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Abstract

This thesis argues for a Resource-Market approach to Micro and Small Enterprise (MSE) Development. The argument is based on the finding that the basis for competition between firms has shifted to the resource-market level. Resource-markets are markets of inputs, functions, activities or components which, when integrated, form a production process. The shift in the basis of competition has resulted from the emergence of increasingly decentralized and integrated structures of industrial organization which call for the participation of many firms, each being specialized at various stages (or resource markets) of the production process.

A five-step framework for resource-market level strategy formulation is provided in this thesis. This framework allows MSEs, when grouped, to get better terms of trade within the context of their integration into such decentralized and integrated production networks. The thesis compares this approach with the 'Missing-input', the Flexible Specialization, and Sub-Sector approaches, indicating the advantages of the former over the latter.

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Acronyms and Abbreviations

CA	Competitive Advantage
ILO	International Labor Organization
IT	Information Technology
OECD	Organization for Economic Cooperation and Development
SEWA	Self-Employed Women's Association
NICs	Newly Industrialized Countries
PCs	Personal Computers
RBVF	Resource-Based View of the Firm
RDP	Resource-Dependence Perspective
RMO	Resource Market of Opportunity
SCA	Sustainable Competitive Advantage
TNCs	Trans-National Corporations
UN	United Nations
UNDP	United Nations Development Program
UNIDO	United Nations Industrial Development Organization
UNCTAD	United Nations Conference on Trade and Development
US	United States
WIR	World Investment Report

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CHAPTER 1- Introduction

1.1 Background

The first United Nations (UN) development decade (1960-1970) was characterized by modern sector, large-scale, and capital-intensive industrial development in many developing countries. As a result, rapid growth was registered on an international scale, with developing countries as a group achieving greater than average growth, and a small number of countries were being transformed into newly industrialized countries (NICs).

However, in the early 1970's, intra-national distributional analysis led to the realization that great inequities in income had resulted from such development strategies. It was also discovered that this form of industrialization strategy had failed to 'trickle-down'. Insufficient jobs were created and poverty prevailed in many of these countries.

In response to this failure of the first development decade, the second UN development decade (from 1970 to 1980) promoted development strategies which were concerned with poverty alleviation, employment-creation and meeting basic human needs. Equity was emphasized as an objective and added to the traditional agenda of growth. Robert McNamara of the World Bank became a prominent spokesman of the 'populist' approach to development which the bank supported and termed 'Redistribution with Growth', or 'Growth with Equity'. This populist trend

'Redistribution with Growth', or 'Growth with Equity'. This populist trend became an integral part of the agendas of multilateral and bilateral aid donors at the time.

At that time, in the early 1970's, when poverty in developing countries was 'discovered', the International Labor Organization (ILO) centered itself on the argument that poverty was often due to underemployment, or the phenomenon of the 'working poor'. In fact, the ILO's 1972 figures revealed that out of the 1210 million who were 'seriously poor' in the world, 700 million were people who did long hours of hard and back-breaking toil but received such a small return for each hour of labour that despite their hard work they remained in poverty. The ILO's definition of the 'working poor' were workers whose earnings were not sufficient for achieving minimum standards of living (Kitching, 1989, p.71).

Moreover, the informal sector was identified as the economic sector in which the bulk of the urban 'working poor' in developing countries could be found. This underground and illegal economy permitted the working poor to conduct economic activities which enabled them to survive.

In order to understand the nature and conditions of the activities of the 'working poor' the ILO conducted, in the 1970's, a series of studies about the informal sector.

A first definition of the informal sector was given by the 1972 ILO Kenya Mission Report which saw it as a "way of doing things, characterized by: a) ease of entry; b) reliance on indigenous resources; c) family ownership of resources; d) small-scale of operation; e) labour-intensive and adapted

technology; f) skills acquired outside the formal school system; and g) unregulated and competitive markets" (Lubell, 1991, p. 17). Generally, informal sector activities were defined primarily as microenterprise activities, i.e., activities of very small economic units.

It was also discovered that the informal sector did not hold any protection through laws, contracts, minimum wage, social security, nor safety regulations for its participants (Levitsky, 1989, p. xviii). Further, informal sector participants earned less than the official minimum wage (Lubell, 1991, p. 64).

However, from these studies on the informal sector also arose surprisingly positive findings. First, it was discovered that the informal sector had the ability to absorb labor surpluses arising from the exploding population growth in developing countries, a surplus which could not otherwise be absorbed by the formal sector. Those who could not find wage employment in the formal or modern sector could find some refuge of self-employment in the informal sector. Moreover, the great magnitude and complexity of the underground economy was revealed and it was found that the sector was characterized by significant levels of entrepreneurial dynamism, economic efficiency, technology development, and linkage development. Apprenticeship systems which could provide the necessary skills to those who could not afford conventional education or training were also discovered and stressed as a positive asset of the sector. (Lubell, 1991)

Thus, although it may seem ironic, a solution to the lingering poverty in developing countries was discovered where it already existed: in the informal sector itself. It was agreed by development agencies that, through its support and legitimization, this sector should become the object of special development efforts.

The decision was motivated by the argument that assistance to the informal sector represented a stimulating low-cost investment for employment creation. It was also believed that support to the informal sector would not undermine the growth of the modern formal large-scale sector, since it was believed that the relationship between the formal and informal sector could be characterized as complementary, or qualified as 'balanced interdependence' (Nelson, 1987, p. 5- 7). In this sense, assistance to the informal sector for development purposes could bring about change in a 'gradual and peaceful' manner.

A first means of assistance to the informal sector which was put forward was its legitimization. A well-known proponent of this ideology is Hernando De Soto in his well-known book entitled 'El Otro Sendero' (The Other Path) (1989). De Soto's main proposition was that governments should ease the regulatory constraints on micro-enterprises' entry into the formal sector. His book put forward a series of examples of absurd and excessive formalities which small-scale producers in Latin America had to conform to in order to become part of the formal sector. If unable to meet the requirements, they were forced to continue their activities in illegality, a state which denied workers decent working conditions and disabled microenterprises from growing into larger units. He argued that if

discriminatory policies against the informal sector were abolished, then small enterprises could actually prosper and grow under free market institutions.

The ILO and the World Bank, during the 1970's, were also initially very concerned with liberalizing the informal sector and eliminating macro-economic policies which discriminated against the informal sector. Examples of such discriminatory policies were: protection for local monopolies, implicit and explicit subsidies to larger firms through import restrictions, high import tariffs, irrational tariff structure, overvalued exchange rates, exchange controls, lower than market rates of interest, ... (Lubell, 1991, p.13).

In the 1980s, regulations and policies which were biased against the informal sector and in favor of the modern large-scale sector were largely eliminated as Structural Adjustment Programs were implemented in developing countries. As a result, the illegal or informal aspect of the informal sector lost its importance. Gradually, agencies accepted microenterprises, rather than the informal sector, as the target group whose assistance was meant to bring 'poverty alleviation', regardless of their legal context or whether they belonged in the formal or informal sector.

The micro-enterprise sector, as described by Jacob Levitsky, a World Bank advisor and consultant on small enterprise development, is composed of "very small, non-farming income-generating units, including artisanal operations, family businesses, cottage industries, etc." (Levitsky, 1989, p.

xvi). Participants of the 1986 International Conference on Microenterprise Development agreed on a more broad description of microenterprises: "a very small income-generating unit, owned and managed by entrepreneurs who worked in it themselves, from which they derived most of their livelihood, which employ very few people, if any, mainly relying on family members, and using very little capital" (Levitsky, 1989, p. xviii). Although no consensus amongst the participants at the conference could be reached towards defining the suitable size for a micro-enterprise, most authors agree on an operational definition of five or fewer employees.

The policies which were established to assist these micro enterprises consisted mainly in providing 'missing inputs', such as credit, training, and technical assistance. Such assistance could also take the form of government-led efforts for creating infrastructure facilities as well as policies conducive to microenterprise development.

Also in the 1980s, a global recession had prompted a need for generalized and decentralized economic growth in order to re-build a demand from middle-class consumers. Small enterprise development became another target of assistance, which was this time geared towards the objectives of decentralized industrialization and growth.

Research on small enterprise development in the 1980s revolved mostly around identifying opportunities and barriers to the growth of small enterprises. In general, it included more economic analysis, which resulted in the creation of better, more integrated approaches, as opposed to simple traditional 'missing input' types of assistance. For example, branch-

specific analysis (or the Subsector approach) was a major advancement developed during this period. With it, industry-specific or 'sub-sector'-specific factors were taken into account, as opposed to traditional approaches which viewed small enterprises as a sector in itself.

The Flexible Specialization concept as an approach of assistance to small enterprises, also appeared in the 1980's. This approach promoted the clustering of small enterprises in response to a new context of industrial organization in production.

To demonstrate the importance of the field of assistance to small enterprise development, an International Committee of Donor Agencies for Small Enterprise Development was established in 1979, still active in 1996. The World Bank acts as the secretariat for the committee which groups representatives of bilateral and multilateral donor organizations from Europe, Japan and North America engaged in programmes of assistance to small-scale enterprises in developing countries. According to Levitsky, the assistance to small enterprises is a rapidly growing field in the agendas of these donor agencies.

In summary, the assistance to micro and small-scale enterprises has evolved from an emphasis, in the early 1970s, on assisting the 'working poor' in the informal sector, to an emphasis on poverty-alleviation and employment-creation with micro-enterprises, and then, in the 1980s, to an emphasis on growth and industrial development with small-scale enterprises.

In the 1990s new political and economic trends emerged which impacted the informal sector, or micro and small enterprises: the globalization, liberalization, and the deregulation of trade and markets, as well as the privatization of governmental institutions induced industrial transformations towards greater specialization, division of labor, integrated network structures, market segmentation and rapid changes.

A resulting impact has been the increasing integration and interdependence among economic systems of different countries and among economic units of all kinds. Actually, this also meant growing integration of small production units into larger production systems or networks. A common form of such interrelationships is for micro and small enterprises (or the informal sector) to produce goods whose raw material come from large enterprises (or the formal sector) and whose distribution and sale is also conducted by the latter.

In this context, Sengenberger and Loveman (1990) of the ILO (1992) argue that there is a growing trend for subcontracting and outsourcing. Nanjudan (1992) of UNIDO puts it this way: "there is a growing and permanent role for the small-scale industry to work as a subcontractor to the large industry" (p.112) and Cox (1987) refers to a revival of the 'putting out' system.

Further, another consequence of the liberalization and deregulation of markets is an argument brought forward by Bruce Kelley (1994). He has been analyzing macroeconomic implications of Structural Adjustment Programmes on the informal sector in Peru. In a 1994 article, he

challenged De Soto's argument that 'free of government-imposed barriers, informal producers would prosper.' According to Kelley's findings, "the macroeconomic implications of this much-touted 'Other Path' are seen to undermine the microeconomic logic as higher informal sector productivity results in a deterioration of the terms of trade and income in the sector. Thus, while informal activity will continue to play an important role in Peru, ..., this sector should not be viewed as the key to economic growth and improved living standards for Peruvians" (p. 1393).

Again, a 1991 conference on MSEs (Micro and Small Enterprises) in the changing policy environment in Africa, sponsored by the International Donor Agencies Committee for MSE Development, provided a rare piece of data on the impact of Structural Adjustment Programmes on small business and microenterprise development. In fact, the conference participants agreed that "while the reforms opened up increased opportunities for new and expanding MSEs, most of the small enterprise sector suffered considerably in facing up to the liberalization of the economy, including the freeing up of imports, the reduction in protection of local products and the sharp devaluation of the local currencies" (Agency News, 1991, p. 59).

Also, a study by Nii K Sowa, A Baah-Nuakoh, K.A. Tutu and B. Osei of 1365 small enterprises in Ghana led to a first conclusion that Ghana's Economic Recovery Programme, as an initial impact, had allowed small enterprises to take over the markets of the poorly performing large-scale enterprises. Their second conclusion, however, which is also supported by another study of 600 small enterprises in Kumasi, Ghana, by Jonathan

Dawson is that, while small firms prospered over the 1974-1984 period, the period which followed brought a decline in demand, an increase in imports, and an increase in inflows of small-scale producers which led to a decline in output of MSEs (Brophy, 1993), (Dawson, 1990).

