SME Clusters and Responsible Competitiveness in Developing Countries

AccountAbility with UNIDO[1]

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Contents

Executive Summary

This report examines the convergence of three important issues: cluster development, responsible business practice, and business and national competitiveness. Specifically, it identifies the implications of responsible business practice on the performance of SME clusters in developing countries. There are thousands of industrial clusters in developing countries. Will growing demands for health and safety, environmental management and community involvement drive these already struggling clusters into a cycle of desperate competitiveness?

This report suggests that SME clusters can, instead, *develop a model of responsible competitiveness, where collective action enables simultaneous improvements in business results and social and environmental impacts*. The research, by AccountAbility for the SME Branch of UNIDO, assesses seven in-depth case studies from Africa, Latin America and Asia, as well as a range of other cluster examples from the literature, and interviews with 40 leading experts.

Many clusters evade responsible business practices, either because the 'corporate responsibility (CR) agenda' is judged to be relevant only to large / European companies or because local regulations are felt to be too difficult. In other cases, individual companies identify a business case and develop or adopt improved social and environmental practices, but the impact on the competitiveness of the cluster as a whole is uncertain.

But the report identifies examples of how, under the right conditions:

- Responsible business practices can help support upgrading in existing clusters, and even create the trust needed for new clusters to form.
- Businesses working together in clusters and multi-sector partnerships have achieved social and environmental improvements unavailable individually.

The spur to cluster innovation is often compliance with international codes of conduct on labour standards or environmental management, which are increasingly being targeted at SMEs in developing countries. But competitiveness can also be enhanced through home-grown initiatives that address local needs or create new markets. *In either case, responsibility initiatives will improve overall competitiveness only if they build on existing social networks, build trust and are seen as key to survival.*

Policy-makers now seek to enhance competitiveness by shaping business sector strategies and practices, and the context in which they operate, to take explicit account of their social, economic and environmental impacts. In countries like Cambodia (textiles), Chile (fruit) and South Africa (wine), such strategies involve *partnerships between groups of SMEs, NGOs, global buyers, local and national government, as well as international financial institutions, in 'responsibility clusters'*.

What do the cases show? Firstly, clusters can offer a *useful entry point for agencies seeking to encourage responsible business practise*. Some of the case studies involve external agencies in initiating CR initiative either through trade agreements (Cambodia) or national competitiveness strategies (El Salvador), although one highlighted the role that a dynamic local initiator could play (Colchagua, in Chile).

Secondly, working collaboratively within a cluster, SMEs are able to *take advantage of market opportunities that they could not achieve alone*. Performing clusters have moved from seeing social and environmental challenges as risks to their survival, to trying to turn them into market opportunities by working to improve their industry's reputation internationally (such as the Sialkot surgical instruments example).

Thirdly, cluster approaches can *reduce the pain barrier of cost and risk*, **and adapt international tools and standards for local contexts**. Several responsibility clusters concentrate on shared monitoring or certification systems which reduces cost and increases learning (as with the Wine Industry Ethical Trade Association in South Africa).

Finally, responsibility pressures provide an external challenge which *catalyses collective action, dialogue, trust and capacity building* within clusters and with other linked organisations and sectors (all the cases).

How can cluster development agencies and those promoting business responsibility best work with SME clusters? The report suggests there are five key components to the development of responsibility clusters:

1. **External support** from outside the local business sector can often be a key factor in catalysing the development of responsible clusters, but initiatives also rely on dynamic local champions and informal as well as formal local networks.

2. Responsible cluster initiatives should be designed to respond effectively to specific **challenges and market opportunities** that the cluster faces in the short term.
3. Development of **appropriate standards** is a key part of the response of local clusters to international pressures to demonstrate responsible business practises. This should be driven by cluster requirements not by consultant preferences or global standard setters' ambitions.
4. Responsibility cluster initiatives should focus on **local capacity development** to overcome the obstacles of meeting higher standards of social and environmental performance.
5. **Effective collaborative governance** is crucial to allow clusters to seize responsible business opportunities. This refers as much to informal social networks as to more formal cluster institutions.

The report concludes by proposing a seven step programme for promoting responsibility clusters, combining research, pilot projects and communication. These are:

1. **In-depth on-the ground research** with existing and emerging responsibility clusters to understand the dynamics of cluster development and collaborative governance.
2. **South-South learning** sharing this experience with other industrial clusters that have not yet taken on responsible business issues.
3. **Identify opportunities** with these clusters for addressing responsible business issues.
4. **Work with clusters** to pilot an approach to responsible cluster development based on market opportunity analysis, standards development and capacity building.
5. **Build capacity in local & national organisations** such as business schools to deliver ongoing support and services to clusters outside of the industry-specific pilots.
6. **Share learning and experience internationally** through a high-level report and symposium.
7. **Build links** and continue to share information with other ongoing cluster development and responsible competitiveness initiatives.

1 Understanding the Dynamics: Business Responsibility and Clusters

1.1 Introduction

The conventional economic view of firms as atomised, individual entities, responding to price signals to efficiently employ resources and create the products that people want, is a powerful tool for policy makers and business people alike. However, persistent poverty and pervasive social and environmental problems highlight the failure of policies based on this model to deliver on the promise of business-led development.

