to greater distancing from the supply base. In a fully outsourced environment like the US specialty apparel retail sector, deep involvement in manufacturing is clearly not a lead buyer’s priority and the associated capabilities are not viewed as a core competency; as a result, the more a supplier needs “hand-holding” the more likely that buyers will choose to distance themselves from the supplier interface, using the services of third party firms adept at bridging gaps between the supplier capabilities and the buyer’s requirement. By doing so, they either establish a triangular relationship with the supplier through sourcing agents, or fully outsource the buyer-supplier interface by using trade intermediaries, despite intermediation costs in the order of 6% of the cost of goods sold for agents, and 9-12%, and possibly higher, in the case of trade intermediaries.

6.3 INSTITUTIONAL BROKERAGE

The existence of transactional and relational barriers to exchange at both country level and supplier level creates a special challenge for lead buyers in the specialty apparel sector who rely in average on 50-100 suppliers in four or five different host countries to produce one thousand or more orders every year, each involving dozens of steps in which buyers and suppliers need to interface. It is easy to see how the small incremental costs that arise at the interface from institutional distance barriers and supplier capability gaps can add up to significant cost overruns that significantly affect the bottom line. A quick analysis of the annual reports of publicly traded specialty retailers shows that in most
years, net incomes are in the same order of magnitude of the sourcing department costs, 
without counting any intermediation costs, making sourcing the object of continuous cost 
reduction experiments in governance. Understanding the true impact of GVC governance 
on performance is complicated by at least two other factors: firstly, the time lag between 
any changes in sourcing strategy and their impact on the bottom line exceeds one year, 
during which the effects of old sourcing decisions carry over. The full year-long effect of 
a change in sourcing strategy is not really seen until two years after the change, making 
for a more tenuous causal correlation between sourcing strategy and performance, 
especially because quarterly income pressures may lead to additional reactive changes 
such as staff and travel budget cuts, and the severance or establishment of sourcing 
relationships with agents and intermediaries that could confound the effect of the new 
strategies. Secondly, an emergent trend of acquisitions by private equity firms like Ascena 
Retail Group and Sycamore Partners who also own global sourcing and shared services 
companies, leads retailers targeted for acquisition to disinvest in global sourcing staff and 
capabilities for tactical reasons associated with valuation, rather than for long term 
performance and growth. Despite these confounding factors, a few clear patterns 
emerged in the interviews regarding how lead buyers seek to address institutional 
distance barriers and to bridge supplier capability gaps by means of institutional 
brokerage and how this is procured through their choices of governance mode for their 
interfaces with suppliers in the various host countries.

To engage successfully with a wide range suppliers in host countries in emerging 
markets, lead buyers need institutional brokerage to lower the transactional and
relational costs associated with the cognitive, normative and regulative institutional barriers linked to institutional distance. In this light, the governance decision is fundamentally about the extent to which the lead buyer intends to engage in the brokerage activities and develop the associated capabilities as opposed to outsourcing them to specialized third parties; this decision hinges on the firm’s view of the strategic value of their supply chain and of the role of suppliers as a core resource. Institutional distance in GVCs manifests itself in the form of hundreds of daily communication barriers, micro-conflicts, misunderstandings, rework and delays, as well as in clashes of business culture that fuel mutual distrust between buyers and suppliers.

The ‘Holy Grail’ in the professional experience of all executives interviewed seems to be the perfect balance between control and disengagement in their global value chain. Lead buyers’ institutional brokerage seems to be determined by their strategic views of the value chain, resulting in two bottom-line oriented, cost-minimization strategies and one topline, resource-maximizing strategy. In a fixed cost minimization strategy, the retailer outsources most sourcing to a trade intermediary, in one famous instance, in 2009, Liz Claiborne sold the exclusive rights to its sourcing to Hong Kong based Li & Fung for US$ 83 MM (Li & Fung 2009a) and in the process virtually shut down its own sourcing organization. In the same year, another retailer under cash flows and cost pressures, Talbots also drastically reduced the size of its highly respected sourcing team (Birnbaum 2000) entering a similar agreement (Li & Fung 2009b). While both Talbots and Liz Claiborne failed to reap the anticipated benefits from this outsourcing strategy, others
firms like Tommy Hilfiger have successfully outsourced production and product development to Li & Fung, while focusing on brand development.

In all cases, these were strategies of disengagement from the global value chain, with the institutional brokerage function also outsourced to the intermediary. This extreme outsourcing option has the advantage of taking advantage of an extensive key-in-hand modular supply chain managed by an experienced trade intermediary, reducing the commitment of managerial resources to sourcing, product development and logistics, but it also brings with it extreme dependency from one trade intermediary, with very high switching costs due to lack of connections in the supply chain, as well as lack of managers and executive with true international business capabilities.