Beyond this informal sector or micro and small enterprise perspective, a labor view seems to indicate the same kind of effects resulting from these great forces of globalization, liberalization, deregulation, etc., which characterize the political and economic map of the 1990s.

To start with, the 1994 WIR argues that there is an increasing number of jobs in subcontracting (WIR, 1994, p. 193). A few studies conducted by the ILO about the labor aspect of the informal sector in the 1990's have analyzed issues related to growing linkages between the formal and informal sector. Studies of this sort have most often been conducted in Latin America, where, according to Harold Lubell of the OECD's Development Centre, "a system of cascading subcontracting from large firms to small firms to basement workshops to household workers appears to be in full development" (Lubell, 1991, p.21). Lubell explains that "subcontracting down the chain is a method of cutting costs, in the first instance by the formal sector enterprise that avoids the fixed costs and social charges attached to direct employment of a large labour force and then by successive layers of subcontractors, each of whom tries to reduce the costs to his own enterprise by squeezing the margin of the next producer in the chain. Exploitation of the weaker links in the chain in the relatively free market of the informal sector is one of the implicit characteristic of the system" (p. 113).

Nanjudan (1987), believes that, while it is possible that small-scale enterprises receive some information, technology, assured market or other benefits from their large contracting firms,

"usually, however, it is the small-scale supplier, being unequal in economic power with the large contractor, who runs the risk of being squeezed or exploited. The parent firm can pass on the burden of market fluctuations to the subcontractor, by delaying payment or refusing delivery, or postponing inspection. Onerous terms and prices could be imposed on the subcontractor, ..., and even in a recession large enterprises may often find it more cost-saving to retain subcontracting activity rather than incur higher costs through maintaining employment of higher-paid labour in their own factories. The latter situation is particularly relevant in labour-surplus economies or those having labour market rigidities" (p.39).

Similarly, a 1991 ILO publication entitled 'The Dilemma of the Informal Sector', questioned whether supporting employment-creation in the informal sector was compatible with protecting workers rights and the welfare of the poorest and most vulnerable groups. The document recognized that enhancing social protection to the informal sector can increase the costs of the enterprise and therefore jeopardise employment creation altogether (Microenterprise News, vol. 2, No. 4, July 1994).

Moreover, the ILO's World Employment Report 1995 also addresses the problem of maintaining labor standards in a context of increasing globalization. The report supports the view that countries are likely to do better in terms of employment if they adopt policies which respond positively to globalization, because of advantages of trading and other opportunities. However, it also cautions that raising the minimum wage

or labor conditions could cause multinationals to move out of the country. The report therefore concludes with the dilemma that policies which respond positively to globalization are necessary but not sufficient for reducing underemployment and poverty.

The same report describes the labor situation in different areas of the world. It states that:

1. unemployment in OECD countries is rising and is now around ten percent;
2. there is mass unemployment in the transition economies of Eastern and Central Europe;
3. in Latin America there is a reduction of modern sector jobs and an increase in informal sector jobs, while the minimum wage and the informal sector earnings are declining;
4. in Africa there is a collapse of the modern sector and therefore a decline in modern-sector employment and an expansion in low-productivity informal activities;
5. in South-East Asia there are low levels of unemployment, real incomes have grown and there has been a reduction in poverty levels. However, in other countries of Asia, such as India, Bangladesh, and Sri Lanka, a slight growth in manufacturing employment is largely "accounted for by the number of low-productivity self-employed workers" (cited in Microenterprise News, vol. 4, no. 6, 1995, p.7).

In conclusion (respecting the 1990s), increasing globalization of markets and the implementation of Structural Adjustment Programmes which contributed to liberalization, privatization and deregulation of markets,

led to an interesting contradiction: while there was an increase in the number of small enterprises working as subcontractors to the large-scale sector, and an increase in the amount of employment created by such subcontracting units, the 1990s also showed signs that the terms of trade of MSEs (or the informal sector) declined and that workers were being pushed into 'informalized' low-productivity and low-paying jobs.

1.2 Posing the problem

The increasing integration of MSEs into larger production networks does show some evidence of exploitation, especially in the case of MSEs involved at the bottom of 'pyramid subcontracting systems'.

In the context of such increasing integration, the approaches to MSEs development must be concerned with helping MSEs obtain a greater bargaining power and better returns for their participation into such integrated systems.

The aim of this thesis is, therefore, to provide a theoretical framework for the competitive and successful integration of MSEs into larger production systems as an approach to MSE development.

An important argument which is brought forwards in this thesis is that the integration of MSEs into larger production systems is most likely to be competitive and successful if it focuses its span of analysis and its intervention strategy based upon a resource market level of competition.

For these reasons, the approach to MSE development which is proposed in this thesis is called the 'Resource-Market' approach.

1.3 Methodology

In order to find how to increase the revenue-generating and the bargaining power of MSEs amongst larger production networks, it is necessary to conduct an analysis of recent forms of industrial organization in production and an analysis of the reasons why MSEs are not getting sufficient return for their participation. This shall be undertaken in Chapter Two. It is shown that a resource-market analysis represents the new basis for firm competition and is therefore a more accurate level of analysis for understanding the revenue-generating and bargaining power of MSEs in the context of production networks. Resource markets are markets of components, inputs, productive functions or services which, brought together into a production process, can produce a finished good, which will in turn compete in finished or end-product markets.

Chapter Three introduces the 'Resource-Market Strategy Formulation Framework for MSEs'. This framework presents a five-stage procedure which would enable MSEs to identify resource markets of opportunity (RMOs), implement strategies to win a competitive advantage (CA) over them, and, over time, gain control over strategic resource markets.

The fourth chapter deals with a comparison of this approach with existing approaches of assistance to MSEs. Three major approaches are reviewed: the Missing-input, the Flexible Specialization, and Subsector approaches.

The conclusion summarizes the main findings and contributions of the thesis.

As an end note: the reason for using the term Micro and Small Enterprises (MSEs) is founded on a belief that the assistance approach which is introduced in this thesis combines goals of poverty-alleviation and employment creation, usually associated with microenterprises, with goals of decentralized economic growth, usually associated with small enterprises. It also aims to include all the activities of the working poor as its target group.

CHAPTER 2 - Recent Trends in Corporate Strategy and Industrial Organization in Production, the Shift in the Basis of Competition between Firms, and Implications for MSE Development.

2.1 Introduction

The internationalization of production is a recent phenomenon which has developed according to certain specific patterns or trends in corporate strategy and industrial organization. According to the 1994 World Investment Report (WIR) by the Transnational Corporations and Investment Division of UNCTAD (United Nations Conference on Trade and Investment), 'complex integration strategies' can most appropriately define the new 'best production practices' in corporate strategy and industrial organization.

A careful study of these recent developments in corporate strategy and industrial organization, which are reflected in the latest industrial restructuring trends in global production, is essential for understanding how the role or position of MSEs might be affected, especially since MSEs are becoming increasingly involved in such integrated production systems or networks.

'Complex integration strategies' began to appear in the 1980s, as corporations started to fragment, in whole or in part, the value chains of their production processes. A 'vertical disintegration' of value chains

began with large corporations finding it cheaper and more efficient to subcontract or outsource many of their traditional responsibilities in the value-chain.

The intense fragmentation of the production process often takes the initial form of subcontracting labor-intensive operations in countries which offer the lowest labor standards in the world, e.g. Vietnam, Cambodia and Bangladesh. It can also take more complex forms, as it has been the case more recently, where larger parts of the production process are being outsourced or decentralized, to a point where 'pyramid subcontracting' systems emerge and allow many agents or firms to take part in the production process. Although these value chains become intensely fragmented, they still remain organized in 'systemic global (or regional) forms of integration' (WIR, 1994). This is also what the WIR calls 'complex integration strategies' or what Barnett and Cavanagh (1990) call the 'globally integrated assembly line'.

Before examining more specific explanations and describing the characteristics of the latest trends in corporate strategy and industrial organization in production, it is important to explore the causal factors which have influenced or enabled the emergence of such 'complex, systemic, global (or regional) forms of integration'.

2.2 Recent trends in corporate strategy and industrial organization in production: causal factors, recent trends, and empirical evidence

2.2.1 Causal factors

A first causal factor has been the influence of recent advancements in information technology. For instance, production can become decentralized geographically because "with today's technology, not only can orders be relayed around the world in a matter of seconds, but designs can be created in one hemisphere and transmitted by computer thousands of miles to where the product will be produced" (Economic Justice Report, 1994, p.6).

Another reason at the source of 'complex, systemic, and global integration strategies' is the intensifying of competitiveness requirements or standards dictated by markets which have become global. As the WIR states "Transnational corporations are pursuing complex integration strategies in response to competitive pressures in the expectation of greater efficiency" (WIR, 1994, p.144).

As a matter of fact, subcontracting the functions of the production process to wherever it is most profitable, or economically advantageous, or wherever there is a most competitive advantage to do so, does give a clear competitive edge to such a decentralized system of production. According to the 1994 WIR, "the shift to a more complex integration at the corporate level requires a breakdown of the value chain into discrete functions (e.g. assembly, procurement, finance, research and development,

etc.) and their location to wherever they can be carried out most effectively in light of the overall needs of the firm as a whole" (p.139).

Last and most important, is the influence of the global political and economic environment which is becoming what Jeffrey Sachs calls a 'globally integrated free-market system' (Sachs, 1994). This refers to a global trend towards the homogenization or convergence of national domestic policies which is emerging as an increasing number of countries are adopting neo-liberal agendas. Accordingly, the WIR states that "the general trend in the national and international regulatory environment has been towards greater deregulation and more openness towards flows of trade and investment" (WIR, 1994, p. 148).

Besides, the WIR 1994 also underlines the importance of production in the phenomenon of globalization, and how it has influenced integration between countries to shift from *shallow* when at the level of markets, to *deep* because it is now at the level of production. In fact, the report states that "the nature of the world economy is undergoing a fundamental change: from being a collection of independent national economies linked primarily through markets, the world economy is becoming, for the first time, an international production system, integrated increasingly through numerous parts of the value-added chain of production " (p. 146). This process of deepening integration amongst countries is also due to the internationalization of transactions within Trans-National Corporations (TNCs), or what is also termed 'intra-firm trade' (WIR, 1994). The report also estimates that the overall integrated international production system accounts for approximately one-third of total world output.

The 1994 WIR also argues that national economies which are increasingly integrated together at the level of transnational production are no longer subject to domestic governance structures. Therefore, because of this process of deepening integration, the existing policy frameworks of regulation, being still defined by national boundaries, are becoming inadequate. Traditional powers of national governments, such as labor market regulations and competition laws, are disappearing, while not being adequately replaced by international governance.

Consequently, the deepening integration amongst countries, the loss of sovereignty over certain governmental powers, and the homogenization effect of countries adopting liberalized political agendas are factors which have contributed to the emergence of a globally liberalized and deregulated political and economic environment.

In conclusion, the advancements in information technology, competitive pressures for efficiency requirements, and the growing enabling liberalized and deregulated political and economic environment have become important factors in the emergence of 'complex, systemic and global forms of integration' in the industrial organization of production.

2.2.2 Recent trends

TNCs are currently outsourcing functions which used to be under their control. This phenomenon is called a 'vertical *disintegration*'.

This contrasts with vertical integration which is when all the functions and components of the production process are integrated under the authority and control of a single company. In such a case the company controls, for example, the functions of raw material production, transformation, manufacturing, marketing as well as the distribution of a finished product.

The computer industry used to be vertically-integrated under the centralized authority and ownership of companies like **IBM**. Like many other industries it has now become vertically-*disintegrated*. It is now under the shared authority of many actors, each specializing in a few components or functions of the production process. For example, "**Intel** and **Motorola** dominate the component business. **Compaq**, **IBM**, and **Apple** are big on hardware. **Microsoft** dominates the operating systems. **Lotus** and other application vendors specialize in clusters of application. There is a wide variety of distribution channels, - **Dell computers**, to **Sears**, to **Value Added Resellers**, to owned distribution channels " (Prahalad and Hamel, 1994, p. 7).