Three streams of thinking have emerged in recent years to better understand the complex dynamics that affect companies and markets. They have highlighted the ways that business decisions, actions and ultimate impacts are influenced by:

- ✓ **Societal expectations.** The drive towards *corporate responsibility* has focused on the rewards (in terms of for example cost savings, risk and reputation management, meeting consumer demand, and learning and innovation) that companies can reap by understanding changing stakeholder expectations and investing in better management of their social and environmental impacts.
- ✓ **Local business partners and competitors.** The recent interest in *industrial clusters* has highlighted the role of the local economic environment in terms of firms trading and competing together in ways that strengthen the ability of individual companies to thrive.
- ✓ **The business environment.** The field of *competitiveness* focuses on the key factors which underlie business success at a regional and national level; in particular the health of the macroeconomic environment, the quality of public institutions and the ability of firms to innovate and adopt new technologies.

Each of these streams of work has identified and examined an empirical phenomenon that has emerged organically and tried to understand the factors that drive or constrain its development. But they have gone further, to actively design and implement tools, strategies and policies to foster *more* competitiveness and take up of corporate responsibility, as well as greater collaboration with SME clusters, in order to overcome obstacles to business driven development.

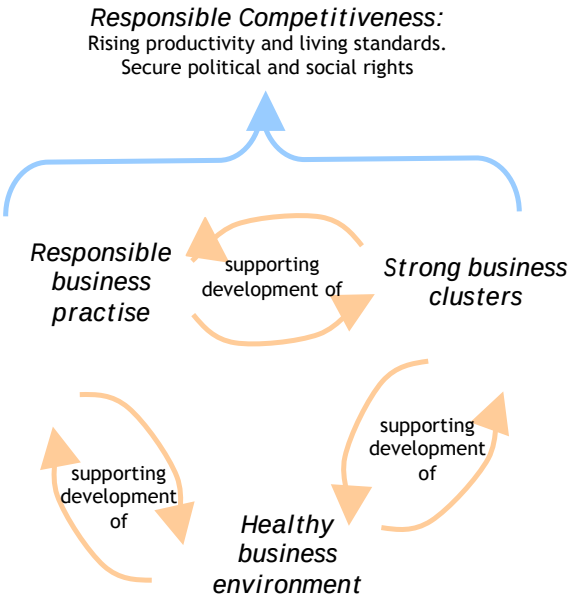
The three streams have remained parallel but often disconnected, and in many cases are seen to be in conflict with each other – for example the conflict between the desire to support business clusters in nationally important industries and the imperatives of enabling free trade and fair competition, or the drive to respond to demands for both higher labour standards *and* lower prices.

However, recently AccountAbility and others have considered how these three phenomena can be linked together within a framework of *responsible competitiveness*. They have considered how:

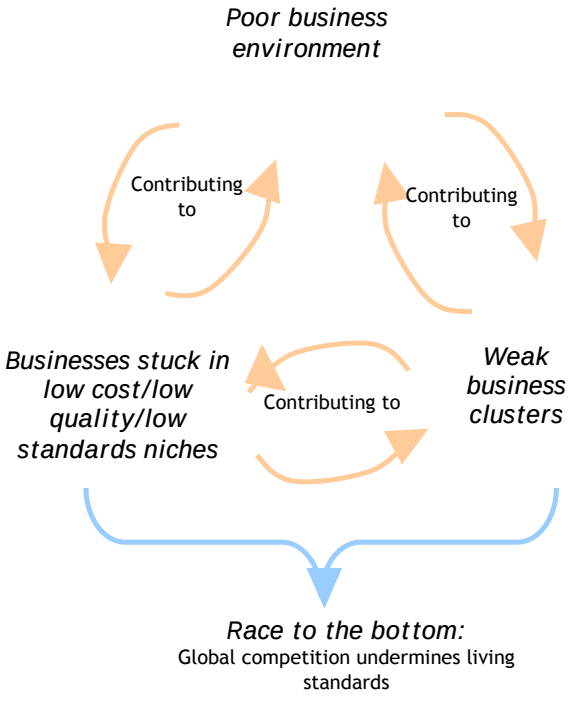
- Corporate responsibility can help support upgrading in existing clusters or even coalesce new ones.
- Businesses working together in clusters and multi-sector partnerships can achieve social and environmental improvements and economies of scale, which individual businesses working alone cannot.

It is widely recognised that corporate responsibility depends on an enabling business environment. But recent work on Responsible Competitiveness has also highlighted how corporate responsibility can help to build a healthy business environment by strengthening the legitimacy of the business community,

Responsible competitiveness: the race to the top



Desperate Competitiveness: the race to the bottom



enhancing trust between it and other key institutions, such as labour organisations and public bodies and increasing the flexibility of business to respond to changing market circumstances (AccountAbility 2005).

A Responsible Competitiveness strategy would aim to enhance productivity by shaping business strategies and practices, and the context in which they operate, to take explicit account of their social, economic and environmental impacts

But it is by no means the guaranteed outcome of global competition; it is not something that will just happen. The relationship between businesses, clusters and the market environment can get stuck into a negative cycle where individual companies are unable or unwilling to upgrade from low cost, low quality, low standards niches, and clusters use their collective strength to evade regulation or seek subsidies and special favours.

The challenge now is to examine the linkages between corporate responsibility, clusters and competitiveness in practise. To analyse the situations and mechanisms, which have proved useful in developing the synergies between them, and to use this learning to develop policies and strategies that mould markets towards sustainable development. The Responsible Competitiveness framework provides a basis for analysing the potential of more responsible business practice impacting on the competitiveness of nations.

This paper builds on the foundation of research and practise from the three areas of corporate responsibility, cluster development and competitiveness policy. We conducted a literature review - both academic and grey – and conducted over 30 informal interviews with cluster and responsibility experts worldwide (see annex B). It also draws from the wider Global Policy Dialogue, which AccountAbility has been facilitating for the past three years with a network of organisations, including the UN Global Compact, European Commission (DG Social Affairs, and DG Trade), Instituto Ethos in Brazil, Centre for Social Markets and Confederation of Indian Industries, and the Rockefeller Brothers Fund, to name but a few.