A second cost minimization strategy focuses on disintermediation, with a strong preference for direct sourcing. As discussed in Chapter 5, direct sourcing requires a commitment to minimizing transaction costs, and to maintaining in-house capabilities associated with order management. This type of lead buyers tends to focus and specialize in transactional brokerage, which really consists in fail-proofing cross-border order management, through standard operating procedures, routines and detailed order processing, activities that fall within the traditional domain of supply chain management. This approach limits the supply base to a few compatible suppliers, for the most part the largest manufacturing MNCs headquartered in developed East Asia, namely Taiwan, S. Korea and Hong Kong, who have the capabilities to manage production in China and in more institutionally distant countries like Vietnam and Indonesia, acting more as
intermediaries between the lead buyer and these host countries than as pure manufacturers. By selecting East Asian suppliers with a very high level of international business sophistication and greater brokerage capabilities within their region, transactionally oriented lead buyers are de facto distancing themselves from production, entrusting its management to regional MNCs. There are obvious advantages dealing exclusively with these well-known globally integrated manufacturing groups in terms of production capacity, management and information systems and compliance; at the same time, high switching costs due to the lack of true institutional brokerage capabilities narrow the supply pool excessively, giving the incumbent suppliers greater bargaining power, eventually leading to loss of competitiveness.

Several lead buyers adopt a different approach, based on a view of the global value chain as a resource to be maximized, and engage with a broader range of suppliers in multiple countries in search of product capabilities, and of economic arbitrage opportunities. These firms will also source from large manufacturing MNCs and forge long term relationships with them as in the case of their more transactional peers, but they differ in the number and variety of suppliers and countries in which they have a direct interface with supplier. Not only are suppliers viewed as resources but agents are often viewed as extensions of the firm, offering a second institutional bridge between the buyer and the supplier. This strategic approach can be described as a social capital strategy, in which the lead buyers place themselves as central nodes in a cross-border network of trust networks made up of raw material suppliers, agents and factories. This social capital strategy relies on relational brokerage activities aimed at lowering the cross-border
institutional barriers to trust in the global value chain and require a significant investment on the part of the lead buyer, in terms of human resources as well as in terms of development of a corporate culture conducive to effective institutional brokerage.

Relational institutional brokerage starts with recruiting; while virtually every participant agree that cultural intelligence comes from exposure to multiple cultures and professional experience, companies that value more cooperative relationships with suppliers and agents, and definitely the agents who help bridge the gaps with suppliers make the assessment of the cultural intelligence of potential hires an important part of the recruiting process, well aware that a host of candidates, from intermediaries and from retailers with a more adversarial approach to the value chain, may have the global sourcing experience but have not acquired the necessary knowledge of the business culture sin which they are called to operate and the behavioral scripts associated with good cultural intelligence. Selecting the right skill set in new hires is especially important because, while some skills can be taught through training, most companies, on both sides of the Pacific, expect new hires to be up and running quickly and do not have extensive ‘onboarding’ training; thus, many executives put prospects through extensive interviews probing them the kind of real-world business scenarios they are expected to encounter in their work.

Much of relational institutional brokerage activities promote the continuous development of cultural intelligence of all staff that may interface with suppliers overseas, through frequent travel and through lengthy embedding of sourcing staff and
merchandisers at the suppliers and at the agents facilities for periods of two to three weeks, as well as hosting supplier and agents for similar lengths of time to continuously improve cross cultural communications and negotiation skills: this represents a significant investment in time and money, but results in a far superior understanding of the business culture and of the constraints under which suppliers operate, building more cooperative and trusting relationships with the suppliers, and legitimizing buyers’ expectations and requirements. More importantly, these lead buyers establish a corporate culture in the feedback from embedded staff is valued for problem solving and preemption, reducing escalation of the inevitable conflicts that arise in pre-production and in manufacturing.

