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**RESPONDING TO GLOBAL PRESSURE :
THE ROLE OF PRIVATE PARTNERSHIP AND PUBLIC
AGENCIES IN THE SINOS VALLEY, BRAZIL**

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Introduction

It is now well established that clustering and networking help small and medium enterprises to grow and compete in distant markets. The evidence comes from case studies carried out in many countries and covering the 1970s and 1980s. It is less clear how local clusters cope with the global competitive pressures typical of the 1990s. This paper sums up the experience of a Brazilian cluster which one would expect to do well: the shoe producing Sinos Valley in Rio Grande do Sul.¹ By the end of the 1980s, the cluster had become a major exporter of leather shoes to the USA and Europe. Recent research has shown both success and failure in responding to the global competition of the 1990s. Drawing lessons from this case is particularly interesting for this conference. It shows that co-operation amongst local enterprises strengthens their ability to compete globally and that business associations can play an important role in identifying the key problems and proposing solutions. However, it also shows that the state is not redundant. Even where local industry and business associations are already well developed, public agencies are needed to mediate conflicts between business associations and entrepreneurial alliances and help forge a local innovation consensus.

¹ Conference participants interested in a more detailed account of the cluster's recent experience should contact the author and request 'Responding to Global Competitive Pressure: Local Co-operation and Upgrading in the Sinos Valley, Brazil' IDS Working Paper 82, December 1998.

The Challenge

‘The Dragon Advances’. This was the headline of a Special Report by a Brazilian journalist on the Chinese shoe industry. He had gone to China to see for himself how and why China was able to out-compete the Sinos Valley. The low wages, long working hours and low taxes in China were the main themes in his report which was published in three instalments in the main local newspaper (NH, 13,14,15 April 1995). Coinciding with the news of several local factory closures it sent ripples of fear through the Sinos Valley. It seemed that the whole cluster had finally internalised a threat had been known for several years.

Before summarising the cluster’s response, it should be stressed that equating the challenge with China’s entry in the international footwear market is simplistic. There were multiple challenges: (a) Taiwanese manufacturers relocating to mainland China and using their production expertise and trade networks to export at unprecedented low prices; (b) the rapid growth of US imports slowing down and (c) buyer behaviour - in external and internal markets - changing from just-in-case to just-in-time. These three changes began to make themselves felt in the late 1980’s but a clear perception of these new challenges only emerged in the early 1990s. In a way this is not surprising, few entrepreneurs had direct knowledge of the international market, inflation rates fluctuated wildly, as did exchange rates. As a consequence there were time lags, first in perception and then in responses

In order to understand the response to the challenge it helps to recall the advantage which enterprises derive from clustering. Compared with dispersed enterprises, clustering enterprises have two competitive advantages (a) economies of agglomeration and synergies tend to arise spontaneously with sectoral and geographical concentration; (b) co-operation between firms tends to

be easier. The former advantage is incidental and the latter is consciously pursued. The hypothesis which arises from earlier research on clusters is that *responding to major opportunities and crises requires more and better co-operation between the clustering firms*. In other words, economies of agglomeration are important to growth but are not sufficient to ride out major changes in product or factor markets: that requires joint action.

As stressed above, the Sinos Valley has been confronted with such a major change. Competition in the global shoe market has intensified over recent years. Other producer countries with even lower wages are squeezing into the market and buyers in the US and Europe are imposing standards of quality which would have been thought unattainable a few years ago – at the prices they are prepared to pay. Since beating competitors like China on labour costs is hardly possible, the challenge has been to raise quality, speed and flexibility and to open up new markets and marketing channels.

This paper shows how local producers have responded to the challenge. Have they – in line with the above hypothesis – stepped up co-operation? Have enterprises which increased co-operation performed better than those which did not? What was the role of public agencies in the failures and in the advances?

The information comes from a number of sources and was collected using a combination of methods: a survey of 65 enterprises; in-depth interviews with selected manufacturers and their suppliers; interviews with the officials of business associations and public agencies; participant observation at meetings of industrialists; screening of the local press, and the usual secondary sources.

Local Co-operation

The focus on inter-firm co-operation in this paper does not imply that individual excellence does not matter. Far from it. Performance within clusters varies and the excellence of one firm tends to have incidental positive effects on others. Proximity ensures that such external effects do not ‘evaporate’. The proposition is that relying merely on such spontaneous effects is not sufficient to cope with crisis, hence the focus on joint action.