The automobile industry is another example. US automakers produce fewer than one half of their parts (Fortune magazine, Jan. 1995), and **Chrysler** outsources two-thirds (Stewart, 1995, p.170). The "world car" (Barnett & Cavanagh, 1994) is a good way to describe the extent to which the decentralization of the production process has happened in the automobile industry.

Barnett & Cavanagh (1994) illustrate this point with the following example;

"When an American buys a **Pontiac Le Mans** from **General Motors** he engages unwittingly in an international transaction. Of the \$10,000 paid to **GM**, about \$3,000 goes to South Korea for routine labor and assembly operations, \$1,8⁵⁰ to Japan for advanced components (engines, transaxles, and electronics), \$700 to the former West Germany for the styling and engineering, \$400 to Taiwan, Singapore and Japan for small components, \$250 to Britain for advertising and marketing services, and about \$50 to Ireland and Barbados for data processing. The rest, less than \$4000, goes to strategists in Detroit, lawyers and bankers in New York, lobbyists in Washington, insurance and health care workers all over the country, and to **General Motors** shareholders all over the world" (p.280).

Further, this breakdown of vertically integrated structure can even be carried to the extreme of outsourcing every productive function, except for the central one of controlling the brand name, or organizing/coordinating these 'globally integrated assembly lines'. As a result, some TNCs have become what has been termed either 'hollow', 'post-industrial', 'virtual', 'modular' or 'footloose' corporations.

An example is the case of **Galoob Toys Inc.** which relies on independent inventors and entertainment companies to invent their products, outside specialists to design and engineer them, a private credit corporation to set their credit policy and take charge of their accounts receivable, and contractors in Hong Kong who manufacture the toys by subcontracting the most labor-intensive parts to factories in China (Business Week, 1986).

Similarly, "Nike owns no factories, puts no investments into manufacturing facilities and hires no employees who manufacture their

products; yet they are the #1 athletic shoes manufacturer in the world" (Economic Justice Report, 1994, p. 7).

Also, like Nike, IKEA has developed sophisticated integrated international production and distribution systems. In fact, most of IKEA's production is manufactured by many small independent subcontractors in Central and Eastern Europe, and the number of subcontractors is estimated at 2,300 firms. The company, however, keeps control of the functions of product design development, material testing, production and construction design, stock management, transport and sales to the final consumer (WIR, 1994, p. 193).

Again, Benetton, which considers itself a 'clothing service company', controls the functions of the production process that it considers crucial. These are the design, cutting, dying, and packing functions. It subcontracts the rest of the manufacturing functions as well as trading outlets for distribution (WIR, 1994, p. 194).

A first explanation for the corporate strategy which underlies the decisions of TNCs when choosing which parts of the value chain to subcontract and which ones to keep under their control, is given by the 1994 WIR. This report suggests that TNCs subcontract the physical production of goods and keep control over the research and development and marketing stages of the production process (WIR, 1994, p. 193).

However, a more accurate or precise way to describe this emerging trend in corporate strategy is as follows: Basically, TNCs separate the functions

in the value-chain according to their respective strategic values. They get rid of low-yielding and low strategic value activities while keeping control of high-yielding and strategically important activities.

Examples of strategically important and high-yielding value-added activities usually kept under the control of what Van Liemt of the ILO calls 'production organizers', are "brand loyalty, superior organization, design and marketing, their hold over distribution network, access to a protected market, quality control, or a combination of these" (1992, p.312).

Werner Sengenberger (1994) of the ILO's International Institute for Labor Studies, in his book dealing with labor standards in industrial restructuring, acknowledges that by contracting out large parts of the value-chain, including production and services, the internal structure of the Multi-National Enterprise (MNE) is becoming vertically disintegrated. His explanation is that "the big firms tend to externalize functions considered of less strategic importance, retaining those viewed to be essential for strategic control" (p.400).

Similarly, the 1994 WIR indicates that, by subcontracting physical production, TNCs shift the tasks they perform to higher value-added activities (p. 193). The Report also states that " it appears that a number of restructuring strategies implemented by TNCs in recent years, particularly workplace reform and rationalization tend to refocus on core businesses, the externalization of non-core tasks ..." (p. 272).

The externalization of non-core tasks, or the divestiture of less strategic activities in a value chain, are corporate strategies which can provide an explanation for the current 'vertical disintegration' trends.

On the other hand, horizontal integrations represent a parallel event to vertical disintegrations. They signify a refocusing on core businesses (or tasks, functions) by creating horizontal cooperative arrangements.

Horizontal level integrations happen between the same productive functions or resources, which can cut across different value-chains. For example, a single name brand or technology can be extended to the production of different goods. What is currently happening is, therefore, a simultaneous process of vertical disintegration and horizontal integration.

2.2.3 Empirical Evidence

A first piece of evidence as to how recent corporate strategy promotes horizontal cooperative arrangements is that "one of the most distinctive features of the new pattern of corporate strategies involves the increased use of cooperative arrangements between firms,..., to speed up market entry, gain access to technologies and share financial costs and risks" (WIR, 1994, p.140). Further, "network relationships form a dynamic mixture of internalized and externalized activities, all of which require more horizontal linkages to ensure effective coordination " (idem, p.140).

Prahalad and Hamel, in a 1990 Harvard Business Review article entitled 'The Core Competence of the Corporation', express their belief that horizontal competence-building across different vertical end-product

chains is a strategy that will determine which corporations will be the winners of the 1990s. "Thinking in terms of core products forces a company to distinguish between the brand share it achieves in end-product markets and the manufacturing share it achieves in any particular core product" (p. 85). For example, "Canon is reputed to have an 84% world manufacturing share in desktop laser printer 'engines', even though its brand share in the laser printer business is minuscule. Similarly, Matsushita has a commanding core product share in compressors worldwide, estimated at 40%, even though its brand share in both the air-conditioning and refrigerator businesses is quite small" (p.85).

In relation to this, an interesting study by Joel Bleeke published in the Harvard Business Review (1990) addresses the effects on U.S. companies of the opening of markets and increased deregulation. His conclusion is that

"only a small number of companies can remain broad-based competitors. Most are forced to narrow their product-range and spin off noncore activities to survive. The reasons are mostly financial: at the same time that profits are falling and cross-subsidies are unwinding, the cost of competing in each segment shoots up as new entrants increase competitive pressure and force established companies to improve productivity, research and development, marketing, and customer service. Given these pressures, many companies choose, or find it necessary, to focus on core activities in which they have strong skills and a competitive advantage. The result is much greater segmentation within the industry" (p. 160).

Williams, Paez and Sanders, in their 1988 study of restructuring patterns also found evidence of this increasing trend to horizontal integration and vertical disintegration. Their study, which was conducted during the 10

year period from 1973-1984, monitored the patterns of acquisitions and divestitures of 84 U.S. corporations, in order to assess the types of restructuring which were undertaken. The result was that during these ten years, there were, in total, 746 acquisition and divestiture events. Of this total, 389 were acquisitions and 357 divestitures. These acquisition and divestiture events were then categorized further as: horizontal, vertical, complementary, supplementary, or unrelated. As a result, vertical restructuring was the least frequent (only 35 of 746 events); unrelated divestitures were twice as frequent as unrelated acquisitions; and acquisitions based on supplementary or complementary businesses outweighed divestitures by a factor of 1.9 for the complementary and 1.36 for the supplementary. Complementary restructuring was defined as "involving a business which enhances one of the conglomerate's major lines of business with a different skill or technology" (p. 409). Similarly, their definition of supplementary restructuring is "involving a business which serves a different market than one of the conglomerate's major lines of business, but which is based on a similar skill or technology used in one of the major lines of business" (p. 409)

This study, therefore, showed that US acquisitions and divestitures during the 1970s to the 1980s primarily followed restructuring strategies of vertical disintegration (with unrelated divestiture events) and horizontal integration (for enhancing the major line of business with a specific skill or technology or for augmenting the business' utilization efficiency of existing skills and technology).

Constantinos Markides, in his 1995 article entitled 'Diversification, Restructuring and Economic Performance', provides an economic model demonstrating that corporate refocusing in the 1980's by over-diversified firms has led to profitability improvements. His definition of corporate refocusing is a "voluntary or involuntary reduction in the diversification of U.S. firms, usually but not necessarily achieved through major divestitures, what Bhagat, Shleifer, and Vishny (1990) call 'the return to corporate specialization' " (cited in Markides, 1995, p. 101). According to him "a significant proportion of major diversified firms in the U.S. have reduced their diversification in the 1980s by refocusing on their core businesses" (p. 101). The author also found that this type of restructuring is, according to the existing evidence, "by far the most common and most beneficial form of restructuring undertaken by firms" (p. 101). A similar finding was made by Malnight (1995), who, in analyzing the case of a Transnational Corporation, argues that globalization occurs at the level of the function (horizontal level) rather than the firm (or vertically-integrated structures).

In summary, empirical evidence and the views of many authors in strategic management seem to point to a trend in corporate strategy of vertical disintegration (intense fragmentation of the production process and divestitures of non-core activities) and horizontal integrations (the tendency for firms to specialize on the horizontal, resource, functional or core activities level).

2.3 Shift in the basis of competition between firms

A major implication of these recent trends in corporate strategy and industrial organization in production, is that by breaking the value-chain into separate activities or functions and re-orienting strategy at the level of such functions, they have induced a **shift of the firms' competition basis from end-product markets to resource markets.**

In fact, as firms (or corporations) become vertically disintegrated, they are being replaced by networks of firms which become the competitors in end-product markets. Prahalad and Hamel (1994) discuss how the traditional assumption which views the business unit (or the firm) as the primary focus of business strategy, is now challenged by the reality that "competition, in many industries, even extends beyond inter-corporate competition. Often clusters of firms compete. The Intel-led coalition is battling the Motorola-led coalition in microprocessors for PCs. Competition (in end-product markets) must therefore be understood at not just the business level, but at the level of corporations and at the level of coalitions or clusters of firms" (p. 10).

As a result, individual firms tend to turn away from end-product markets, and to specialize instead at the resource-market level. Resources are functions, activities, components or inputs involved in the production process of a finished good.

2.4 Implications for MSE development

2.4.1 Introduction

As highlighted in Chapter One, MSEs are increasingly participating in integrated production systems or networks. Very few studies have been conducted on the impact of such integration of MSEs activities in larger production networks. However, it is well known that many MSEs involved in such networks receive unreasonably small shares of the revenue accruing therefrom.

With this shift in the basis of competition between firms to the resource market level, this impels an analysis of MSEs activities at the level of resource markets. This section therefore provides a resource-market perspective for understanding the impact of MSE integration in larger production networks and argues for the necessity of a resource-market level type of intervention which increases the value of MSEs' contribution in relation to the production process.

2.4.2 Asymmetric value of resources

As the previous section showed, the current 'best practices' in corporate strategy and organization in production follow a) 'vertical disintegration' strategies involving divestitures of non-core, less strategically important, or low value-added activities or functions of the production process; b) parallel 'horizontal integration' strategies and c) a tendency to specialize in

high-yielding, strategically important, core functions or resources across different value-chains.

Since TNCs are following such strategies, it means that different resources, functions or activities obviously carry different strategic values, in terms of their strategic importance towards the production process. For example, it was shown in the previous section that **Benetton** subcontracts the manufacturing of its clothes, but keeps control over the design and dying functions. The reason for subcontracting manufacturing is that it can be done more cheaply by the subcontractors than by **Benetton** itself. The subcontractor therefore receives a smaller share of end-product revenues, while **Benetton**, by controlling the 'crucial' or 'strategic' functions, receives a larger share.

It has been acknowledged in the literature that an inequity in revenue between those who control 'strategic resources' and those who control 'peripheral or less strategic resources' results from such an asymmetry in resource value. For example, 'production organizers', or those who orchestrate and coordinate 'globally integrated assembly lines', represent a resource (or function) which is often considered strategically important (Van Liemt, 1992). In fact, according to Van Liemt (1992) of the International Labor Organization (ILO) "production (and sales) organizers" reap most of the mark-ups since they have control over "high value activities" (p.312).