Relational institutional brokerage is not only a ‘feel-good’ cooperative approach to the global value chain: by establishing greater trust with agents and suppliers, the lead buyers enjoy freer communication with all parties in the GVC, with agents accepting direct communication channels between buyers and suppliers without fear of buyer opportunism, creating truly effective triangular relationships that facilitate the transfer of knowledge among parties, and give the lead buyer preferential access to the capabilities and knowledge of its suppliers, which can free more creative options for the brand’s designers. While relational institutional brokerage may contribute to reducing some transaction costs associated with miscommunication or distrust between buyers and suppliers, it is for the most part a topline contributor, opening access to more creative and productive resources from a wider range of suppliers, as well as reaping the benefits of supplier trust through preferential treatment in production, and through a greater willingness to expedite orders, or to reserve capacity for these lead buyers.
Table 6.1 Institutional Brokerage, Governance and Strategic Outcomes in GVCs

<table>
<thead>
<tr>
<th>Strategic Driver in GVC</th>
<th>Dominant Governance and Institutional Brokerage</th>
<th>Strategic Outcomes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Cost Minimization</td>
<td>Trade Intermediaries</td>
<td>Outsourcing of sourcing functions. Leaner organizational structure; lower fixed costs. Modularity trap, high switching costs.</td>
</tr>
<tr>
<td></td>
<td>No Institutional Brokerage</td>
<td></td>
</tr>
<tr>
<td>Variable Cost Minimization</td>
<td>Direct. Transactional Institutional Brokerage: focus on transaction cost minimization, SOPs, routines, order processing; directional, somewhat adversarial.</td>
<td>Disintermediation; cuts intermediation costs. Complex organization: high fixed cost. Good strategic alignment with loyal suppliers. Inflexible, narrow supply base, dependency on key suppliers, high switching costs.</td>
</tr>
<tr>
<td></td>
<td>Hybrid: Direct and Agents. Relational Institutional Brokerage: cultural intelligence through embedding, leadership and training, selective recruiting, high focus on cross-cultural communications and negotiations.</td>
<td>Uses agents in triangular interface with suppliers. Maximizes access to supplier capabilities, greater product variety. Establishes supplier trust; preferential terms and effort. Flexible; country mobility. High fixed costs, potentially higher prices.</td>
</tr>
</tbody>
</table>

6.4 CONTRIBUTION

The most important contribution of this study is the extension of the theory of governance of global value chains to include home-host country institutional distance and lead buyer agency as determinants of governance mode for the buyer-supplier interface.
in buyer led global value chains. The critical finding that in outsourced GVC lead buyers will externalize the buyer supplier interface as institutional distance increase, explains the continued importance of intermediary firms that specialize in facilitating the coordination of complex and geographically dispersed GVCs. The finding also suggests that for lead buyers, pressures to control production are not as strong as pressures to outsource the associated functions. A second related contribution comes from analyzing institutional distance in terms of cognitive, normative and regulative barriers, and then breaking them down along transactional and relational dimensions, a promising analytical perspective that can be particularly valuable in understanding the hidden transaction and organizational costs associated with sourcing through extended global value chains, characterized by high transaction volume and great need for coordination of production across borders.

The third contribution to theory comes with the introduction of the concept of institutional brokerage, a set of activities and capabilities aimed at lowering institutional distance barriers that lead buyers seek to procure with their governance choice. In parallel with institutional distance, institutional brokerage has a transactional and a relational dimension, each representing a distinctive strategic focus by the lead buyer: cost driven in the case of transactional institutional brokerage, a resource driven in the case of relational institutional brokerage. In this light, the governance mode decision is fundamentally a decision on whether to procure this essential brokerage function or to invest in it and develop the associated capabilities internally.
The study also makes a contribution to management highlighting a critical set of capabilities in GVCs, especially as the apparel global value chain migrates to lower cost countries, like Myanmar and Ethiopia, and closer to home countries, with near-sourcing (KSA 2016) raising the stakes for US buyers in currently secondary Central and South American countries. Investment in these institutional brokerage capabilities are not only critical for lead buyers, but will also be the key to continued success for emerging market apparel manufacturing MNCs, with whom lead buyers deal directly, as they expand the geography of their manufacturing base to these emerging regions to continue to serve their clients’ needs.

6.5 LIMITATIONS

This research has several limitations associated with its exploratory nature and the qualitative methodology selected, in the absence of viable metrics for a quantitative study. For one, the selection of the specialty apparel retail subset by design amplifies the effects of institutional distance and supplier capabilities at the buyer-supplier interface because of the number of transactions and the detail that goes into each order, making institutional brokerage whether by the lead buyer or procured through agents, intermediaries, or manufacturing MNCs essential. The generalizability of the construct, and its importance in the commodity side of the apparel sector, dominated by big box retailers could be in question, because of the specialization of suppliers, the simplicity of the goods procured and the scale of the orders. Wal-Mart obviously has the scale and the organizational might to place direct orders for multi million units of T-shirts with known
factories in Bangladesh that specialize in these large, technically simple, low cost productions, with little need for cultural ‘subtlety’. Large trade intermediaries like Li & Fung, and large manufacturers who work with Wal-Mart, Kohl’s and Target all the big-box retailers have given however anecdotal evidence that even for these mass retailers global sourcing presents some trappings that are not resolved by the sheer scale of their purchases, making it necessary for them to avail themselves of the services and brokerage capabilities of intermediaries in certain countries, and with certain suppliers.