From the literature and discussions, we identified a number of SME clusters responding positively or negatively to the corporate responsibility agenda (see annexe A), as well as further indicative examples (see box cases in Section 2). These are used to provide an overview of the state of knowledge in each of these areas and the analysis of the implications for responsible competitiveness.

1.2 Responsible business practise

Responsible business practice is now on the agenda of many leading businesses as well as civil society organisations, and governments, who all recognise the need for business to be part of the solution if the goals of sustainable development are to be met.

Re-defining Corporate Responsibility

Corporate Social Responsibility, as it most commonly known, has been defined in many ways. Essentially however, it has two key dimensions:

(i) *Substantive* – how issues such labour standards, human rights, environmental sustainability and transparency are addressed, and

(ii) *Process* – the ways in which business engages with other actors in achieving these objectives and identifying its boundaries of accountability, for example compliance with international standards and involvement in stakeholder dialogue, multi-sector partnership.

A number of commentators have pointed out that the term 'corporate' may be off-putting or confusing for micro, small and medium sized enterprises, especially outside the Anglo-Saxon world. In Latin America, for example, most practitioners use the term RSE or '*responsibilidad social empresarial*'. The word 'empresarial' has connotations of entrepreneurialism and is more welcoming for small enterprises than 'corporate'. In this report, we use the term **Responsible Business Practice**, and define it as being,

"the process by which the boundaries of accountability of the business community are renegotiated and realigned."

This rise in prominence has been driven by a number of underlying shifts in the way in which economic value is created (Zadek, 2005).

- The historic *increase in the importance of intangible assets* as a value driver for companies. Some of these assets are impacted by how business deals with social and environmental impacts, most visibly and negatively, brand damage.
- *Public value as a* growing *source of economic value*, with a growing proportion being located in businesses' delivery of public goods such as health, education and policing, often through partnerships with non-commercial organizations.
- *The impact of the growth in size and reach of individual businesses*. This has the effect of enormously increasing the potential for externalities to strike back, and hurt.
- *The changing communications environment*, which further increases the potential for amplifying – both positively and negatively – the performance of one part of a business on the others, whether through corporate communications or civil campaigning.

These factors have tended to concentrate both the pressure and the rewards for responsible business practise initially on large, branded companies with markets in developing countries, and secondly on those companies that supply them.

The main driver of CR impact in developing countries has been the inclusion by international buyers, as well as Northern governments of social and environmental clauses in contracts and trade agreements. Responsible business practice is increasingly becoming a reality for those engaged in global value chains, and research has concluded the need to rise to the challenge in order to turn a threat into an opportunity (Luetkenhorst, 2004). Developing country suppliers in many industries are now either responding to demands for compliance with social and environmental standards in order to retain market access, or acting proactively to gain a competitive advantage in what they perceive to be a market opportunity (UNIDO, 2005b).

The *first wave* of developments in corporate responsibility focused around the emerging best practises of a few innovative companies (e.g. in the UK the cosmetics firm, The Body Shop and in India Tata Steel, and the oil giants BP and Shell) and individual business leaders (e.g. Phil Knight of Nike, who in the late 1990s called for international standards for the auditing of supply chains).

Building on these foundations, subsequent initiatives have worked both to upscale the *uptake* of corporate responsibility practise as well as their *impact on communities and economies*. This *second wave* involved a wider cohort of major international companies and civil society organisations working together to develop tools, standards and institutions to guide corporate performance and to push the boundaries of responsibility into new issues and into closer alignment with business strategy. These include the Forest Stewardship Council, the fair trade labelling organisations, SA8000, AA1000, the Global Reporting Initiative and the Equator Principles to name but a few initiatives.

Sustainability Standards

The Forest Stewardship Council is an international network to promote responsible management of the world's forests (www.fsc.org)

Fair trade labelling organisations include, Fair Labelling Organization (FLO, www.fairtrade.net); Fair Trade Foundation (FTF, www.fairtrade.org).

SA8000 is a standard for the ethical management workplace conditions in international supply chains (www.sa-intl.org)

AA1000 is the accountability framework for managing the overall performance of an

organisation, and includes the AA1000 Assurance and Stakeholder Engagement standards (www.accountability.org.uk)

The Global Reporting Initiative is a multi-stakeholder initiative whose mission is to develop globally applicable sustainability reporting guidelines (www.globalreporting.org).

The Equator Principles are a framework for financial institutions to manage environmental and social issues in project financing (www.equator-principles.com).