One of the main results of the survey is the positive and significant relationship between co-operation and performance. Enterprises which increased co-operation tended to perform better than those which did not. The survey, combined with other fieldwork methods, showed however that changes in co-operation over the period 1992-97 varied with the type of co-operation considered. The findings are summarised in the following table.

	Bilateral	Multilateral
Horizontal	No change	Varies with association
Vertical	Substantial increase	First increase, then decline

What stands out is the strong increase in bi-lateral vertical co-operation, notably between shoemakers on the one hand and their input suppliers and subcontractors on the other. The results of the survey are very clear in this respect, but so is the limitation of the research instrument. How real is the reported ‘increase in co-operation’? The detailed case studies of shoe manufacturers and related firms confirmed the increase but also provided

important qualifications. For example, in subcontracting relationships, the co-operation was selective in that it was limited to core subcontractors.

As shown in the above table, horizontal co-operation changed little. This is clearest in bilateral horizontal relations, but less so in multilateral co-operation. The latter is more difficult to summarise because there are several business associations in the Sinos Valley which have developed in different directions. More interesting than discussing them individually is their joint initiative, the 'Shoes from Brazil Programme'. The mere existence of this programme commands attention because it encompassed associations representing the entire local value chain, because it was based on the explicit recognition of interdependence and because raising competitiveness was its mission. This included a number of upgrading proposals which ranged from the targeting of new markets, to raising the image of 'Made in Brazil', eradicating child labour, joint participation in fairs, and creating a local design capacity. While a lot of the groundwork was carried out by local consultants and association officials, the entrepreneurs themselves were involved in the analysis and formulation of proposals.

Based on a combination of in-depth interviews and participant observation, the rise and fall of this programme was traced. The reason for its decline was that some of the leading enterprises were not interested in the programme succeeding; they put their alliance with a powerful foreign buyer above local co-operation. Producing for this buyer served them well for many years but it kept their strategies firmly limited to intra-firm upgrading whereas the 'Shoes from Brazil Programme' was aimed at upgrading along the entire local supply chain and moving into marketing and design.

Presumably such conflicts of interest - whether carried out openly or not- are not unique to the Sinos Valley. The question is whether their resolution follows a global or a local rationale. The research suggests that the decline of the programme was not a necessary consequence. The local rationale might have prevailed had there been a knowledgeable public mediator – an issue discussed later.

In summary, the research shows that bilateral vertical co-operation increased and that multilateral co-operation across the entire local value chain collapsed. So what? Why should these findings be of wider concern? They are of concern because they have direct implications for the ability of the cluster to compete globally and create jobs and income locally.

The increasing co-operation in bilateral vertical relationships (between shoe manufacturers and suppliers) was essential for achieving increases in quality, speed and flexibility. The survey findings show very clearly this improvement in performance. This improvement is confirmed by European and US buyers who suggest that - on the above parameters - their Brazilian suppliers are close to the Italian competitors. In this sense, stepping up co-operation has helped the Sinos Valley to live up to the global competitive pressure.

The problem is that these improvements in production have merely enabled the cluster to stand still. Exports in 1997 were at the level of 1990 - with some fluctuations in between. More problematic still, profits declined. The survey shows this very clearly, particularly for exporting firms. Detailed interviews suggest that this is not just the usual tendency of entrepreneurs understating their profits and that profits fell by more than half. As a result there is a downward pressure on wages.

Thus this case study confirms recent writings on globalisation, warning that a focus on manufacturing alone may not lead to sustainable income growth and that a shift to other stages of the value chain - such as design or marketing - may be a more rewarding target. Upgrading outside production has, however, been very limited in the Sinos Valley. While the cluster is a world class producer it has not been able to establish a positive and recognisable image in the European and US market, it has not exhibited in a substantial and regular way at the world's key trade fairs, it has very few own brands in its main export markets and very little capacity for innovative design. Progressing in these non-production areas was one of the main objectives of the 'Shoes from Brazil Programme'. Its failure means that the chances of the Sinos Valley differentiating itself in the international market are a more distant prospect. The final section deepens the anatomy of collective failure focussing on the role of public agencies.

The absent mediator

Even though some of the largest enterprises were not committed to promoting the cluster as a whole, the collapse of the 'Shoes from Brazil Programme' was not a necessary or predictable outcome. There were instances in the evolution of the programme which could have triggered an upward rather than a downward spiral in co-operation. In other words, there were moments when the programme could have gone either way. Informed political mediation was required for the alliance of private sector institutions to work. But government agencies did not recognise their opportunity of industrial policy by mediation.