Across sector comparison in global value chains also brings with it questions of generalizability of the institutional brokerage construct, especially when comparing the geographically dispersed apparel, footwear, toy and accessories global value chains with cluster based producer GVCs such as electronics and automotive, which are more capital intensive and specification driven, dominated by large global original component manufacturers and original equipment manufacturers, contracted directly by the auto makers and electronics brands. Considering the relevance of the institutional distance construct, and the promise shown in this study treating it as a set of relational and transactional barriers that are instantiated at cross-border interfaces, institutional brokerage as a strategic response to institutional distance is a promising concept that needs further refinement, and empirical hypothesis testing.

6.6 FUTURE RESEARCH

Further research in the use of transactional and relational dimensions of institutional distance in global value chains might lead to a metric with great theoretical value, and
contribute to management, facilitating the assessment a priori of the challenges associated with outsourcing cross-border. The research would require the validation of a survey instrument constructed to assess cognitive, normative and regulative barriers from a transactional and a relational perspective. The resulting metric can be used to score the institutional distance of country pairs, as a decision-making tool for country selection and to identify the appropriate strategic response to home-host country institutional distance. A second line of research will further investigate the institutional brokerage construct in buyer led GVCs, and assess the conditions under which relational institutional brokerage can be a lead buyer core competency, as opposed to when the function is outsourced to specialized third parties. As relational institutional barriers appear to be primarily a reflection of trust gaps between buyers and seller, this line of research explores the role of intermediaries as brokers of trust in the GVC.

An unrelated line of inquiry emerged during the interviews concerning some possible generational effects in the perceptions of cognitive and normative distances between home and host countries in GVCs; I was initially alerted to this possible effect by the youngest among my interview participants (ITI2), and it continued to resurface as I paid more attention to the variation of attitudes and perceptions based on the respondents’ age. Younger participants appear to see greater cultural convergence with the various GVC host countries due to globalization, and attach less importance to the cognitive and normative barriers in cross-border exchanges; older participants on the other hand tend to be more jaded, and regulate their behavior through more biased and
unchanging perceptions. This generational difference can be assessed with both a survey instrument, and experimentally.
REFERENCES


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Hymer, S. H. (1960). The international operations of national firms, a study of direct foreign investment, Massachusetts Institute of Technology.


Several terms used in this dissertation are used with slightly different meaning in different disciplines, and at times altogether different terms are used. The terms listed below are either trade terms in the apparel industry or were explicitly defined as listed below, during the interviews.

**Agent:** A sourcing intermediary who places orders and administers relations with suppliers at the direction of a lead buyer, typically compensated with commission on the FOB value of goods booked. A sourcing agent does not take title to the goods, does not finance transactions and does not own manufacturing assets.

**Apparel:** Articles of clothing, as defined in chapters 61 and 62 of the US Harmonized Tariffs Schedule.

**FOB value:** The dutiable value of imported goods at the port of origin, before ocean freight, duties, agent commissions, and US import and distribution costs. For apparel, this is typically 20-25% of the initial retail price.

**IMU:** Initial Mark-U Term used in the apparel industry representing the target percent margin, calculated as full unit retail price less unit FOB cost.
**Intermediary:** Any third-party firm or individual performing intermediation sourcing services on behalf of a lead buyer. The term includes both sourcing agents and trading companies, or trade intermediaries.

**MMU:** Maintained Mark-U Term used in the apparel industry representing the net percent margin after all discounts and loss factors, calculated as the final average unit retail price less unit FOB cost.

**Specialty Retailer:** A retailer specializing in the sale to consumers of its own apparel brands, in its own physical and online stores.

**Supplier:** A garment factory or network of garment factories, with manufacturing assets.

**Trade Intermediary:** A trading company that purchases garments from suppliers at the direction of a retailer, and then resells them and delivers them to the retailer. Trade intermediaries take title to the goods, finance transactions but do not have significant manufacturing assets.