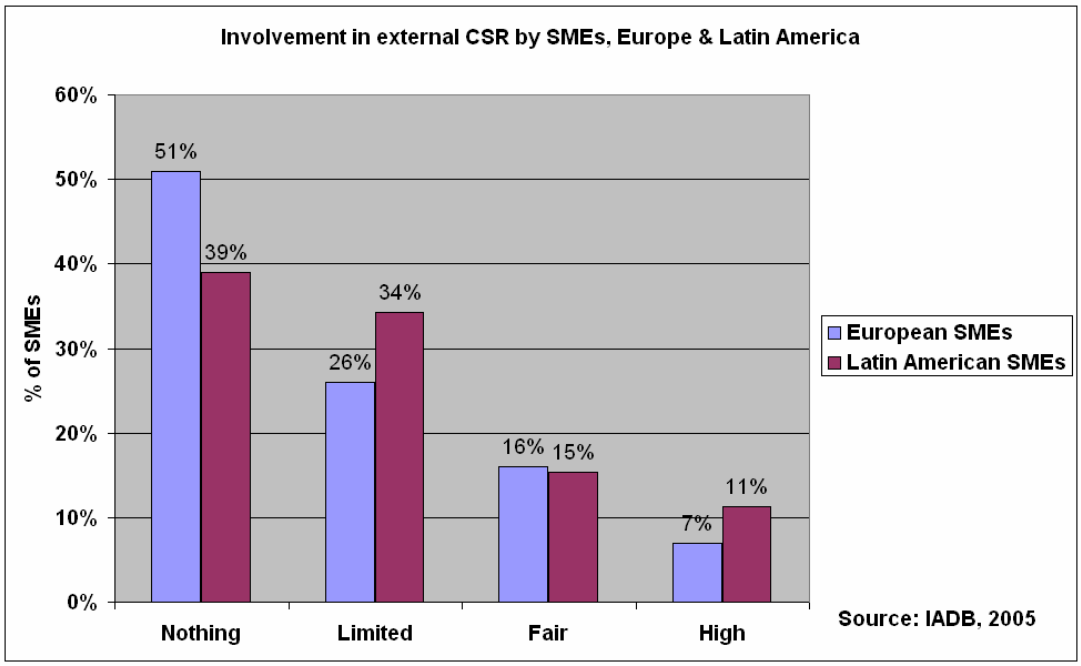
They aimed to drive a wider uptake of corporate responsibility practises by creating a demand both for ethically branded and marketed products and for the tools and services (such as advice and assurance) needed to support companies in improving (and proving) their social and environmental performance.

These strategies have had some success, with corporate responsibility increasingly becoming a mainstream concern for multinational companies. However, responsible business is still a limited concern among SMEs, particularly in developing countries (UNIDO, 2002b). Whilst there is growing evidence that social and environmental compliance is becoming part of global value chain agreements in some key industries, it is less clear whether the consumer demand for responsible trade in the US and Europe, let alone the huge emerging economies of China and India, can be relied on to drive a viable and growing market.

On the other hand, pressure for change is no longer driven solely by Northern consumers; there is also a rise in local, net-empowered campaigning NGOs. 'Silent Responsibility' practices (i.e. those embedded in the fabric of business strategies) such as community philanthropy and workforce development are also a feature of surprising numbers of small and medium sized firms in developing countries. For example, a number of Indian businesses of all sizes fund their own NGOs. A recent survey for the Inter-American Development Bank found, surprisingly, that over 60% of Latin American SMEs were undertaking external CSR activities such as involvement in social inclusion and education, as well as health, culture and sport projects, compared to just 49% of European SMEs (in Spain, Portugal, Italy and France) (Vives *et al.*, 2005).

However, as the chart below shows, the proportion of SMEs engaging seriously in these activities is still small (around a quarter in both regions). One can also question whether the philanthropic activities included in this survey contribute much to business strategy. Whilst corporate responsibility leaders have demonstrated that improvements in eco-efficiency and workforce development *can* be win-win

investments, individual small businesses will only act where they can see a strong business case and are convinced of the short-term financial benefits.



Further uptake of CSR practices may be limited by the development of global standards to steer corporate responsibility in a more formal and integrated direction. SMEs have been notable in their inability to engage in such standards. The ISO26000 process is a more recent and prominent case; for example, "The Chilean national standardization body *Instituto Normas Nacional* (INN) admits that the participation of SMEs in the design and implementation of new standards is quite limited [and] in South Africa, the lack of representative structures for SMEs means that they are not represented in ongoing standardization processes ...[I]n developing an international social responsibility standard, ISO should ensure that at a minimum, it does not work against the interests of SMEs." (IISD, et al, 2004). Clearly there are practical issues of representation; how does one represent the interests of 1 billion SMEs? Still, practical problems need not impede the imperative of including SMEs in the governance of global standards.

Given the slow and patchy progress in upscaling responsible business practice on a business-by-business, consumer-by-consumer basis in the face of harsh competitive forces and pervasive social and environmental problems, a third wave of developments is now emerging which seek to harness the synergies between responsible business practice and competitiveness at a national level.

Countries such as Cambodia and El Salvador have developed 'responsible competitiveness' strategies (see Annex A), which seek to "enhance productivity by shaping business strategies and practices, and the context in which they operate, to take explicit account of their social, economic and environmental impacts" (Zadek et al, 2005). The attempt is to move beyond a balancing act between economic growth and social responsibility, to one where they are both part and parcel of a competitive economy.

The challenges of such a strategy, not least for developing countries, include ensuring that:

i. added costs, most notably labour costs, do not drive down price competitiveness;
ii. developing country manufacturers develop the ability to exploit intangible assets such as brand reputation in the same way as developed country firms can;
iii. focusing on Responsible Competitiveness does not distract business and policy makers from the core task of stimulating economic growth; and
iv. this does not become a zero-sum game in competitiveness terms in which all countries strive to reach environmental and social standards and none are able to gain a sustainable competitive advantage.

Mirroring developments in corporate responsibility, most of the examples of responsible competitiveness strategies at a national level are aimed at capturing export markets based on a reputation for sound production conditions. For example the Chilean horticulture, Cambodian garment, South African wine, and Sialkot soccer ball industries are all seeking a first mover advantage in this way. However, the vulnerability of this strategy to the criticisms outlined above, coupled with the need for responsible business practices to address local issues if they are to contribute to poverty reduction, all suggests a need for responsible competitiveness strategies to understand how local environmental and social conditions affect productivity and competitiveness more directly (whether in domestic or export industries).

1.3 Industrial clusters in developing countries

Clusters are geographic concentrations of interconnected companies engaged in similar or highly related economic activities (UNIDO, 2005a). They have become the focus of a new wave of research and economic development policy, which focuses on the role of location and local competition in fostering global competitive advantage.