Similarly, the "flagship firm" model which was developed by D'Cruz of the University of Toronto and Rugman (1995) of Dalhousie University

resembles the 'production organizer' view in the sense that the authors consider the 'flagship firm' to be the production unit which "pulls the network together and provides leadership for the strategic management of the network as a whole" (p.10). They also acknowledge that this flagship unit has an "asymmetric strategic leadership" in relation to the other network participants (p.10).

Information technology (IT) is another resource which has been found to be very strategically important. Since IT allows the fragmentation of the production process and the coordination of outsourced work, it therefore has the capacity to yield a very high share of value-added from the value-chain of the production process. In fact, it has been found that information technology can actually account for three-fourths of value-added in manufacturing (Stewart, 1995).

Now, a relevant question which concerns MSEs and their labor force is what happens when they become subcontractors of these 'globally integrated production lines' and find their contribution to be of peripheral or less strategic value than the strategically important, retained resources (functions).

A first issue of concern regarding this question, is the danger of MSEs' share of returns being too small, or what some would describe as exploitative. For example, in the case of NIKE shoes, the company controls the strategic functions of marketing and design while subcontracting the less strategic parts of the production process, such as manufacturing. The result is that NIKE can sell shoes for about 88 US\$

while each pair is actually manufactured for 12 cents by some woman or child in Indonesia (Economic Justice Report, 1994).

Similarly, via the 'pyramid subcontracting system', " an article which a *maquilladora* produces for a dollar, is produced in the 'little *maquilladoras* ' for between two cents and thirty cents a piece" (Economic Justice Report, 1994, p. 4). In other words, one producer can squeeze the profit margin of the next in the subcontracting pyramid.

Studies done from a labor perspective have also drawn equally alarming conclusions about labor conditions at the bottom of these pyramids. For instance, Charles Oman of the OECD unveiled a striking revelation: that since the 1970's, the share of low-skilled labor in production costs has fallen from 25% to 5- 10% (cited in Dale, 1995, p.48). Tipple (1993), in his article 'Shelter as a Workplace: A Review of Home-Based Enterprises in Developing Countries' gives the example of the lacemaking industry in Narsapur, India, where the earnings of the outworkers are approximately 5 U.S. cents per day, due to "the cuts levied by a multitude of agents and sub-agents" (p. 531).

Tipple also explains how home-based enterprises (or informal sector micro-enterprises) could become 'exploited':

"The roots of exploitation in the outwork system can be traced to the organization of production, which not only keeps the workers isolated and in competition with each other but prevents them from forming any overview of the production process as a whole, and realizing the extent of their fragmentation of the production process deprives the workers of the knowledge necessary to begin independent production" (p. 531).

Similarly, Pye (1988), in studying artisans in Asia (Sri Lanka, India, Thailand, Malaysia, Indonesia and the Philippines), found the same types of 'exploitation' arising from subcontracting. "Examples were found of entrepreneurs who deliberately fragmented the production process so that workers could not compete against them. In Java, factory batik workers are isolated from each other and the various steps in production are carried out in different parts of the building or in entirely separate locations. Few workers are allowed to master more than one skill. This is most common in rural subcontracting. The extreme division of labour has advantages for entrepreneurs, who keep competition at a minimum and exploit the availability of labour" (p. 14).

He also explains why subcontracting is preferred to traditional factories: "despite the high export levels, there is little evidence to suggest that large factories have taken hold, even in India. This is due to the fear of unions and to legislation that does not allow manufacturers to lay off workers in slow periods. Entrepreneurs are unwilling to invest in factories that may remain idle during periods of weak demand; subcontracting is preferred. Labour legislation, except in the Philippines, also means that employers have to pay bonuses and contribute to welfare funds and insurance schemes" (Pye, 1988, p.15).

This fragmentation of the production process, therefore, keeps workers from accessing the necessary knowledge and skills to start their own independent production, and extends their exploitation in that their labor conditions do not measure up to the standards of labor legislations.

Beyond this, Cox (1994) has developed the core-periphery model for understanding new forms of decentralized organization in production, which he suggests are responsible for precarious labor conditions. In Cox's view, the 'mass production of standardized goods model' of industrial organization (or Fordism) has become obsolete:

"The new model is based on a core-periphery structure of production, with a relatively small core of relatively permanent employees handling finance, research and development, technological organization, and innovation, and a periphery consisting of dependent components of the production process. While the core is integrated with capital, the fragmented components of the periphery are much too loosely linked to the overall production process. They can be located partly within the core plant, e.g., as maintenance services, and partly spread among different geographical sites in many countries. Periphery components can be called into existence when they are needed by the core and disposed of when they are not. Restructuring into a core-periphery model has facilitated the use of a more precariously employed labour force segmented by ethnicity, gender, nationality, or religion. It has weakened the power of trade unions and strengthened that of capital within the production process. It has also made business less controllable by any single state authority" (p. 47).

In an earlier publication, Cox (1987) associated the growth in underground activities, the shift of industry towards non-unionized sites, the expansion of domestic outwork with a "declining proportion of core jobs and an increasing proportion of peripheral jobs" (p. 324). He terms this trend the 'peripheralization of the labor force'. He also argues that there is a revival of 'putting out' as a form of 'dependent self-employment', and thus a shift from wage workers to an independent productive activity of a "non-class of non-workers" (Cox, 1987). Nike, for example, has a

'formal' core staff of 9,000, while employing 75,000 through subcontracting (WIR, 1994, p.193).

Like Cox, Van Liemt (1992) who also uses the core-periphery mode of analysis, acknowledges an asymmetry in working conditions between employees who belong to the core and those who belong to the periphery parts of the production process. According to him, "to the extent that a 'core-periphery' model is becoming widespread, more people will be faced 'with less stable, and frequently less favourable, employment conditions' (p.318). "The bargaining power of those who do not belong to the core, because they do not possess a critical skill or are not indispensable on other accounts, is more limited" (p.319). He indeed points out that, as a matter of fact, "trade union power has (already) diminished in many if not most countries" (p. 319).

As pointed out in the background section of this study, the ILO's 1994 World Labor Report describes the world labor situation as following a general trend towards a reduction of modern sector jobs and an increase in low-productivity informal sector jobs, a situation which, in turn, is leading to a general decline in real wages.

In summary, this section has shown that the fragmented nature of the organization of production, the shift towards non-unionized sites, the expansion of domestic outwork, and the spread of pyramid subcontracting systems are bypassing state labor regulations, keeping workers separated in order to prevent them from learning the functions that could enable them to start independent production, as well as

reducing their collective bargaining power. Further, as Cox mentioned, the increased use of outsourcing has decreased the number of core jobs, leading to the peripheralization of labor, a decline in the power of trade unions, and informalization of working conditions, a view which is also supported by the ILO's 1994 World Labor Report.

This section has also demonstrated that different resources involved in production processes (including labor), carry different revenue potential. Several examples showed how production organizers, or owners of strategic resources like information technology, can reap extraordinarily high shares of the value chain in comparison to the low-skilled workers who actually manufacture the products. The literature has also shown us how different categories of labor (skilled or unskilled, belonging to the core or peripheral parts of the production process) could also lead to different labor conditions or shares of revenue from the value-chain.

Since few resource-market level studies could be found with a MSE perspective, conclusions must be deduced from studies with a labor perspective. This deduction can be justified by the fact that MSEs, like labor, are small production units which are also increasingly and inescapably falling under the authority of production networks or 'complex, systemic and global forms of integration'.

Like labor, MSEs are also in danger of seeing their bargaining power decline because of the highly fragmented and decentralized nature of the global production process which inhibits these small productive units from rallying themselves into more economically or politically powerful entities, and most importantly into a strategic position. Dangers similar to

those of labor could therefore arise: growing dependence, declining protection from state regulations and laws, declining bargaining power and revenue-yielding capacity, etc.

Consequently, by focusing on the strategic importance of the resource market in which a firm competes, a resource-market analysis can explain why some firms have more bargaining and revenue-generating power than others. The facts and examples presented in the preceding discussion show that resources which have less strategic importance to the production process receive exploitative returns. The case of MSEs (extrapolated from the case of labor) was given to exemplify this situation.

2.5 Conclusion

The most recent trends in corporate strategy and industrial organization in production have resulted in changing the competition field of firms: Resource markets are the new basis for competition. As a result, it has been argued in this chapter that resource markets have become a more appropriate basis for analysing competition between firms.

The series of cases and examples of resource market level analysis demonstrate a relationship between the revenue-generating/bargaining power of firms on one hand, and the strategic importance of the resource market in which they compete in relation to the production process on the other. The chapter also explains that the low share of returns of MSEs when they are integrated into larger production networks, is due to the

peripheral or low strategic importance position of the resource-market in which they compete. This chapter thus introduces the next chapter by stressing the need for an approach to MSE Development to be analyzed and formulated at the level of resource-markets and for an approach which focuses on giving MSEs more strategic importance in the context of their integration in larger production networks.

CHAPTER 3 - A Resource-Market level Strategy Formulation Framework for MSEs.

3.1 Introduction

Chapter Two examined how traditionally vertically-integrated production processes are becoming intensely fragmented, allowing many firms which are specialized at the resource market level to participate in them.

It was also observed that there is an asymmetry in the revenue-yielding power of various resources involved in the production process (or value-chain). This led to a concern about the situation of small firms or individual workers being allocated shares of the production process that are so small that they can be qualified as 'exploitative'. This is especially true when the value of the resource market in which they compete is not considered to be sufficiently strategically important to the production process.

Accordingly, the aim of this chapter is to introduce a theoretical framework for resource-market level strategy formulation for MSE development. Its deliberate purpose is to enable MSEs to enter production networks in a successful and competitive way, at the level of resource markets. This is done through enabling firms to identify opportunities for profitable integration in production processes (or value-chains) at the

resource-market level as well as providing strategies for sustaining this integration.

Value-chains (Porter, 1985) or production processes represent a collection of discrete activities or inputs which are also called resources. The definition of a resource can therefore be very broad. The following framework recognizes a definition of resource given by Wernerfelt (1984): resources are tangible (raw materials, equipment, machinery, etc.,...) as well as intangible (skills, capabilities, competencies, management and production practices, technology, relationships with suppliers or distributors, etc.,...) productive assets (Wernerfelt, 1984).

In order to remain faithful to a changing reality in the market place, the following proposed framework will consider each resource in each value-chain as an actual market where many firms may be competing. A value-chain is therefore composed of many resource markets. In addition, the same resource markets can also be part of many value-chains. Resource markets compete against other resource markets for shares of the value-chain and firms compete against other firms for shares of the resource market.

This figure can illustrate this concept:

value-chain 1
res. market A firm 1
res. market B firm 2,3
res. market C firm 4,5,6
res. market D firm 7,8,5
res. market E firm 9, 7
res. market F firm 10, 11, 12, 13, 9

The framework which is about to be introduced is applicable to firms of any size, which hold any type of resource or resources of any value, for as long as the firm can find at least one opportunity to compete as an input in any larger production system or value-chain in its environment.

In this framework, like illustrated above, it is assumed that firms are not vertically integrated but rather actors which are competing for a share of a resource market in a production process along with other actors.

Consequently, opportunities for strategy formulation at the resource-market level are identified externally from the firm.

This framework will use some concepts from the **Resource-Based View of the Firm (RBVF)** (Wernerfelt, 1984) (Barney, 1991) and the **Resource-Dependence Perspective** (Pfeffer & Salancik, 1978), which are the closest theories in strategic management for strategy formulation at the resource market-level.

3.2 The Resource-Market level Framework for Strategy Formulation

A synthesis of the Resource-Market level Framework for Strategy Formulation is presented in the following table.

The Resource-Market level Framework for Strategy Formulation

1. Internal Analysis

Firm-specific resource assessment and identification of the nature of the firm's offer as a resource (input) to external value-chains.

2. External Analysis

a) vertical analysis

identifying specific resource-markets of opportunity (RMO) in the firms' vertical environment which is/are value-chain(s)

b) horizontal analysis

identifying our competitors' competitive advantages (CAs) in the horizontal environment which is/are identified RMO(s)

3. Drawing out the best resource-market of opportunity (RMO).

Combining vertical and horizontal analysis with other criteria in order to select the resource market(s) which offers the best opportunities for our firm

4. Selecting and implementing a strategy for best exploiting a CA over the selected best RMO(s).

5. Adding a dimension of sustainability to the firm's CA

The following sections will describe in detail each step of the framework. Each step will be illustrated with a fictional example of a case of MSE assistance in a developing country.