**Vendor:** a general term indicating a third-party supplier or service provider.
APPENDIX B.
Retailers’ Interview Protocol

I. **Dependent variable – GVC governance**
   1. What is the governance of your value chain? [Governance intended as how your firm’s GVC is governed; the boundaries of your firm in its GVC; the degree to which your firm internalizes or outsources its global sourcing activities]
      i. Describe your value chain
         1. Mostly direct sourcing
         2. Mostly outsourced
         3. Hybrid / ad hoc
      ii. What are the advantages of your GVC governance mode?
      iii. What are the shortcomings of your GVC governance mode?
   2. Why have you chosen this governance mode?
      i. What was the decision logic?
         1. Variable costs
         2. Fixed costs
         3. Internal capabilities
         4. Social capital
   3. How was the decision made?
      i. Describe decision process
         1. Proactive
         2. Reactive
         3. Evolutionary
      ii. How much are changes in GVC governance determined by prior choices
      iii. How much are GVC governance decision influence by competitors’ behaviors
      iv. How much advantage do incumbents have over new vendors (incumbency rate)
   4. Do you have knowledge of / experience with alternative GVC governance modes?
      i. What are the pros / cons of the alternative GVC governance modes?

II. **Independent variable – Country level variance - Institutional distance**
   1. Does governance vary as a function of the host country?
      i. Provide examples of different governance modes in different countries / regions
         1. China
         2. Southeast Asia
         3. South Asia
4. Mexico and Central America
5. Maghreb and Turkey

2. Why does governance vary with the host country?
   i. Do vendor trust relations vary with the host country?
   ii. Provide examples of trust issues across countries in your GVC

3. What are key barriers to doing business in your key host countries?
   i. Probe on institutional barriers - defined as the barriers imposed by cultural and institutional distance with the host country
   ii. Probe on person-to-person barriers – related to interpersonal exchange Specifically: language, cognitive styles and cultural schemata
   iii. Probe on firm to firm / firm-to-network barriers – related to differences in informality / non-market exchange coordination with the local vendor network
   iv. Probe on country-to-country distance – refers to cultural and institutional distance; differences in legal system, contract and trade laws, and enforcement

4. What are ways to overcome these barriers?
   i. Probe on existing solutions (local offices, exclusive agents, trade intermediaries)
      1. What are the advantages of the current solutions? Probe on organizational aspects.
      2. What are the disadvantages of the current solutions? Probe on competitive constraints.

III. Independent variable – Vendor level variance

1. Does governance vary as a function of vendor characteristics?
   i. How would you categorize vendor capabilities?
   ii. What is the geographic distribution of these capabilities?

2. Is there a difference in governing relations with full package vs. CMT (Cut+Make+Trim) vendors?
   i. What organizational demands do the different types of vendors impose on your firm?
   ii. Do you engage in direct sourcing with full package vendors?
   iii. Do you engage in direct sourcing with CMT vendors?

3. Is there a difference in governing relations with globally integrated vs. locally embedded firms?
   i. What organizational demands do the different types of vendors impose on your firm?
   ii. Do you engage in direct sourcing with globally integrated vendors?
   iii. Do you engage in direct sourcing with locally embedded vendors?

4. How do these vendor characteristics (FP vs. CMT; GI vs. LE) affect the development of trust relations with them?
   i. What is the essence of trust in your GVC? Please define trust in vendor relationships.
i. How much trust do you have in your vendors?
ii. How is it established? (Signaling? history? compliance? performance? credible commitments?)
iii. What are the consequences of trusting relationships with a vendor (or lack thereof)?
iv. Is trust important in determining the governance mode?

ii. Provide examples of how trust relations may vary with vendor characteristics

IV. Moderator – Lead buyer institutional brokerage capabilities

1. On what particular set of skills, routines and procedures do you depend when you do business in your host countries?
   i. Provide examples

2. On what particular set of policies, systems and organizational/reporting structure do you depend when you do business in your host countries?
   i. Provide examples

3. How much do you rely on cultural intelligence, cross-cultural communication and cross-cultural negotiation skills do you depend when you do business in your host countries?

4. How important is it to develop trust with your vendors?
   i. What barriers hamper it?
   ii. What activities and capabilities facilitate it?

5. How important is knowledge transfer in doing business with your vendors?
   i. What barriers hamper it?
   ii. What activities and capabilities facilitate it?
APPENDIX C.