Although clusters are usually identified as geographical concentrations of businesses irrespective of their degree of actual cooperation, they gain their strength and distinctive advantages from a supportive network of nearby institutions, such as trade associations, research units, universities and NGOs, which facilitate information exchange, joint working and alliance building.

In the 1990s, there was a great deal of optimism about the ability of SME clusters to provide forms of collective efficiency, inspired in large part by successful examples of clusters in Italy and other OECD countries. In theory, firms working together in a cluster should be better able to respond to the challenges of global trade than isolated SMEs, gaining economies of scale and scope.

Focus needs to shift to improving internal efficiencies using CR as a management tool. This can be achieved through linking SMEs with their larger corporate counterparts in knowledge-transfer and capacity-building partnerships that develop responsible, cost effective solutions to create a ripple effect.[2]

Benefits of clustering
Proximity to raw materials, Customised business development services, Abundant clients attracted by the cluster tradition, A skilled local labour force, Vibrant competition among entrepreneurs, which spurs innovation and increases efficiency (UNIDO, 2005a).

Evidence on the prevalence of SME clusters in developing countries is patchy. According to the cluster meta-study by Harvard's Institute for Strategy and Competitiveness, of some 800 studies, 164 are in developing countries. Of these, over 100 are in India, with the next being 9 in Palestine.[3] The USAID-funded 2005 Global Cluster Initiative Survey (GCIS) received 250 responses to questionnaires sent to developing country cluster initiatives.

These surveys form an incomplete assessment of developing country clusters. The Indian state of Kerala alone has over 50 clusters, and UNIDO India is compiling a database of 350 Indian clusters identified to date. Possibly there are thousands of unidentified SME clusters in developing countries. Detailed studies of the clusters in Vietnam and in mainland China such as 'Sock Town' (Yiwu), Wooden Toy City (Yunhe), or Supply Chain City (Dongguan), and the 1,500-village cluster of soccer ball

stitchers in Sialkot Pakistan are notable by their absence. Because there is no reliable worldwide 'cluster map', we don't know whether certain countries, regions or sectors have a propensity for cluster formation.

Researchers and practitioners have evaluated the performance of around a dozen developing country clusters in considerable detail. Among these are the Sinos Valley footwear cluster in Brazil, the blue jeans cluster of Torreón, Mexico, the surgical goods and sports goods clusters of Sialkot, Pakistan, the wineries of Colchagua in Chile, and the textile clusters of Tirupur and Ludhiana in India.

On the basis of these studies, many developing country clusters have recently been judged to be under-performing (UNIDO, 2005a). Reasons for such under-performance include endogenous factors such as introspection, lack of trust, resistance to innovation and the weakness of collaborative institutions. Zaleski (2004) rated six clusters in Santa Catarina state in Brazil, using a robust methodology and found that only three could be rated as 'organised'. None of the six could be classified as 'innovative'. An assessment of the electrical fan cluster in Gujrat, Pakistan, which employs around 50,000 people in 500 units, identified the following weaknesses:

a) Unregistered members.

b) Unsmooth flow of funds.

c) Majority of manufacturers do not seem interested in acquiring modern technology and high skill.

d) Majority of workers in the industry are illiterate.

e) Coordination between the smaller and bigger units - lack of trust. (UNIDO, 2001).

Such difficulties, repeatedly identified in the literature, have been exacerbated by the external pressure of increasing global competition. Falling commodity, labour and transport costs have begun to outweigh the traditional benefits of clustering. As a result, even formerly successful clusters such as the Sinos Valley footwear cluster in Brazil are now struggling against global competition (Giuliani *et al.*, 2005). Cut-throat competition has led to lack of time, resources and even inclination to cooperate amongst companies making up the cluster.

Many governments, institutions and NGOs remain committed to supporting SME clusters, on the grounds that if these problems are overcome, clusters are likely to

make a stronger contribution to employment and poverty reduction than isolated SMEs. In addition, focusing SME support on clusters gives donors the opportunity to spread their scarce resources. As a result, hundreds of clusters in developing countries have been supported by national and regional government, by international agencies and NGOs. State governments in countries as varied as India, Brazil, South Africa and Slovenia have been equally active. Bilateral agencies including the Italian General Directorate for Development Cooperation (DGCS), German Technical Cooperation (GTZ), the Swiss Development Agency (SDC) and the UK Department for International Development (DfID), as well as international agencies, notably UNIDO, which has worked in fifteen countries over ten years, have supported cluster development programmes. USAID alone is supporting clusters in 23 countries, and has contracted consultancy Chemonics to promote clusters in Kosovo, Macedonia (goats cheese), Vietnam (software), Sri Lanka and Bolivia (coffee growing coops).[4] In addition, a number of consultancies (e.g. Cluster Navigators, Mesopartner, Swiss Contact Services) also undertake cluster development in developing countries. UNIDO.

So what have these projects learned?

1.4 Cluster development strategies (creation and upgrading)

There are essentially two components to cluster development; the first is cluster creation, the second cluster upgrading. Some experts claim that 'any effort to build clusters from scratch is doomed to failure' (Altenburg & Eckhardt, 2005). Others believe that 'SME agglomerations [can] be created in green field areas. There are certainly very interesting experiences around the world of dynamic export processing zones or technology incubators that have delivered sustainable results' (UNIDO 2005a). There is more agreement on the key elements of a successful upgrading strategy, with the following components all being identified as important:

- *Active stewardship* from a full time cluster development agent (CDA) or equivalent professional. The time commitment could be 3-5 years or more, before an initiative becomes sustainable (UNIDO, 2005a).
- Existence of one or more *dynamic business associations*. In the case of the Ludhiana hosiery cluster, the presence of several local training institutes had not led to the development of a trained workforce (UNIDO, 2005a).