Our fictional example consists in a small association of 10 skilled batik-dying art workers from a small Sub-Saharan West African village, who own artisanal means of production and grow their own plants to make indigo-blue natural dye. They have learned specific agricultural skills for growing the natural dye which comes from the indigo plant, as well as the technology to extract the color pigment from the plant.

This association has recently been created in order to share skills and gain more bargaining power towards their sole employer, a local pagne-making company. Pagnes are rectangular pieces of cloth which woman wrap around themselves as a long skirt or dress.

Since the formation of this association which has more or less acted as a trade union, the workers have been able to exercise more authority over the pagne-making production process and therefore extract a greater share of revenues from the value-chain. However, although the share of the pie has increased a bit, the pie itself remains very small, because the local market for pagnes is actually very small and the local economy is not doing so well either. Growing desertification is causing a decline in the economic growth of the region.

The association of workers therefore need help. Their returns from the pagnemaking industry remain very small and insufficient to provide the necessary means for sustaining their families and meeting essential human needs.

Our framework is built for a target-group of reference which is termed the 'firm'. The 'firm' may be any owners of any productive resources, including even workers. The fictional example's association of workers can therefore find an application in this framework and become, in this case, the 'firm'.

3.2.1 Step One: Internal Analysis

Firm-specific resource assessment and identification of the nature of the firm's offer as a potential resource (input) to external value-chains.

The first step in this resource-market level procedure for strategy formulation is simply to assess the firm's own resource(s) (capabilities, assets, skills, etc...) and conceptualize them in terms of how they could become resources or functions to be offered to external value-chains.

In our fictional example, the resources which our firm could offer to value-chains in its external environment would be the function of batik dying and the supplying of a natural dye.

3.2.2 Step Two: External Analysis

The purpose of this second step of the procedure is to identify specific potential resource market opportunities in the firm's environment.

As mentioned earlier, this framework for strategy formulation has been conceived for a situation where firms compete for resource markets which are part of larger production processes. The firm's environment in this case is therefore composed of two dimensions: vertical and horizontal. The firm's vertical environment is the value-chain and the firm's horizontal environment is the resource market.

This thesis suggests that the analysis of the firm's environment should be limited to a scope of reach that is within the firm's means, which would most likely mean its immediate environment.

a) Vertical analysis

The vertical analysis of the firm's resource environment seeks to find resource market opportunities which are specific to the firm and to evaluate the strategic value (or strategic importance) of such resource market opportunities in relation to other resource-markets in the value-chain.

The notion of resource market strategic value refers to a concept which is established both in the Resource-Based View of the Firm and in the Resource-Dependence Perspective.

In the Resource-Based View of the Firm, it is assumed that opportunities for strategy formulation are internal and that the firm should focus its strategy around its most crucial resources (often being specific capabilities or skills).

The attributes or characteristics of such strategic resources, according to Amit & Shoemaker (1993), are that they are **scarce (rare), durable, not easily traded (difficult to buy and sell), and difficult to imitate or substitute.**

In contrast to the Resource-Based View of the Firm, the Resource-Dependence Perspective views the opportunities for firms to control strategic or 'critical' resources to be external to the firm, or in the firms' environment.

A 'critical' resource's characteristics, according to the Resource-Dependence Perspective are: **it must be important to the organization's activities and survival, difficult to find elsewhere, and in a situation where the organization has a lack of control over.** (adapted from Pfeffer & Salancik, 1978, p.260)

Yet, it is important to keep in mind that within both perspectives, it is recognized that resources within a value-chain have different value in terms of strategic importance. In other words, both theories acknowledge the asymmetry between the strategic value of different resources in a value-chain.

However, since the Resource-Market approach sees firms, and especially MSEs, as participants in resource markets which are part of larger production processes or value-chains, then like the RDP, our framework adopts the view that opportunities for our firm are to be found in its external environment.

Further, whereas the RBVF and the RDP consider resources as the unit of analysis, this framework considers resources as actual markets, where many firms may be competing. By viewing resources as markets, this allows a horizontal dimension of analysis. Whether the resource is considered as a market or not, it will remain a vertical unit of analysis, regardless of the composition of firms or the identity of ownership over this market. Strategic resource markets can therefore adopt the same attributes as those of strategic resources which were developed by the RBVF and RDP.

There are two possible scenarios in the vertical analysis of the firm's environment: the case where the firm's vertical environment is a single value-chain or the case where there are many value-chains.

i) Single Value-Chain Case

In the case in which our firm resource(s) can only be used in a single value-chain we must proceed to a **value-chain analysis**. To do this, one must do the following:

First, identify a value-chain which contains specific resource markets in which there is an opportunity for our firm's resources to integrate in. These resource markets will be called '**Resource Markets of Opportunity (RMO)**'. They are 'ports of entry' for our firm in this specific value-chain.

Secondly, order or rank existing value-chain resource markets on a scale, according to attributes of strategic resource markets. Accordingly, in a combination of the RBVF and the DP definitions, the attributes for such resource markets of strategic or critical value are **scarce (rare), durable, not easily traded (difficult to buy and sell), and difficult to imitate or substitute, important to the value-chain's activities and survival, and in a situation where the value-chain has a lack of control over.**

Thirdly, position the resource markets of opportunity (RMO) (in which our firm's resources could possibly be integrated) amongst the other resource markets in the value-chain, again according to their strategic value.

In our fictional example, because the batik dying association is in a remote rural area, the only opportunities for fabric-dyeing which were ever known by our association were with the only local pagne-making organization. The only possible vertical environmental analysis in this case is therefore within the pagne value-chain.

example:

pagnes value-chain

HIGH

strategic value

<i>pagnes</i>
<i>coordination</i>
<i>batik dying</i>
<i>dye supply</i>
<i>fabric supply</i>
<i>brand name</i>
<i>distribution</i>

LOW

strategic value

*This table illustrates a value-chain composed of resource markets integrated together as the pagnes production process. Each resource is a market in which many firms can be competing. The shaded boxes in the table are resource markets which have been identified as our association's potential '**Resource Markets of Opportunity**'.*

In this ordering or ranking of resource markets, the coordination function is the most strategically important. This function belongs to a 'production organizer' who is the central agent in the production process. The production organizer maintains long term friendships throughout the years with the suppliers and distributors involved in the production process. This factor makes this

coordination function a very strategic one since it would be hard for a new-comer to replace him effectively. For the same reason, this function also has a high bargaining power over other functions.

The dyers association, coming second in line, also has pretty high bargaining power because of their long tradition and their accumulated knowledge and skilled expertise about the trade. Their hand-made artwork is difficult to imitate. The fact that they are grouped into an association gives them some kind of 'monopolization' or trade union power.

Distribution comes last in terms of strategic value because of the over-abundance of local small distributors. It is the easiest function in the production process to be appropriated and can be provided by many people in the area. Because of high competition between the numerous small distributors in the industry, revenues are low.

ii) Many Value-Chains Case

In the case where the firm's resources can find an application in many different value-chains, we must identify all resource markets of opportunity (RMOs) for our firm in each value-chain.

Building a resource-product matrix is a good way to start. It identifies resource-market opportunities for our firm's resources in different value-chains.

In the case of our fictional example, let us assume that new opportunities were found in the city for our batik-making association. The RMOs found were: one in a local paint firm, one in a national curtain company, and one in a multinational fabric-shoes production network. They are grouped in the table below, along with the two opportunities in the rural area. The shaded areas represent all RMOs which are specific to our firm's environment;

	<i>pagnes</i>	<i>curtains</i>	<i>fabric shoes</i>	<i>paint</i>
<i>batik dying</i>	RMO	RMO	RMO	
<i>dyes supply</i>	RMO			RMO

As in the case of a single value-chain, one must rank RMOs in each value-chain according to their strategic value, and position our firm's RMOs (shaded area) amongst them.

HIGH
strategic value

<i>paganes</i>	<i>curtains</i>	<i>fabric shoes</i>	<i>paint</i>
<i>coordination</i>	<i>national dist.</i>	<i>brand name</i>	<i>technology</i>
<i>batik dying</i>	<i>coordination</i>	<i>coordination</i>	<i>chemicals</i>
<i>dye supply</i>	<i>sewing</i>	<i>design, mktg</i>	<i>dye supply</i>
<i>fabric supply</i>	<i>batik dying</i>	<i>national dist.</i>	<i>coordination</i>
<i>brand name</i>	<i>fabric supply</i>	<i>local dist.</i>	<i>blending</i>
<i>distribution</i>	<i>brand name</i>	<i>batik dying</i>	<i>distribution</i>

LOW
strategic value

In each value-chains different resource markets can have different values. In one industry a rare technology may be the prime determinant of success for the entire the value-chain; in another a special combination of specialized machinery and know-how which may account for most of the success of this value-chain. Such resources are therefore strategically valuable and important. As a consequence, the same RMO will vary in strategic value from one value-chain to another.

For instance, in our example of the pagnes value-chain, our worker's association's resources have a high value because the pagne industry is a local industry where our batik making workers are the only ones with these skills.

Second, in the curtain industry, which is situated in the urban area, our association of batik workers has less bargaining power because of competition from other groups of workers in other regions. However, since the nature of the work requires highly skilled and competent workers, the resource market still remains midway in the hierarchy of resources in this particular value-chain. The function of supplying dyes in this value chain is absent because the organization prefers using artificial dyes which offer a greater variety of colors.

In the third value-chain, which is a multinational production network of fabric shoes, white fabric shoes are first produced in South-East Asia and then distributed in many southern and warm countries. The production network leaves firms in the countries where the shoes are distributed to decorate and dye them according to local preferences. The value of the contribution of the dying function resource market in this value-chain is smaller than in the previous value-chains because of the complexity and sophistication required by other functions in the making of fabric shoes. Our association cannot use their dyes supply function either because of the color fastness of natural dyes is not long-lasting enough; the color tends to wash away too easily.

In our last value-chain, our batik-making workers association has found an application of their dye supply function for a local artisan paint factory. The color pigment from the indigo plant is used as an input in paint making. In this chain

the function of dye supply again commands relatively high value because of the scarceness of the resource in the region.

b) Horizontal analysis

All of the resource markets of opportunity (RMOs) which have been identified in the vertical analysis are actually markets in which many firms can be competing.

The horizontal analysis therefore represents a market analysis which should be conducted for each RMO which has been identified in the vertical analysis.

In this analysis, the firm's competition in each RMO is examined in order to find out if it is possible for the firm to gain a market share which is worthwhile.

For example, if our association of workers wishes to enter the value-chain of the fabric shoes multinational organization, after having identified a resource-market of opportunity in its vertical analysis, (which is the batik-dying function), it must now evaluate its ability to gain a worthwhile market share within this resource market.

To this end, a first step is to examine the identity and composition of the competition amongst each RMO.

For example, in the batik dying resource-market of the fabric shoes value-chain, there are already five competing groups of rural batik dyers from other regions of the country, and one seemingly powerful group from the city. In the curtain industry there is one competitor. In the dye supply resource-market of the paint value-chain there is no other direct competitor, but the threat of the use of substitutes (or of chemical pigments) is arising with the arrival of a new importer in the city. Lastly, in the pagnes value-chain there are no other direct competitors for the batik dying resource market, nor for the dye supply, except again for the potential threat of the importer of chemical dyes in the city.

Secondly, the ability of the firm to gain a worthwhile market share will directly depend on its ability to win a competitive advantage (CA) over its competitors. Winning a CA is essential because it determines whether our firm can survive or not in face of competition within the RMO itself.

Barney (1991, p. 102) defines a CA as a firm's "implementing a value creating strategy not simultaneously being implemented by any current or potential competitors". In other words, a CA represents the standard of competitiveness which our firm must at least reach (or benchmark) , if not surpass, in order to win a decent resource market share. A CA therefore acts as a barrier to new entrants. The usual forms of CAs are cost or differentiation advantages (Porter, 1980). (see next step in framework)

Our firm must therefore compare its potential sources of CA against the competitors' sources of CAs in order to find which resource markets of opportunity could be 'benchmarked' by our firm.