Intermediaries’ Interview Protocol

GVC governance – your clients

For the purposes of this study, governance is the manner by which retailers’ GVC is governed; the boundaries of the lead firms in their GVC; the degree to which the lead buyers internalize or outsource their global sourcing activities (reliance on HQ and local sourcing offices, vs. agents and/or intermediaries)

I. What are most common governance modes in the apparel GVC
   a. Mostly direct sourcing
   b. Mostly outsourced
   c. Hybrid / ad hoc

II. What are the advantages of the different governance modes?
   a. Mostly direct sourcing
   b. Mostly outsourced
   c. Hybrid / ad hoc

III. What are the shortcomings of the different governance modes?
   a. Mostly direct sourcing
   b. Mostly outsourced
   c. Hybrid / ad hoc

IV. What was the decision logic behind the different governance choices – what drives them?
   a. Variable costs
   b. Fixed costs
   c. Internal capabilities
   d. Social capital

V. How do your clients typically make the governance decision? Describe decision process
   a. Proactive
   b. Reactive
   c. Evolutionary

Intermediaries ‘role

Country level variance - Institutional distance

Doing business in countries like China has become a lot easier over time; vendors have learned to do business with US firms and, to an extent, so have US firms. However,
cultural and institutional distance are persistent; and the solutions in place often carry significant “taken for granted” costs, among them, of course, intermediation costs.

I. What is the most critical brokerage function you perform in the GVC?

II. What are the key transactional barriers faced by a US buyer doing business in the various (Asian) countries in which their GVC is dispersed?
   a. What are possible solutions?
   b. What do intermediaries “do better”? 

III. What are the relational barriers faced by a US buyer doing business in the various (Asian) countries in which their GVC is dispersed?
   a. What are possible solutions?
   b. What do intermediaries “do better”? 

IV. What are key barriers imposed by cultural and institutional distance with the host country – how important are they and how do you lower them
   a. Person-to-person barriers – related to interpersonal exchange
   b. Specifically: language, cognitive styles and cultural schemata
   c. Firm to firm / firm-to-network barriers – related to differences in informality / non-market exchange coordination with the local vendor network
   d. Country-to-country distance – refers to cultural and institutional distance; differences in legal system, contract and trade laws, and enforcement 

**Vendor level variance**

For the purposes of this study a vendor is a garment or accessory manufacturer – the vendor may own/control a small number of factories and may provide additional services, but is essentially a maker of goods. Specifically, intermediary firms that do not own significant manufacturing assets, but may take title to goods produced by many third-party producers, such as Li & Fung or MGF, are not vendors for this analysis, but intermediaries.

I. How would you categorize vendor characteristics?
   a. What are you looking for?
   b. What metrics do you use to assess vendor capabilities?
   c. What is the geographic distribution of these capabilities?

II. Does governance vary as a function of vendor characteristics? (in terms of acting as an agent vs. trade intermediary)

III. Is there a difference in governing relations with globally integrated vs. locally embedded firms? (in terms of your brokerage functions)

IV. Is there a particular type of vendor than intermediaries bring to the table with whom your clients would be unable to do business ‘direct’? If so, why?

**Institutional brokerage capabilities**
For the purposes of this study we define as institutional brokerage the set of activities that lower cultural and institutional distance in the Buyer – Vendor dyadic relations. This function can be internally by the buyer, but is often best performed by intermediaries.

Please compare and contrast how you perform this brokerage function vs. the buyers and/or the vendor.

I. On what particular set of policies, systems and organizational/reporting structure do you depend when you do business in your host countries?
   a. Do you have formalized country risk management tools?
   b. What is the involvement of your legal team in transactions with foreign vendors?

II. On what particular set of skills, routines and procedures do you depend when you do business in the various host countries?
   a. How do they help? Provide examples
   b. How are they institutionalized within your firm?

III. How much do you rely on cultural intelligence, cross-cultural communication and cross-cultural negotiation skills do you depend when you do business in your host countries?
   a. How are they developed inside the organization?
   b. Is transaction performance more important than maintaining relationship? What is the threshold?

**Trust**

I. What is the essence of trust in the GVC? Please define trust in vendor and buyer relationships.

II. Does trust mean something different depending on the role (buyer, vendor, intermediaries) in the global value chain?

III. What does trust mean for your US retail clients? What do they fear most from their vendors?

IV. Does it mean something different for the vendors in your network? What do they fear most from their buyers?

V. How do you broker the trust gap between buyers and vendors?
   a. Is it difficult for US buyers to trust overseas vendors?
   b. What barriers hamper trust development in the GVC?
   c. What activities and capabilities facilitate it?
   d. How is trust established? (Signaling? history? compliance? performance? credible commitments?)
   e. What is the cost of mistrust in the GVC?