- A *demand-led* approach to insertion into global value chains (Humphrey & Schmitz, 2002; Gereffi *et al.*, 2005). This means a hard look at *what* the cluster produces, and *who for*, not just *how*, especially in the case of artisanal clusters.
- Securing a *comprehensive policy package*, demanding regulatory standards and a network of supportive institutions that extend beyond the tight geographical focus (Porter, 1999). In Nicaragua, cluster support is housed within the President's Competitiveness Council.
- Activities should involve *a broad range of related firms*, not just those that imitate each other and compete solely on price (Altenburg & Eckhardt, 2005). Activities will likely be *holistic* in scope.
- *Securing buy-in* from a critical mass of SMEs. Participation will not be forthcoming unless the gains are tangible. In some cases, financial contributions can help secure ownership.
- Activities over time to *build trust*, first on a one-to-one basis, and only after that across the cluster as a whole. One example was the process of ISO9000 certification in the Bangalore machine tool cluster, where entrepreneurs only gradually agreed to allow peers to visit their workshops (UNIDO, 2005a).
- *Responding to external challenges* can enhance collective action, as in the case of the Pune food cluster's response to challenging food quality standards that initially appeared to threaten the cluster's very survival (UNIDO, 2005a).
- Accepting the '*tremendous heterogeneity*' in how different clusters and firms react (Giuliani *et al.*, 2005). Upgrading will change cluster dynamics, benefiting certain sorts of firm (depending on levels of education, size, openness to innovation, *etc*).

Cluster upgrading programs that take account of these nine factors can be effective, as evidence from India (UNIDO, 2005a) and Latin America (Pietrobelli & Rabelotti, 2004) suggests. Recently, researchers have hypothesised that corporate responsibility could be an additional factor helping to galvanise existing or even coalesce new clusters. In this study, clusters of organisations, whether driven by statutory or voluntary means, emerged to address an issue of responsible business practice (AccountAbility, 2003). A recent collection of essays makes frequent reference to the impacts of labour and environmental standards to clusters, most notable being the

Sinos Valley footwear cluster, which is covered in more detail in the annex (Giuliani *et al*, 2005).

1.5 Responsible business practise and clusters: a hypothesis

Both corporate responsibility and cluster development as a strategy have emerged as new perspectives for understanding and promoting business success and positive impacts on society. Both offer real potential for overcoming some of the obstacles to business-led development. However, there are many under-performing clusters and corporate responsibility is failing to go into the mainstream of business strategy:

- Clusters often fail to develop into active collaborations to improve infrastructure, skills and local reputation because of lack of trust and weak collaboration. Even where there is stronger cooperation they often remain inwardly focused, resistant to innovation and prone to defending the status quo.
- Corporate responsibility remains marginal in addressing many of the problems of developing countries because of low uptake and because it has tended to be skewed towards rewarding big international brands and not developing country industries.

The hypothesis of this study is that responsible business practice can help cluster development, and clusters can help increase the impact of such practice in developing countries.

This proposition is based on a set of premises that we seek to check against the experience of corporate responsibility in clusters around the world to date:

- **Premise 1:** Clusters offer a useful and cost-effective entry point for agencies seeking to encourage responsible business practise by large numbers of SMEs.
- **Premise 2:** Working collaboratively within a cluster, businesses are able to take advantage of market opportunities that they could not achieve alone by addressing issues such as local capacity and infrastructure, regulation, and national reputation.
- **Premise 3:** Cluster approaches can reduce the pain barrier of cost and risk, and adapt international tools and standards for local contexts making it more attractive for individual business to take on responsible business practises and increasing uptake.

- **Premise 4:** Responsibility pressures provide an external challenge which catalyses collective action, dialogue, trust and capacity building within clusters, and with other linked organisations and sectors.

These premises are based on a vision of responsible business practise that does not start and end at compliance with the social and environmental demands of international markets, but which can be a mechanism for upgrading processes and products and for involving businesses, governments civil society organisations, academic and professional institutions in positive collaboration which improves the business environment. The next section explores the evidence (what evidence there is) for such a vision.

2 Responsible Business and SME clusters in practise[1]

2.1 Responsibility clusters: a patchy literature

In 2003, AccountAbility developed the concept of 'responsibility clusters', which could "*create competitive advantage within one or several sectors arising through interactions between the business community, labour organisations and wider civil society, and the public sector focused on the enhancement of corporate responsibility*" (AccountAbility, 2003).

There is growing interest in the potential of responsible competitiveness and clusters among policy-makers, from the UK's regional development agencies to Nicaragua's Presidential Competitiveness Commissions. 'There might be other things we should do on a regional level too, such as promoting networks or clusters of businesses that have made CSR work and are willing to spread the message', said former UK minister for CSR Stephen Timms in 2002. Several Italian municipalities have begun to promote Eco-Management and Audit (EMAS) certification for their industrial districts. The ceramics cluster of Sassuolo is one example; the province of Viterbo another.[5] The Punjab government has launched Lahore Garment City, a cluster that aims to include compliance to social, environmental and supply-chain security standards part of their business model.

But what actually happens in practice when responsible business practice is taken up by a cluster? How does it affect the competitive position of the cluster? The topic was touched on in a special issue of *World Development* (1999); was given some prominence in a Harvard Business Review paper by Porter & Kramer (2003); and occurs more regularly in a more recent collection of papers (Giuliani *et al*, 2005). Yet when we consulted around 40 academics, consultants, cluster development agents, entrepreneurs and policy makers internationally:

- Most CSR experts could think of no examples of CSR in clusters.
- Most cluster experts could think of no examples of CSR.