The Resource-Based View of the Firm suggests that heterogeneity in firms' resource value and resource endowment explains variations in economic rent creation. This is also applicable to resource-market level competition. Our firm must therefore learn to identify its own specific skills, capabilities, learning experience or other special resources which could give it an 'edge' before it can assess whether it truly has a potential competitive advantage over its competitors.

For example, in the batik dying resource market of the fabric shoes value-chain, the most powerful group uses advanced and sophisticated equipment which makes their work of better quality. They are already starting to take some market shares from the smaller producers in the rural areas. It would therefore be difficult for our firm to 'benchmark' the CA of this rival, since our firm does not have any capital in its savings yet. It could however be feasible some time in the future.

In the dyes supply resource market of the paint value-chain, and in both the dyes supply and batik dying resource markets of the pagnes value-chain, since there is no direct competitor, then there is not any CA to benchmark. However, the new importer of chemical dyes poses a threat to our firm in the paint value-chain dye supply RMO. Most likely the firm's natural dyes will not be able to compete against chemical dyes since the latter offer a greater choice of colors and better color-fastness properties.

In the batik-dying resource-market of the curtains value-chain, the existing competitor has fewer workers than our association and cannot keep up with large orders. Moreover, their work is not as good because they do not have a long

tradition of batik-dying as our association has. It is therefore easy for our firm to win a CA over this rival.

Lastly, the firm must discern and identify the RMO(s) of it's environment in which it has the ability to out-compete its rivals with a competitive advantage (CA).

In conclusion, it is therefore most likely impossible for our firm to 'benchmark' the CAs of rivals in the fabric shoes and paint RMOs, but is likely to be possible in the curtains and pagnes RMOs.

3.2.3 Step Three: Drawing out the best resource-market(s) of opportunity (RMO).

This step discerns amongst all the identified RMOs the one which offers the *best* potential for our firm to integrate and compete successfully in.

The criterion used in vertical analysis is the strategic value of the identified RMOs. The criterion used in horizontal analysis is the firm's ability to out-compete its rivals with a competitive advantage (CA) in the identified RMOs. Besides these, two other criteria, which are the RMO's market size and growth rate, are added in this selection of the best RMO process.

An RMO's market size depends on the value-chain share of the RMO and on the size of the value-chain's end-product market. Its growth rate is directly related to the value-chain's end-product market growth rate. Both these criteria require some market analysis at the end-product-market level of our value-chain.

In the following table, the RMOs in each value-chain are evaluated according to such criteria for selecting the *best* RMO(s) for our firm. For example;

	<i>pagnes</i>	<i>curtains</i>	<i>fabric shoes</i>	<i>paint</i>
strategic value (vertical analysis)	<i>high (batik dying) medium-high (dye supply)</i>	<i>medium-low (batik dying)</i>	<i>low (batik dying)</i>	<i>medium-high (dye supply)</i>
ability to benchmark rivals' CA (horizontal analysis)	<i>yes (in both RMOs)</i>	<i>yes</i>	<i>no</i>	<i>no</i>
size	<i>very small (in both RMOs)</i>	<i>medium</i>	<i>very large</i>	<i>small</i>
growth rate	<i>decline</i>	<i>growth 10%</i>	<i>nil</i>	<i>growth 5%</i>

A careful analysis of such a table is required in order to select the *best* RMO(s) for our firm. This selection process assesses each RMO according to the criteria which are introduced in this section and eliminates the RMOs which are not fulfilling enough criteria. In this way we narrow down the possibilities until we find the best RMO for our firm.

The most important criterion we should first begin to examine is the result of our horizontal analysis: the firms' ability to win a CA over its competitors in each potential RMO. This criterion is essential because it represents the viability of the integration of our firm into these RMOs, or their ability to compete.

In our fictional case, this would mean that, as explained in the horizontal resource-market analysis of the previous section, integration in the batik-dyeing RMO of the fabric shoes value-chain and in the dye supply RMO of the paint value-chain are two possibilities which need to be eliminated.

Other criteria are examined after this horizontal analysis criterion.

In our example, we are therefore left with the three other RMOs: two (batik dying and dye supply) in the pagnes value-chain and another (batik dying) in the curtains value-chain.

The pagnes value-chain is now in decline because the already small market which it is serving is declining in growth. So, although both RMOs for our firm are of high strategic value and hold a high share of the production process (value-chain), their market size is small and, most importantly, it is in decline.

The curtains industry is showing prospects of growth because the production organizer has started to create links with distributors in Europe. The size of the RMO for our firm in this value-chain is now medium and the strategic value of the RMO is medium-low, but the prospects for exporting compensate. Moreover,

as mentioned in the vertical analysis, the possibility for our firm to benchmark the competitors with a CA is obvious.

Finally, the RMO which fulfills most criteria, as well as the most important criteria is selected.

A wise choice would therefore be for our association to select the batik-dying RMO in the current value-chain as their best RMO.

This selected *best* RMO represents the resource market which offers the best opportunities for our firm, in light of our firm's specific situational variables.

3.2.4 Step Four: Selecting and implementing a strategy for best exploiting a CA over the selected *best* RMO(s).

After having chosen which RMO(s) holds the best opportunities for our firm, this step will suggest strategies for our firm to win a competitive advantage (CA) over it (them).

Two sources of CA are normally found in strategic management literature: they are **lower cost advantages** and **differentiation advantages** (Porter, 1980).

Lower cost advantages are a form of competitive advantage which requires a firm to be a cost leader or lower-cost producer in the resource market. In order to win a lower-cost competitive advantage, the firm

must achieve parity or proximity in the bases of differentiation, while maintaining a lower cost advantage (adapted from Porter, 1980). Such lower cost advantages are obtained through the amortization and sharing of costs, or through efficiency in utilization and scale efficiency (economies of scale).

In our fictional example, this could mean that if our association of workers share the same dying equipment, using them to their maximum capacity, some cost advantage could be obtained over other competitors in the selected best RMO. This may result in obliging some workers to work at night and some during the day, but in the end the cooperative will be able to offer a product at a lower cost, which will also allow the cooperative as a whole to reap control over a greater share of the RMO.

A **differentiation advantage** is a unique competitive advantage which a firm offers to the resource market. To this effect, the firm selects one or more ways to answer market needs in a unique way (or differently from its rivals) and in a way which the market judges as important. The means for differentiation can vary in each resource market (adapted from Porter, 1980), and include:

- implementing the latest "best production practices" (just-in-time, lean production, flexibility, etc.)
- use of sophisticated productive technology
- use of personnel with good managerial skills
- use of information technology
- product innovation, R&D, technological capability, know-how, specific skills, capabilities

- patents, brand reputation
- superior inputs and market access, etc.

Such cost and differentiation competitive advantages can be won through strategies of sharing (Porter, 1987), networking (Amit & Shoemaker, 1993), acquisitions (Porter, 1987), alliances and linkages (Markides & Williamson, 1994), cooperative agreements, etc.

Some forms of organization, deployment, sequencing or combinations of firm resources can also become sources of competitive advantage. In fact, they can create synergy effects between complementary assets (Amit & Shoemaker, 1993), can "make the whole add up to more than the sum of its parts" (Porter, 1987), or can magnifying or enhance each other (Black & Boal, 1994), and create firm-specific capabilities (Amit & Shoemaker, 1993).

If we use our fictional example again, in the RMO which has been chosen (batik-dyeing in the curtains value-chain) our firm has a differentiation CA of having very skilled workers and the ability to respond quickly to large orders. Both of these CAs are due to the fact that workers have formed an association which allowed skills to be shared and a scale of operations large enough to respond quickly to large orders.

It is most unlikely that small economic units, such as MSEs, will initially and individually hold such CAs. However, strategies for winning a CA are more likely to succeed if MSEs are grouped into some collective form of organization such as clusters, associations, cooperatives, etc. Grouping their resources allows a necessary scale of operations for gaining

economies of scale and obtaining greater efficiency of utilization for winning low cost advantages, or for purchasing an asset or skill which can bring them differentiation advantages (e.g. sophisticated machinery), learning experiences, as well as collective bargaining power.

For example, in our fictional case, if both low cost advantages and differentiation advantages are gained by our firm, then their contribution to the resource market would be more valuable than that of rivals which are not grouped into some form of collective organization. If the contribution of our firm is more valuable than its competitors then it means that our firm will have won a competitive advantage over its rivals as well as over their market-share.

As a result, the application of this framework to the case of MSEs is most likely possible if MSEs are grouped in a collective form of organization.

3.2.4.1 Selecting a collective form of MSE association

This subsection identifies specific considerations for the creation of collective forms of MSE association.

Collective forms of MSE organization are essential for MSEs to win some of the different types of CAs which were outlined above. The ability to win such CAs determine the ability for MSEs as a collective to win control over their best RMO(s) and therefore gain a good revenue-generating ability as a whole.

Moreover, collective forms of organization can also become effective institutions to provide the infrastructure for achieving social objectives such as growth with equity and poverty alleviation.

The design, or selection of a form of collective organization should therefore be based upon competitiveness and social objectives.

The literature addresses specific areas of considerations which are relevant to the design of appropriate collective forms of MSE organization.

For instance, Michel Voyer, who is a private consultant in this area, has drawn a typology of various existing forms of micro-enterprise associations. According to him, 'there are as many forms of MSE associations as the imaginative abilities micro-entrepreneurs will allow'. Yet, according to Voyer, the usual factors to consider as a basis for building such micro-enterprise associations are: the ownership of the means of production, the decision power within the organization, and lastly the redistribution of profits (Giguère, Kalala & Trudelle, 1990).

Another aspect which should be taken into account when selecting a form of MSE collective organization is deciding which responsibilities will be collective and which will remain individual. Mahajan and Sen (1993) suggest that "given the dispersed nature of producer households in rural areas" (1993, p. 45), the extent of decentralization should be as great as possible. They suggest "decentralizing the stages of production which are scale neutral" (1993, p. 45). In other words, amongst all the activities which are under the control of the collective organization, the functions

which do not necessarily benefit from any advantage from being collective could remain under the control of small individual entrepreneurs.

These authors also point out that control over the collective enterprise is an important dimension to consider: "The extent of control by the target group over the enterprises can vary from them being only wage-earners in NGO-run enterprises to being full owners and managing all operations themselves" (Mahajan & Sen, 1993, p. 40). Similarly, the NGO or the assistance agency must decide on the extent to which it will act as a coordinator and regulator of the clustering and cooperating action of micro-enterprises.

Finally, since the organization should support social as well as growth objectives, modes of regulation should be promoted amongst collective forms of MSE organization. As such, the organizations should impose decent labor standards, and good standards of hygiene in the workplace, as well as other measures to ensure equality in treatment of its members along class, gender, and racial lines.

Without modes of regulation, individual workers might become exploited or a differentiation process might emerge where a few MSEs grow to become very large and end up stealing other MSEs' market shares. Another possible situation would be that the collective form of MSE organization might become a smaller subcontracting pyramid in itself where a few MSEs would exploit and rule over others.

Regulations, however, should not become too heavy or burdensome and should always be weighted against efficiency, growth, and competitiveness considerations.

3.2.5 Step Five: Ensuring the sustainability of the firm's competitive advantage

As the firm grows, it will be able to take more measures to ensure the sustainability of its competitive advantage.

To achieve this, it must re-orient its strategy in order to either get a higher market share within its selected *best* RMO(s), though gaining new forms of competitive advantages (CAs) or to climb up to enter new RMOs which are structurally more strategically valuable or important to the value-chain and therefore more apt to sustain the firm's CA. Strategically important RMOs should become accessible to our firm as its means or resources increase with time.

In the Resource-Based View of the Firm (RBVF), an important precept is that strategic resources are seen as being the basis for a firm to gain a sustainable competitive advantage (SCA). In other words, a strategy designed to win a CA must be based on a distinctive strategic resource if it is to be sustained over time.

Also, the RBVF assumes that opportunities for strategy formulation are based on firm-specific strategic resources. In contrast, our framework sees the value-chain and its resource markets as being external to the firm. The identification of strategically important resource markets is therefore also external to the firm. As a result, if we accept the RBVF's argument that the sustainability of a CA can only be based upon the firm's strategic resources, this framework will similarly argue that the sustainability of a

CA will also associated with the most strategically important resource markets of the value-chain.