VI. Can trust be outsourced? Are you brokers of trust?
# APPENDIX D.

## Coding Scheme

<table>
<thead>
<tr>
<th>CODE</th>
<th>MEANING</th>
<th>NODE</th>
<th>CAT</th>
<th>THEME</th>
<th>PROP</th>
</tr>
</thead>
<tbody>
<tr>
<td>QUOTE</td>
<td>Quotable</td>
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<td>X</td>
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<td>X</td>
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<td>intermediaries</td>
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<td>GOVITI</td>
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<td>cognitive barrier</td>
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<tr>
<td>FS</td>
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<tr>
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</table>

**Governance, trust**:

- **GOV**: Governance
- **DIR**: direct sourcing
- **AGE**: agents
- **ITI**: intermediaries
- **GOVDIR**: direct governance
- **GOVAGE**: governance through agents
- **GOVITI**: governance through intermediaries

**Country variables**:

- **COGBAR**: cognitive barrier
- **NORBAR**: normative barrier
- **REGBAR**: regulative barrier
- **TRUSTDEV**: trust development barriers
- **TRABAR**: transactional barriers
- **RELBAR**: relational barriers
- **ID**: institutional distance
- **PROP1**: Proposition 1
- **PROP2**: Proposition 2
- **PROP3**: Proposition 3
- **PROP4**: Proposition 4
- **CMT**: CMT - full package
- **FS**: full service
- **SUPTRA**: supplier transactional capabilities
- **SUPCAP**: supplier capabilities
- **SUPREL**: supplier relational capabilities
- **LE**: locally embedded
- **GI**: globally integrated
- **PROP5**: Proposition 5
- **PROP6**: Proposition 6
- **PROP7**: Proposition 7
- **PROP8**: Proposition 8

**Supplier variables**
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<td>X</td>
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<tr>
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<td>cultural intelligence</td>
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<td></td>
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<td>CCN</td>
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</table>

Lead buyer agency - Inst Brokerage
July 3, 2014

Dear...

My name is Alessandro (Alex) Perri, and I am a doctoral candidate in the International Business Department at the University of South Carolina. I am currently conducting field research as part of the requirements of my PhD degree in International Business, and would like to invite you to participate in a study entitled: “Institutional Brokerage in Global Value Chains: The Case of the Global Apparel Industry.” This project is funded by a research grant by the Center for International Business Education and Research (CIBER).

[...] kindly referred me to you for your help and expertise. For my dissertation, I will be conducting interviews with sourcing executives in the US apparel industry and in Hong Kong to investigate the impact of cross-national business barriers on lead buyers’ global sourcing activities, and the different strategies employed by lead buyers and intermediaries to lower the costs imposed by these cultural and institutional barriers. Should you agree to participate, I can meet you at a location of your convenience, for an interview that should last about one hour. The interview will
be recorded in audio-tapes to be transcribed and analyzed by the research team and then subsequently destroyed.

Although you will probably not benefit directly from participating in this study, your responses will contribute to our collective understanding of the challenges posed by cross-national differences in global sourcing, and to the identification of the key skills and strategies to overcome them.

Your participation is confidential, and the study information will be kept in a secure location at the University of South Carolina. The results of the study may be presented at academic conferences, and submitted for publication in academic journals, but your identity will not be revealed. Most importantly, your participation is voluntary, and you may decide not to answer any specific questions, or quit being in the study at any time.

I will be glad to answer any question you have about the study. You can contact me by phone at (803) 447 3243 or via e-mail (alessandro.perri@grad.moore.sc.edu), or my faculty advisor, Prof. Tatiana Kostova (Kostova@moore.sc.edu). If you have any questions about your rights as a research participant, you may also contact the Office of Research Compliance at the University of South Carolina at (803) 777-7095.

If you would like to participate in this research, you can contact me at your convenience for scheduling; I look forward to the opportunity to learn from you and thank you in advance for your consideration.

With kind regards

Alessandro (Alex) Perri
University of South Carolina
1705 College Street
Columbia SC 29206
Phone: (803) 447 3243
E-mail: alessandro.perri@grad.moore.sc.edu
APPENDIX F.
Selection of Top US Specialty Apparel Retailers