Anecdotal evidence from developing country cluster managers and academics suggests either that many of them do not consider corporate responsibility an urgent priority compared to other issues; or the emergence of global labour and

[1] There are a number of box cases throughout this section, the * examples of which are expanded on in the Annex.

environmental standards is presented as yet one more potential barrier to trade. CSR is not covered as an issue in UNIDO/ILO's cluster training programme in Turin; in the Competitiveness Institute's work programme; or in the biannual *Green Book* survey co-funded by USAID. The cases in *World Development* are from the mid-1990s and are now out of date.

However, a number of recent cluster studies do discuss environmental or social challenges, for example Michiko Iizuka's 2005 work on the salmon industry in Chile (Izuka, 2005).[6] A number of organisations are gearing up to do interesting work on this issue. Some examples:

- The **Inter-American Development Bank** has commissioned a review of four Latin American clusters to evaluate their contributions to meeting the Millennium Development Goals. The results should be available in mid-2006.
- **GTZ Vietnam** has been running CSR training workshops for Vietnamese footwear companies in Hanoi and HCM City. They have also developed a training/consulting program for small companies called 'Profitable Social Management' aimed not at preparing for certification, but showing entrepreneurs that 'they can make more money at the end of the day by taking good care of their workforce and the environment'.
- **GTZ Pakistan** has started CSR awareness symposiums in major industry hubs in the country supported by AVE the German retail association in partnership with RBI a national CSR centre, and is now developing a training module based on international standards so small exporters can understand compliance to CSR benchmarks and choose to adopt them. This is part of the mandate for a National Business Standards Roundtable in which government, business, consumers and labour are partners in building strategic CSR focus.
- **KIA (Kenan Institute Asia)** runs a Labor Standards Advisory Service which has launched a combined voluntary labor standards manual. The manual folds three international standards (WRAP, SA8000 and FLA) into a single Thai Labor Standard (TLS8001). 'It can reduce the complicated and repetitive activities of conforming to various workplace codes', according to Suriya Yawichian of KIA. The manual has already been distributed to over 300 factories, including SMEs in the textiles, footwear and furniture clusters.
- **UNIDO Cluster Development Programme India** has conducted an informal assessment of responsibility practices in a sample of five clusters. They found a number of examples of clusters supporting philanthropic activities, such as local educational NGOs. UNIDO is to include more systematic data in its database of c. 350 clusters.
- The **Confederation of Indian Industry** supports SME clusters with quality and environmental certification. More than 100 SMEs in India are already certified to ISO9000. 'Clusters would be easily set up if there is a group of companies in geographical proximity who have an interest to go through the process of preparation collectively', according to Dr Sarita Nagpal, Principal Counsellor, CII-Institute of Quality, Bangalore. 'CII would provide a step-by-step approach for preparation for certification, and help to select a suitable certification body who is acceptable to the group. Clusters of this nature have been supported in the auto-component sector and Maruti Udyog has been the sponsor for most of them… we would negotiate with the certification agency to get a good deal for the SME's.'[7]
- **Qinhuangdao Economic & Technological Development Zone** (QETDZ) is ISO14000 certified. QETDZ was among the earliest Chinese development zones, established in 1984. Today it hosts over 30 foreign companies. In 2001, it was authenticated by ISO14000

environment system and the State Environmental Protection Bureau approved QETDZ as an ISO14000 National Demonstration Zone.

- The **Horticultural Ethical Business Initiative** (HEBI) was founded by NGOs, government, industry and other stakeholders in 2002 to improve working conditions in Kenyan flower farms. Neighbouring countries have recently followed suit, for example the Agricultural Ethical Assurance Association of Zimbabwe (AEAAZ).

These examples are too recent to evaluate, but they do at least suggest that promoting responsibility in clusters is coming onto the agenda of some bilateral donors, international agencies, industry associations and global buyers in Asia, Africa and Latin America.

We also identified a range of clusters – some well established, some nascent - where the issue of business responsibility is already having an impact on cluster dynamics and competitiveness. The cases are presented in Annexe B.

Clusters have four basic options in response to the business responsibility agenda.

- The first option is for the cluster to evade the issue.
- The second is to develop home grown activities, which in a previous report we described as 'silent responsibility' (UNIDO, 2002b).
- The third option is to comply with emerging standards, whether these are local, national, global or dictated by buyers in supply chains.
- The fourth option is to seek or create new markets by embracing environmental or social standards.

For each response, the cluster can act collectively or individually. We describe the four responses below.

2.2 Response 1: Evasion: the Devil's Deal

Clusters can be a haven for irresponsible companies. Companies in clusters can use the local importance of their industry to evade local laws on issues such as gender discrimination, long hours, child labour and local pollution. 'Most of the SMEs feel that the compliance codes, especially the ones related to minimum wages and working hours, are simply not feasible to the demands of the business', says Ashima Sashdeva of UNIDO's Cluster Development Programme in India of a five cluster informal survey. 'The availability of cheap labour in abundance and also the willingness of the labour to put in extra hours of work in order to earn more, makes it all the more viable for SMEs to ignore the working standards… [T]he working

conditions in some of the factories (especially those catering to domestic markets) is a serious point of concern in some clusters.'[8]

This evasive approach can affect an entire supply chain. Fairbanks and Lindsay charted the '*no es nuestra culpa*' (it's not our fault) mentality in the Colombian leather industry. Following the supply chain upstream, the answer they found to the poor view of purchasing managers in New York of Colombian handbags was ultimately that *the cows are stupid*. The manufacturers blamed the tanneries for supplying sub-standard hides, they in turn blamed the slaughterhouse for the way in which they only had regard for the meat, not the hide. The ranchers are then blamed for branding the cows too much to ensure they are not stolen, and they blamed the cows for rubbing themselves against barbed wire, thus damaging the hide (Fairbanks and Lindsay, 1997). Clearly, evasive clusters may avoid burdensome regulation in order to remain competitive, but equally may fail to realise their potential as they lack the drive to innovate (Tendler, 2002).

