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Countering Overseas Power in Global Value Chains: Information Asymmetries and Subcontracting in the Plastics Industry☆

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ABSTRACT

Resource Dependency Theory (RDT) and Global Value Chain (GVC) analysis have been deployed in the strategic and international management literatures to address questions of power in dyadic relationships and global production networks, respectively. This paper integrates the two theoretical approaches in order to expand RDT, using insights from Hirschman's exit/voice model to show the options available to some firms but not others. Using the relationship between buyers and contract manufacturers from GVC analysis, we find a correlation between firm size and choice of strategic action in response to contract manufacturers' dependence on buyers. Large firms follow an acquiescence strategy while small manufacturers follow an avoidance strategy, able to use both exit and voice strategies. Enabled by scale or control over information, both of these approaches successfully reduce uncertainty and provide a source of sustained competitive advantage. Using a study of the production chain in consumer plastics manufacturing in China, we show how dependent firms respond to GVC induced pressure. We find that based on the size of the contract manufacturer, the range of strategic responses to power is constrained by the nature of the dependency in global value chains. This opens important insights into the role that structural characteristics of organizations (like size) play in determining strategic freedom.

1. Introduction

The global fragmentation of production and subsequent rise of lead firm (buyer) driven global value chains has been the subject of international business, political economy and economic sociology research for the last twenty years (Gereffi, 1996, 1999; Gereffi et al., 2005; Gereffi and Luo, 2015; Gibbon et al., 2008; Neilson et al., 2014; Sturgeon, 2002). Much of the research addresses the questions of who has power in global value chains (GVC) at the firm, industry, and state level. Depending on the unit of analysis, the literature mostly confirms that lead firms and, at the macro-level their home countries, tend to have the strongest bargaining position, and hence power, in GVCs.

The interest in power suggests the utility of integrating the insights of GVC analysis with Resource Dependency Theory (RDT). Since the 1970s, RDT has offered an explanation for the role control over critical resources plays in the power dynamics within dyads of organizations and the responses organizations undertake to counter the power of controlling organizations (Aldrich, 1979; Casciaro and Piskorski, 2005; Dalziel et al., 2011; Davis and Cobb, 2010; Frynas et al., 2006; Galang, 2012; Getz, 1997; Hillman et al., 2009; Mellahi et al., 2015; Pajunen, 2006; Pfeffer, 1972a, 1972b; Salancik, 1979; Pfeffer and Salancik, 1978). More recently, RDT has

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become a common theoretical tool for analyzing the behavior of corporate boards and firm-subsidiary relations in international business (Lai et al., 2012; Schotter and Beamish, 2011; Du et al., 2015). We continue in this stream by integrating insights from both RDT and GVC analysis.

Based on an inductive study of contract plastics manufacturers in Dongguan and Shenzhen, China, we find that both GVC and RDT analysis can be enriched through integrating their insights in light of our fieldwork. Large and small contract manufacturers in global value chains utilize differing strategic responses to ensure continued access to critical resources – overseas contract orders – and to blunt the controlling influence of their overseas buyers. As the size of the firm appears to be the salient variable determining the differing approaches to strategically responding to power, through our study of the actual responses of contract manufacturers to their condition of dependence, we expand RDT's understanding of strategic responses to power by introducing firm size as a variable. We also extend GVC analysis by showing that within GVCs, firms in the lowest value-added stages may deploy different strategies to secure sustained competitive advantages.

Existing research has acknowledged the role of firm capabilities and industry or task characteristics in determining the behavior of firms. However, to the authors' knowledge, this is the first attempt to consider not just the capabilities of the firms but their actual size as the salient variable shaping their responses to external organizations' control of critical resources. This paper develops this understanding and contributes to RDT and GVC theory as follows. We first introduce both GVC and RDT theory, calling particular attention to the role of power in both and the uncertainty-reducing strategies firms adopt. We then provide our research methodology. Third, the paper presents the case study of large and small contract manufacturing firms in the plastics industry, considering the different strategies they deploy to address the uncertainty of critical resource access they face. We then draw our conclusions and implications for theory and future research.

2. Literature review

Global value chains have been the subject of extensive research for over two decades (Gereffi, 1996, 1999; Gereffi et al., 2005; Gereffi and Luo, 2015; Gibbon et al., 2008; Neilson et al., 2014; Sturgeon, 2002). According to GVC understanding, under the current version of globalization, much international trade (particularly in goods, but also in some types of services) occurs through globally dispersed value chains consisting of branch factories of MNEs as well as independent contracting firms providing production services at different stages in the production process. GVCs are geographically dispersed production systems for different types of goods including their various components and related services (Gereffi, 1996). Mudambi (2008) expanded upon the production chain conception of GVCs to include strategies for the management of knowledge assets through either globally dispersed specialized firms or globally dispersed vertical integration.

GVC analysis shows the distribution of gains in global production networks: lead firms, also called orchestrators, and those producing the most valuable components – as determined by the specialized knowledge required in their development and production – take the largest share of rents (Gereffi et al., 2001; Mudambi, 2008). Suppliers of commodity components and final assemblers – as well as the countries in which these activities take place – have much lower returns as their profit margins are much smaller. Within the GVC for production of the iPad tablet, for instance, Apple – the lead firm – receives 30% of the wholesale value as profits. High valued component providers account for a further 17%. All materials from hundreds of vendors account for 31% and labor value from final assembly only 2% (Kraemer et al., 2011). While lead firms often themselves are not the producers of goods in GVCs, they set the prices and terms under which production takes place. With the ability to set prices, the lead firm has power over the other firms in the value chain.

In addition to this general power structure, GVC analysis argues there are different governance structures for various types of global production systems. The combination of task complexity, knowledge codifiability, and contractor capability determines the type of governance structure at work (Gereffi et al., 2005). Under the general conditions of powerful and less powerful actors, the type of governance largely determines the behavior of organizations within the production chain. Both buyers and contractors may be highly autonomous as in market governance structures. Here, capabilities for all are high and switching costs are low as the tasks are simple, thus granting the highest degree of strategic freedom to all actors. In contrast, where contractor capabilities are most limited – that is knowledge is highly tacit, the governance structure is entirely dependent as in a hierarchical governance structure. For sourcing light manufactured goods in Asia – such as the consumer plastics industry studied here – it would appear to be a case of market governance.

The plastics industry in the cluster we studied produces consumer plastic goods and components. The consumer goods produced include plastic toys, kitchen items, or reusable bottles. These firms receive orders from international traders or directly from overseas buyer firms – or their sourcing representatives – and fill the orders before shipping the completed products directly to warehouses in the destination country. Components firms produce casings for electronics or power tools as well as the internal plastic parts for electronics. Component manufacturers supply locally-based assemblers who integrate the plastic and metal parts of the final goods for shipment. The plastic materials used by the firms under study are universally available bulk plastics which are purchased from wholesalers, not proprietary or unique formulations. Designs for the products or components are provided by the overseas buyers or the final assemblers when subcontracting the plastics work. The main value added by these firms is their labor as well as, for some of the firms, the skills and equipment required to produce the molds for the plastic goods or products.

Since the materials are not unique, the designs provided, and the value-added primarily coming from labor, the tasks in the plastics cluster are relatively simple and highly codified. Hence, they have low knowledge intensity and are easily imitated. Both the Dongguan-based suppliers and overseas buyers should be highly interchangeable given the codified nature of the work. This would suggest a market governance structure in the GVC. However, as will be shown, the insights from RDT help show why, despite the