In this case, a CA held by a firm competing in the most strategically important resource market will be more sustainable than CAs held by other firms competing in other less strategic resource markets of the value-chain. In other words, it would also mean that the more strategically important resource markets are, the more sustainable gaining a CA over them is likely to be.

For example, it is easier for a CA held by a firm competing in a sophisticated product design resource market to be protected and sustained than it is for a CA held by a firm competing in a simple manufacturing of parts (e.g. shoe laces) resource market. Barriers to the entry of new competitors in strategically important resource markets are higher than those in less strategically important resource markets. For example, an entrepreneur who wishes to enter the resource market of sophisticated product design might need to possess a degree in engineering, another in graphic design, and costly computer equipment. These requirements are cost barriers which help those already in place to keep their position. On the other hand, the resource market of simple parts manufacturing is more accessible for firms to enter because it requires a low level of skills, and the use of cheap artisan equipment. The barriers to entry in this case are rather low and therefore it is harder for the entrepreneurs already in place to sustain their CA over this resource market.

Thus, various resource markets in the production process carry different levels of CA sustainability, according to their degree of strategic value or importance. In fact, Hamel & Heene who are supporters of the RBVF believe that some competitive advantages (CAs) may be more sustainable than others, meaning that it will take the competition more time and effort to destroy the firm's competitive advantage (Hamel & Heene, p. 316).

As a result, this means that any resource market can at least hold some degree of sustainability in the CAs of its controlling firms. As much as the strategic importance of resource markets follow a continuum from low to high, the degree of sustainability of CAs gained by firms competing each respective resource markets also follow such a continuum. The objective, therefore, is to win a CA as sustainable as possible, in the firm's identified best RMO(s). Strategy formulation at any level is therefore suggested, rather than emphasizing strategy formulation only at level of the most strategically important resource markets.

Basic strategies for improving the sustainability of a firm's CA are dynamic measures such as engaging in asset accumulation processes (Markides & Williamson, 1994), developing the firm's resource base (Grant, 1991), innovating continuously, or gradually shifting the basis for competitive advantage from basic to advanced factors of production (Michael Porter in Grant, 1991).

Even if these strategies do not enable the firm to immediately get control over the most strategically important resource markets of the value-chain, these strategies can at least allow our firm's CA to be increased in it's

sustainability, at any level in strategic importance that the firm's best RMO may actually be situated in the value-chain.

3.3 Conclusion

This resource-market level framework for strategy formulation is appropriate for the 1990s because it is adapted to a new industrial context where firms, including MSEs are increasingly integrated in larger production networks and competing at the resource-market level. In fact, the framework is applicable to any firm that can find an opportunity to compete as an input in any larger production system in its environment.

With in this framework, the issue of exploitation that was raised in Chapter Two, is being dealt with, since it enables MSEs as a collective (as the 'firm') to win greater horizontal market shares in resource markets as well as higher revenue-generating ability and sustainability in their CAs as they gradually move upwards into RMOs of higher strategic value.

By enabling firms to identify and win a CA over the resource markets of its environment which present the best opportunities in relation to specific situational variables, firms are not confined to the traditional dependent and low-revenue position of subcontracted manufacturing. Other resource markets in the value-chain such as raw material supply, distribution, etc. could be offering better opportunities for our firm and should therefore become a RMO. It all depends on the situational variables.

An interesting aspect of this Resource-Market level Framework for Strategy Formulation is that it provides the firm with both the identification of opportunities in resource markets and strategies to win a SCA in a way which is especially tailored to the firm's own resources and environment. In this sense it considers firm-specific, industry-specific, market-specific and competition-specific situational variables.

Specific considerations have also been taken into account to ensure the applicability of the framework to MSE assistance, including that the framework can be applied to a wide variety of small firms. The framework therefore becomes accessible even to the smallest or resourceless firms, because if grouped in collective organizations there may still be a possibility of entry at least in the resource markets of lowest strategic importance.

Collective forms of MSE organization are not only means for obtaining collective strength or access to some competitive advantage, but are also fulfilling some other development needs such as creating fair employment conditions, encouraging the value of co-operation, as well as reducing poverty and income inequalities.

CHAPTER 4 - Existing Approaches of Assistance to MSEs and to MSE Development, and their Comparison with the Resource-Market Approach.

4.1 Introduction

This section will begin by briefly describing the forms of assistance most frequently used by MSE development organizations. These forms of assistance have been termed 'missing-input' strategies (Mahajan & Dichter, 1990). Following this, more complex and sophisticated approaches to MSE development, the Flexible Specialization and Subsector approaches, will be summarized and compared with the Resource-Market approach.

4.2 Existing approaches

4.2.1 'Missing - input' Strategies

The most common type of assistance to MSEs results from a missing-input strategy, which usually involves provision of credit at subsidized rates, or micro-loans.

Amounts loaned can be as low as US \$12 to \$25. However, most are within the \$50 to \$250 range. These loans are often granted to 'solidarity

groups' which are mutually responsible for repayment (Mann, Grindle & Shipton, 1989). Examples of such credit-led assistance are found in organizations such as *Accion International/AITEC* of the U.S., the *Grameen Bank* of Bangladesh, *Women's World Banking*, the *Calmeadow Foundation* of Canada, the *SEWA* (Self-Employed Woman's Association) *Bank* of India, etc. (Mann, Grindle, Shipton, 1989).

Other more integrated packages of assistance may include some or many of the following extension services:

- vocational training, provision of technical and management skills such as bookkeeping, market feasibility, etc. Such services are provided by government training agencies or other organizations, e.g. *Calcutta 'Y' Self-Employment Centre*, *Sarvodaya* in Sri Lanka, etc. (Mann, Grindle & Shipton, 1989) (Stanton, 1993).

- appropriate non-labor replacing technology, technological assistance, upgrading production methods offered by, e.g., *Appropriate Technology International* of the US, *International Development Research Centre* of Canada, the *Intermediate Technology Development Group* of Britain (Husbands, 1991; Stanton, 1993).

- business incubators which provide facilities and services such as working space, skills, access to credit, trade and market information, etc. The *UNDP's programme of assistance to business incubators* is involved in this area.

- alternative marketing channels, as provided by, e.g., *The Thai Chamber of Commerce*, *The Nepalese Cottage Industries Export Development Project*, the *International Trade Centre* in Geneva, the *Center for the Promotion of Imports from Developing Countries* in Rotterdam, *Oxfam Trading International* (Pye, 1988), and *Bridgehead International* in Canada.

- government incentives such as eliminating policy biases against MSEs (policy reform), removal of restrictive legislation, legal standards and promoting policy biases in favor of MSEs such as the reservation of certain industries or products to be manufactured by MSEs. Institutions involved in this include the *Small Industry Development Programme of India* (Nanjundan, 1992), the *Korean Small Industry Sub-Contracting Act* (Nam Dae Woo, 1993).

- infrastructure facilities such as land, power, and water, appropriate sites and locations, and the creation of marketplaces for microenterprises' products.

- government policies which promote vertical and horizontal linkages between small, medium and large industries through organizing seminars, meetings, exhibitions, etc. This is the concern of, e.g., the *Korean Small Industry Sub-Contracting Act* (Nam Dae Woo, 1993), and the *Small Industry Development Organization in India* (Dhungana, 1993).

4.2.2 Flexible Specialization

A recent academic development in the field of MSE assistance is a 'small firm variant' of the Flexible Specialization concept as an approach of assistance to MSEs. This approach organizes MSEs into clusters which adopt flexible and specialized production methods. The approach was conceived as a way of responding to new requirements for competitiveness in changing markets.

The Flexible Specialization (FS) concept, which was originally defined by the authors Piore and Sabel (1984), explains recent developments in industrial organization as experiencing a decline of mass production, leading to new 'Post -Fordist' forms of industrial organization which are less rigid and more flexible. This Flexible Specialization concept considers that the internationalization of business, the rise of trade liberalization, and the internationalization of capital markets, have led to a new international environment composed of changing and segmented markets. The logic of this concept is therefore that flexibility is required to compete in changing markets while specialization is required for segmented markets (Van Dijk, 1993).

The belief of the 'small firm variant' of the Flexible Specialization concept is that small firms can actually benefit from this new competitive environment if they respond by clustering into industrial districts. The organization of small firms into industrial districts allows the emergence of collective efficiency, flexibility and innovation gains which are necessary for competitiveness in segmented and rapidly changing

markets. It is believed that the ability to respond with flexibility and innovation is a characteristic which is intrinsic to small firms.

Industrial districts represent the clustering effort of small enterprises. They can be defined as "productive systems characterized by a large number of firms that are involved at various stages and in various ways in the production of a homogeneous product" (Van Dijk, 1993).

Pyke and Sengenberger, who are from the ILO's International Institute for Labor Studies, propose a definition of industrial districts which is slightly different. According to them, industrial districts are a collective network of small firms belonging to the same industrial sector which includes all upstream and downstream processes involved in the manufacture of a family of products. Ceramic goods or knitted clothes are examples of such industries (Pyke & Sengenberger, 1992).

In summary, industrial districts are composed of:

- a large number of entrepreneurs, micro and small specialized firms sited in one locality;
- co-ordinated into networks across phases of the production chain;
- possessing vertical and horizontal linkages among them;
- using multi-purpose equipment and exchanging skills through collaboration and cooperation;
- benefiting from a strong inter-firm division of labor and scale/scope economies;

- relying on innovation to follow changing markets, a flexible labor force and flexible production networks, dynamic efficiency, and a permanent process of industrial restructuring and spatial reorganization;
- finally, using a strategic orientation to choose the terrain (or industry or sub-sector) on which to compete (Van Dijk, 1993).

Schmitz argues that the key to small firms' success in the industrial districts lies in their clustering or joint action, which leads to local external economies or 'collective efficiency' advantages (Schmitz, 1992).

4.2.3 Subsector Approach

The Subsector approach represents an important advancement in the field of assistance to MSEs since it is concerned with delivering a more efficient, better-targeted and cost-effective assistance. It is a 'branch-specific' (Schmitz, 1982) view, in contrast to the previous 'cross-section' (Schmitz, 1982) or 'cross-industry' (Boomgard, Davies, Haggblade, Mead, 1992) views that cover all types of small enterprises in different industrial sectors.

The branch-specific view believes that cross-section assistance measures are too uniform. It also argues that the views which consider small-scale enterprises as a homogeneous 'sector' greatly miss out on opportunities and constraints for MSE growth which are specific to industries, sub-sectors or branches of the economy. In fact, Schmitz (1982) rightfully argues that "what is of concern to the small-scale weavers are the actions

of the large weaving firms, not what the small shoe-makers or street-sellers do" (1982, p. 443).

The Subsector approach is a 'diagnostic and prescriptive' research methodology (Boomgard, Davies, Haggblade, Mead, 1992, p. 200) which targets cost-effective assistance to MSEs in the vertical production and distribution system of a single product group, or what it calls a subsector. It recognizes the trend of MSEs towards specialization, or their need to restrict their activities to a few functions (Mead, 1992, p. 35) and to operate within a vertical production and distribution system (Boomgard, Davies, Haggblade, Mead, 1992).

The diagnostic aspect of this Subsector approach seeks to identify sources of leveraged intervention. Leveraged interventions are those that will benefit a great number of MSEs of a single subsector 'in a single stroke'.

Government policies (Mead, 1992, p. 41) such as taxation geared towards discriminating against small firms can be an obstacle to the growth of MSEs and therefore, if removed or reformed, can also become a source of leveraged intervention.

'System nodes' are another kind of obstacle or bottleneck and therefore a source of leveraged intervention. They are usually the critical functions in the chain upon which many small enterprises may depend, or points at which large volumes of product pass through the hands of a few actors (Haggblade & Gamser, 1991, p. 49). System nodes can often be large wholesalers or input suppliers (Boomgard, Davies, Haggblade, Mead,

1992). An example of a system nodes manifesting as a source of leveraged intervention was when a large Javanese exporter was provided with increased means in order to indirectly open new market opportunities for small crafts workers in villages in central Java (Gamser, 1992, p.44).

Another example was a case in which the quality of malt from two commercial malsters was improved in order to increase the number of potential small home brewers (Boomgard, Davies, Haggblade, Mead, 1992).