<table>
<thead>
<tr>
<th>Specialty Apparel Retailer</th>
<th>2014 Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Victoria's Secret Stores, REYNOLDSBURG, OH</td>
<td>$ 6,681,000,000</td>
</tr>
<tr>
<td>Gap, SAN FRANCISCO, CA</td>
<td>$ 6,351,000,000</td>
</tr>
<tr>
<td>Old Navy, SAN FRANCISCO, CA</td>
<td>$ 6,180,000,000</td>
</tr>
<tr>
<td>Abercrombie &amp; Fitch Co., NEW ALBANY, OH</td>
<td>$ 4,116,897,000</td>
</tr>
<tr>
<td>Polo Ralph Lauren Corp., NEW YORK, NY</td>
<td>$ 3,799,500,000</td>
</tr>
<tr>
<td>PVH Corp., NEW YORK, NY</td>
<td>$ 3,668,886,000</td>
</tr>
<tr>
<td>American Eagle Outfitters Inc., PITTSBURGH, PA</td>
<td>$ 3,305,802,000</td>
</tr>
<tr>
<td>Forever 21 Inc., VERNON, CA</td>
<td>$ 3,084,900,000</td>
</tr>
<tr>
<td>Urban Outfitters Inc., PHILADELPHIA, PA</td>
<td>$ 2,901,412,000</td>
</tr>
<tr>
<td>Banana Republic, SAN FRANCISCO, CA</td>
<td>$ 2,603,000,000</td>
</tr>
<tr>
<td>Chico's FAS Inc., FORT MYERS, FL</td>
<td>$ 2,586,037,000</td>
</tr>
<tr>
<td>Ann Inc., NEW YORK, NY</td>
<td>$ 2,493,491,000</td>
</tr>
<tr>
<td>J. Crew Group Inc., NEW YORK, NY</td>
<td>$ 2,428,300,000</td>
</tr>
<tr>
<td>Express Inc., COLUMBUS, OH</td>
<td>$ 2,219,125,000</td>
</tr>
<tr>
<td>Aeropostale Inc., NEW YORK, NY</td>
<td>$ 2,090,902,000</td>
</tr>
<tr>
<td>Lands' End Inc., DODGEVILLE, WI</td>
<td>$ 1,562,876,000</td>
</tr>
<tr>
<td>Charming Shoppes Inc., BENSAMED, PA</td>
<td>$ 1,369,200,000</td>
</tr>
<tr>
<td>Retail Brand Alliance Inc., ENFIELD, CT</td>
<td>$ 1,300,000,000</td>
</tr>
<tr>
<td>The Buckle Inc., KEARNEY, NE</td>
<td>$ 1,128,001,000</td>
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<tr>
<td>The Talbots Inc., HINGHAM, MA</td>
<td>$ 1,095,089,000</td>
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<tr>
<td>Guess? Inc., LOS ANGELES, CA</td>
<td>$ 1,075,475,000</td>
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<tr>
<td>Dress Barn, MAHWHAH, NJ</td>
<td>$ 1,020,700,000</td>
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<tr>
<td>Eddie Bauer Inc., BELLEVUE, WA</td>
<td>$ 1,000,000,000</td>
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<tr>
<td>Rue 21, WARRENDALE, PA</td>
<td>$ 992,000,000</td>
</tr>
<tr>
<td>Charlotte Russe Holding Inc., SAN FRANCISCO, CA</td>
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<td>New York &amp; Company Inc., NEW YORK, NY</td>
<td>$ 939,163,000</td>
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<tr>
<td>Maurices Inc., DULUTH, MN</td>
<td>$ 917,600,000</td>
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<td>The Cato Corporation, CHARLOTTE, NC</td>
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<tr>
<td>Pacific Sunwear of California Inc., ANAHEIM, CA</td>
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<td>Hot Topic Inc., CITY OF INDUSTRY, CA</td>
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<td>Coldwater Creek Inc., SANDPOINT, ID</td>
<td>$ 700,000,000</td>
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<tr>
<td>Specialty Apparel Retailer</td>
<td>2014 Sales</td>
</tr>
<tr>
<td>-------------------------------------------------</td>
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<tr>
<td>Michael Kors Holdings, NEW YORK, NY</td>
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<td>Levi Strauss &amp; Co., SAN FRANCISCO, CA</td>
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<tr>
<td>Tommy Hilfiger LLC (Retail), NEW YORK, NY</td>
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<td>Gordmans Inc., OMAHA, NE</td>
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<tr>
<td>Wet Seal Inc., FOOTHILL RANCH, CA</td>
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<tr>
<td>Bebe Stores Inc., BRISBANE, CA</td>
<td>$484,686,000</td>
</tr>
<tr>
<td>VF Outlet, READING, PA</td>
<td>$480,000,000</td>
</tr>
<tr>
<td>The J. Jill Group Inc., QUINCY, MA</td>
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<tr>
<td>Christopher &amp; Banks Corporation, PLYMOUTH, MN</td>
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<tr>
<td>Limited Stores, LLC, NEW ALBANY, OH</td>
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<tr>
<td>BCBG Max Azria Group North America, VERNON, CA</td>
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<td><strong>US Specialty apparel brands subset sales</strong></td>
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<td><strong>Sales of Interview Participants companies</strong></td>
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Source: Chain Store Guide, 2015