One of the conflicts which required public mediation concerned the export of semi-processed leather (wet blue). In the course of 1996, leather exports were increasing fast, infuriating tanneries specialised in final processing and also shoe

manufacturers. Their concerns were that (a) local raw material prices rose, (b) the best leather was exported, especially in the specification needed for high quality shoes, and (c) most of this leather went to the countries which were Brazil's main competitors in the international footwear market – especially Italy and Hong Kong (for re-export to other Asian countries).

The proposal which they put forward was that a 7% export tax should be levied on semi-processed leather. The reasoning came from a differential in EU tariffs of zero import tariff on semi-processed leather and 7% import tariff on finished leather. This EU regulation clearly benefited the Italian (and other European) tanners so the proposal that the Brazilian government should counterbalance the differential seemed modest and reasonable. Yet the issue remained unresolved harming the 'Shoes from Brazil Programme' far beyond the immediate issue at stake.

Another conflict concerned the frequency and timing of trade fairs for footwear machinery and components. The local trade fair organisation tried to impose timings which suited its international partner (an Italian trade fair organisation) more than the local machinery and component industry. A negotiated settlement was only reached after several years of fierce conflict from which both sides emerged weakened.

These are two examples of conflicts in which public mediation was required and openly requested. The positions of the various protagonists have been set out in more detail elsewhere (Schmitz 1998). My main message here is that there is no capacity within government to assess different claims and assess their validity and likely impact. Nor is there much interest in building up such a capacity. Neither at the federal, nor at state level does a serious attempt exist to conduct industrial policy. Neo-liberalism might be on its way out in Washington but it

continues to dominate in Brazil, a country which used to practice an active industrial policy. The actors involved in the 'Shoes from Brazil Programme' were not hoping for a return to the old-style top down industrial policy. On the contrary, they had taken the initiative, they had done the institutional groundwork, they had explicitly recognised their interdependence in the value chain, they had created a forum for discussing their differences. But there were cases where they could not overcome these differences. What they were hoping for was intelligent mediation by a public actor. This did not materialise.

Instead, government adopted the position that, since the private sector could not agree, it would take no action – which was conveniently in line with the dominant neo-liberal sentiment 'the free market with its potentially perverse effects – is better for the private sector than a situation of state intervention' (*Exclusivo*, 3-9/06/96). It is impossible to know whether private multilateral co-operation would have succeeded with public mediation. It is, however, clear that with public mediation there would have been a much greater chance of resolving conflicts in the private sector.

There is a potentially important policy conclusion not just for the debate on clusters but for the debate on business development services. One of its main tenets is that such services can be provided by the private sector itself - either through specialised enterprises or collective organisations such as business associations, consortia or the like. The 'Shoes from Brazil Programme' both underlines this view but also shows its limits. The private sector did all the preparatory work for what could be called a programme of local sectoral governance but it could not - on its own - resolve the emerging conflicts. What is striking is that even in Brazil, where inefficiency and corruption have discredited the state, it is still seen as the most legitimate mediator. But in addition to legitimacy, mediation requires knowledge of two types: knowledge of

the industrial sector in question and expertise in techniques of conflict resolution. In summary, conflict mediation is an important role even, or especially, for the lean state which relies on the self help of the private sector.

This policy conclusion is also important for the recent debates on regional development and innovation systems. Both have stressed the importance of institutions, especially the relevance of collective institutions. The Sinos Valley has this kind of “institutional thickness” in its professional associations, business associations and technology centres. Clearly this is not sufficient because fragmentation occurs and conflicts arise. Even in an institutionally well endowed region, government is needed to mediate conflicts and help foster an upgrading consensus.

Such a conclusion is inevitably controversial, given the dangers of incompetence and corruption in the public agencies. The development literature of the last decade has given a great deal of attention to the failures of public agencies. The conclusion to be drawn from this debate is not, however, to minimise public intervention but a shift towards different kinds of intervention. The contention of this paper is that conflict resolution is one of those interventions which deserve more attention in future. Experiences from other countries and fields lend support to this proposition. For example, Sabel (1992) has stressed the importance of mediation and arbitration in the studies of European industrial districts: “whenever the parties to these conflicts regulate their disputes through arbitration boards or councils ... the districts flourish; when not, then not” (p.228). Further support comes from Rodrik’s (1998) recent study *Making Openness Work: The New Global Economy and the Developing Countries*. He concludes that societies with weak institutions of conflict management experience lower growth. “Conflict management institutions play a far more

important role in generating the capacity to handle external turbulence than conventional economic analysis has generally allowed” (p.88).

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