A third source of leveraged intervention is geographic clustering as a means to "ensure access to key inputs and market output, or because of zoning regulations, ethnic segregation, or historical happenstance" (Haggblade & Gamser, 1991, p. 49).

The approach therefore consists in seeking and identifying highly leveraged intervention opportunities which have the greatest impact on the largest number of firms in a vertical production/distribution system.

4.3 Comparison with the Resource-Market Approach.

4.3.1 Missing-input

The first category of assistance to MSEs introduced in this chapter are 'missing-input' strategies. These include the provision of one or several of the following inputs: credit, technology, skills and raw materials.

Some agencies using missing-input strategies argue that credit is the input which MSEs mostly need. Others support the view that technology is the input most needed, and others stress that the need is for skills. Some agencies may provide more integrated packages than others. Basically, however, the problem left unsolved by these strategies is that they over-generalize regarding the needs of individual MSEs.

Beyond this, in a context where markets are demanding products which are the result of 'complex integration strategies', and where networks are busy coordinating individual functions of the production process controlled by a great variety of firms, MSEs must also be equipped with competitive means to enter these production networks. Since the missing-input approaches do not adequately take specific situational variables into consideration, their assistance may not provide small firms with the necessary business strategy tools to enter networks and survive in them competitively.

In contrast, the Resource-Market approach argues that the ability of MSEs to enter production networks, and to survive in them competitively, will strongly depend on developing a strategy which takes into consideration certain situational variables specific to both the firm's resources and its environment.

4.3.2 Flexible Specialization

The Flexible Specialization concept is interesting because it acknowledges some changes in industrial forms of organization. The Flexible

Specialization interpretation of these latest trends in industrial organization are perceived to follow a transition from 'Fordism' to 'Post-Fordism', i.e., a shift from mass production of homogeneous goods to networks of smaller, more specialized, flexible units using multi-purpose machinery for a production which is adaptable to changing markets.

However, in comparison to the findings regarding new industrial restructuring events described in this thesis' chapter two, it seems that the Flexible Specialization concept has over-simplified the disintegration trend of the production process into networks of smaller units. In fact, this thesis goes further in its analysis of the disintegration trend, to show that the trend now follows an extreme division or even breakdown to the smallest component (or resource) level, by outsourcing (or subcontracting) each resource where there is the greatest competitive advantage for doing so.

As an approach of assistance to MSEs, Flexible Specialization assumes that, if firms become organized in specialized and flexible industrial districts or clusters, they can manufacture goods in a way which fulfills the competitive requirements of the market.

In this context, manufacturing is a function which is presumably performed by such industrial districts. Pyke and Sengenberger even assume the vertical integration of the entire production process to be internalized by these industrial districts.

Yet, such assumptions are not always right because, amongst all the functions in the value-chain, manufacturing may not automatically be the one which presents the best opportunities for such industrial districts. Nor does any other function of the value-chain. Rather, the best function that could be undertaken by the industrial district depends on situational variables which are industry-specific, firm-specific, market-specific, competition-specific, etc.

Further, Flexible Specialization as an approach also believes that flexibility and specialization are competitive advantages necessary for changing competitiveness requirements. Again, this may be true in some, but not necessarily all cases.

A major difference between the Flexible Specialization and the Resource Market (RM) approaches is precisely the understanding that competition occurs at the resource market level. In fact, the Resource-Market approach emphasizes that each resource (or function) in the production process represents different markets of opportunity, each with a different strategic value and different competitive advantages to surpass. The selection of the firm's 'best' resource market of opportunity (RMO) therefore changes according to such specific situational variables. For example, in one case distribution may be the resource market that offers the best opportunities for the firm (or the industrial district); in another it may be the supply of raw materials.

Therefore, it cannot be assumed, as in the Flexible-Specialization approach, that the best RMO for the industrial district is always the

manufacturing function or even the vertical integration of the entire production process. Further, competitive advantages other than flexibility and specialization may be needed. Each market has different competitors and therefore different requirements in terms of competitive advantages which will need to be benchmarked.

Consequently, only when analysis is based at the resource-market level of competition can the best RMOs be selected and the necessary competitive advantages be identified.

The Flexible Specialization approach is therefore deficient, first because it over-generalizes in its interpretation of industrial restructuring and secondly, because it lacks a resource-market level of analysis which prevents it from finding the best RMO for its industrial districts and from identifying the type of competitive advantage the districts would need to compete successfully in the chosen market.

4.3.3 The Subsector Approach

The Subsector approach is 'branch-specific' because it takes into account conditions which are specific to a branch of the economy, industry, or sub-sector. It is therefore more specific or less general than the Flexible Specialization approach. In this sense it is an improvement upon the Flexible Specialization approach. More than that, the Subsector approach's recognition that many firms can be involved at different functions of the production process and its analysis of the linkages amongst such actors is also relevant. However, the ways to overcome

'bottlenecks' or 'system nodes' suggested in the Sub-sector approach have not been developed appropriately.

A first aspect which has not been developed appropriately relates to the 'removal of the system nodes'. The Subsector approach supports the view that giving assistance to the actors which control 'system nodes' should result in opening new opportunities for more MSEs to enter the production chain (Boomgard, Davies, Haggblade, Mead, 1992). It should be noted that, since system nodes are usually the critical functions in the chain upon which many small enterprises may depend, they also are, in other terms, the strategic functions of the value-chain. Therefore, further assisting the few monopolistic firms which already control these critical functions is only granting them more power over the other actors which hold less critical functions in the vertical production/distribution system.

Accordingly, a major difference between the Resource-Market approach and the Subsector approach is that the latter does not intend to disrupt the existing power structures in the vertical production/distribution system to benefit the numerous small enterprises which do not control critical functions or 'system nodes'. The Subsector approach does not seek to shift control of system nodes in the vertical production and distribution system into the hands of MSEs and thereby reduce the power imbalances in their favor.

In contrast, winning control over these critical functions, or at least of functions which are more critical than those which MSEs originally controlled, is an essential goal of the Resource-Market approach.

Furthermore, the Subsector approach's 'bottlenecks' or 'system nodes' are actually considered as 'barriers to entry' or as being the highest competitive advantage (CA) which needs to be 'benchmarked' in the Resource-Market approach.

The Resource-Market approach supports the use of strategies which will enable MSEs to overcome barriers to entry by pursuing a strategy which will enable firms to win a competitive advantage. In contrast to the Subsector approach, the Resource-Market approach promotes the notion of successfully competing against competitors rather than artificially 'removing' the bottlenecks or system nodes. The Resource-Market approach believes that it is more realistic and sustainable to overcome a barrier in a competitive and economically sound way, since barriers to entry are mostly due to market imperfections.

Further, the Resource-Market approach argues that by competing directly for those key, critical, or strategic resource markets, MSEs can collectively win control over them and thereby internalize higher revenues, instead of always occupying a dependent and low-revenue generating position in the chain.

The Subsector approach thus fails to emphasize increasing MSEs' value-added share from the production process. Rather, it emphasizes maximization of the number of MSEs that could benefit from the intervention.

A final difference between the Resource-Market and Subsector approaches is that whereas the subsector approach uses verticality as a dimension of analysis, it does not have a horizontal dimension to its analysis, where competition and CAs are assessed at the level of resource markets.

4.4 Conclusion

The foregoing analysis emphasizes that in the missing-input approaches, there is a fixed notion of which input should be provided. The Resource-Market approach, in contrast, adopts a more flexible and closely tailored view which recognizes that the notion of market identification and strategy formulation must be contingent upon firm-specific and environment-specific situational variables.

Both Flexible Specialization and Subsector Approaches recognize the trend of increasing specialization and co-operation between firms. They understand the need for networking to obtain collective efficiency. They also recognize that many firms are required to participate in production processes. Further, they are aware of the need to view the activities of MSEs in the light of larger networks, and to examine the nature of the linkages so established. However, both approaches have not expressly accepted competition at the resource market level.

If the Flexible Specialization approach were to recognize competition at the resource market level, it could give more strategic orientation to its 'industrial districts'. For instance, such a recognition would enable it to

select a resource market which could present the best opportunities for the district according to situational variables such as the district's own capabilities or resources and opportunities in its environment. It would not automatically presume that industrial districts must assume the function of sub-contracted manufacturing with the use of multi-purpose equipment. Rather, it would find other functions or resource markets in the production process which may present better opportunities, depending again on the district's own situational variables. Moreover, it could also assess whether flexibility or specialization are really the necessary CAs for the district's selected best RMO.

The Resource-Market approach argues that small units of production need to be grouped into collective forms of organization. This would enable them to gain the necessary competitive advantages in order to compete in resource-markets. However, the fact that they congregate to obtain certain competitive advantages is not sufficient. They must also assess the forces involved in their external environment, and select a market(s) in which the collective form of MSE organization can compete successfully and sustainably. The selection of such a best RMO takes into consideration many situational variables regarding the firms' resources and environment. These points are also omitted in the analysis offered by the Flexible Specialization approach.

The Flexible Specialization approach therefore differs from the Resource-Market approach in its failure to prescribe resource-market level measures for market identification and strategy formulation.

Similarly, if the Subsector approach would recognize a resource-market level of competition, its diagnostic and prescriptive abilities could also be improved. It would find strategic ways to overcome those 'system nodes' (which are in fact 'strategic resource markets'), by designing a strategy for winning a CA over them.

In conclusion, the following two points must be emphasized. First, the Resource-Market approach has a unique advantage over the previously examined approaches. This advantage is that it offers a framework for MSEs to compete in resource markets and thereby fills the deficiencies inherent in the existing approaches by offering a more accurate analysis on account of its resource market level perspective and a more contingent intervention which is adapted to situational variables.

Secondly, it bears repeating that only resource-market level strategies can enable MSEs to win more rent and bargaining power in strategic resource markets of larger production networks. Without having strategies based at the resource-market level, existing approaches are therefore inadequately geared for a qualitative intervention in terms of helping MSEs earn greater shares of revenues from the production process.

CHAPTER 5 - General Conclusion

The increasing globalization, liberalization, privatization and deregulation of domestic markets in the 1990s has led to a general global situation where an increasing number of small enterprises are working as subcontractors to the large-scale sector, and an increasing number of workers are employed through subcontracting. Yet, studies also demonstrate low terms of trade and working conditions resulting from such an integration.

This thesis has proposed to tackle this problem by suggesting a resource-market approach to MSE development. Its main argument is that a resource-market level of analysis and strategy formulation is essential for the successful and competitive integration of MSEs in larger production networks.

Recent trends in corporate strategy and industrial organization in production were examined in Chapter Two. A general trend of vertical disintegration of the production process and specialization of firm activities at the level of resource-markets was found. The conclusion that competition between firms has shifted from end-product markets to resource markets was thus drawn. Assymetry in the strategic value of different resource markets was demonstrated and argued to be the cause of the low-revenue generating and bargaining ability of MSEs which are integrated in larger production networks.

Chapter Three introduced the Resource-Market level Strategy Formulation Framework for MSEs. This procedure for strategy formulation helps firms to identify resource markets of opportunity (RMOs), implement a strategy to win a competitive advantage (CA) over such markets, and over time, win sustainability in their CA by climbing up into RMOs of greater strategic importance. The framework also includes specific considerations for the creation of collective forms of MSE organizations in the context of MSE assistance.

Finally, Chapter Four compared the Resource Market approach of assistance to MSEs with other existing approaches. In general, it was found that the RM approach was more adaptable to each case of assistance because of its consideration for firm-specific, industry-specific, market-specific and competition-specific situational variables. Each resource market faces different situational variables in relation to its context and therefore only an adaptable or contingent approach can find the most appropriate strategy for a given situation. Further, since other approaches have not expressly accepted competition at the resource-market level, their strategies are not adapted to the new shift in the basis for competition between firms.

In conclusion, this thesis provides a more concrete or appropriate approach for the successful and competitive integration of MSEs into production networks because of its analytical perspective and intervention strategies which are based at a resource-market level of competition. Further, it is also argued that by successfully competing in resource markets of greater strategic importance, the Resource-Market approach

can effectively help MSEs get better revenue-generating and bargaining power in relation to production networks.

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