Global buyers, as well as local policy-makers, sometimes pay lip service to business responsibility. 'Sometimes in the initial stages [European buyers] make 'some pious noises' about environmental issues,' according to one Indian leather exporter cited in Alam (2005), 'but these get drowned in the pressure of price cutting and delivery issues.' Many SMEs report that foreign buyers display double standards and do not commit to share the burden of costs involved in ensuring social compliance. Where there is real commitment and improvement in responsibility on the part of businesses, as in the case of the Vietnam Business Linkages Initiative (see below), when pressures to meet deadlines arise, they tend to fall back again.

Complaints of burdensome bureaucracy may sometimes be warranted but can also be used to justify a 'devils deal' between companies and local politicians, where the evasion of regulations is accepted in return for the political or financial support of local entrepreneurs. Almost half of SMEs surveyed in Latin America admitted that they did not uphold environmental regulations (Vives *et al.*, 2005). In clusters, such evasion can become a collective norm. Blackman (2002) studied the response of two Mexican SME clusters to severe local environmental problems – each using cluster-power to evade the issue in a different way.

Evading responsibility: brick kilns in Cuidada Juárez and tanneries in León

In the 1990s, 250 traditional brick kilns employed 2,000 people in Ciudad Juárez, using a range of dirty fuels to fire them and creating severe and fatal air pollution. At the same time,

a bigger cluster of 1,200 leather tanneries in León was responsible for chronic metal contamination of local watercourses.

In both clusters, the transition from being massive local polluters to more responsible practices has been highly problematic, because the clusters were major local employers, and collectively were able to block regulatory efforts. In some clusters, larger firms succeed in evasion. In other cases, larger firms attract attention, whilst the smaller and more informal firms fly under the regulatory radar screen. In the case of the León tanneries, *all* firms in the cluster collectively evaded local water pollution regulations as they refused to respond to a four-year grace period ('convenio') granted by local regulators – *three times*.

In the case of Cuidad Juárez, efforts to encourage the brick kilns to switch from dirty fuels to more expensive propane gas, ultimately collapsed when government subsidies on propane were withdrawn. Before this, however, the cluster had splintered, with half the kilns adopting propane and the other half refusing. Peer pressure ensured that many SMEs took up propane gas even though it was more expensive. 'If a critical mass of micro enterprises can be convinced by hook or crook to adopt a cost-increasing clean technology', writes Blackman, 'eventually diffusion can become self-perpetuating.'

'Informal regulation' (pressure generated by private sector actors with daily contract with polluters) was the crucial mechanism. For example, brick makers' trade unions in several brickyards prohibited their members from using dirty fuels. Citizen complaints to telephone hotlines also generated pressure to act. In León, however, such 'informal regulators' did not exist.

[Source: Blackman, 2002]

2.3 Response 2: Home grown or ' Silent CSR'

Many SMEs in developing countries practice what has been called 'silent responsibility' (UNIDO 2002). SMEs, particularly in clusters, are likely to take a long-term view of investment in an individual locality to which they are usually firmly rooted. Some family-owned companies exhibit strong philanthropic approaches, motivated by religious or moral conviction. Because many SMEs have strong links to the local civil and cultural environment, they are also likely to be more aware of local risks and emerging issues than larger companies.

There is little information available about 'silent responsibility' at the cluster-wide level. An informal assessment of five Indian clusters reported that one common feature of all the clusters was philanthropic activities. 'The total amount that the cluster SMEs spend in charitable works is quite considerable', according to Ashima Sashdeva of the UNIDO Cluster Development Programme, India. Some of the most popular avenues for these charities are education, medical health-care and religious needs of the local community. When this 'silent responsibility' is part of a collective initiative, funds may be collected for donating to various NGOs or to disaster relief. 'SMEs indeed seem to be contributing generously towards various social causes,' says UNIDO, 'and some of them even run their own NGOs depending on their personal or common social priority areas.'

A 2005 survey of Latin American SMEs is indicative of the sorts of activities supported in the region. Over half of the enterprises interviewed supported some kind of external activity, and of these, 44% supported marginal groups, 39% supported educational programmes, 28% cultural activities. A quarter of all SMEs supported health-related projects, just ahead of sporting activities (eg sponsoring team uniforms). One in seven SMEs supported environmental projects (Vives *et al*. 2005). These findings are supported by an executive survey of Sinos Valley companies (Fundação Semear, 2003), which showed that the philanthropic priorities for footwear companies in the cluster were primarily around social assistance, education and health care.

Colchagua: Environmental awareness spreads through a cluster, driven by a single enterprise* (see annex)

Colchagua, with 100 wineries, is one of Chile's most successful export-driven wine clusters. One dynamic winemaker, Alvaro Espinoza, persuaded a vineyard to invest heavily in the biodynamic system of agriculture, which goes beyond organic standards to encompass a holistic approach to agriculture. At the time, there was no demonstrable demand for biodynamic wines, which could only by certified by the Demeter standard from Germany. The drive came from the entrepreneur's own principles and view that there was a market opportunity.

Awareness and adoption of organic approaches and integrated pest management has begun to spread through the remaining wineries in the cluster, beginning with an inner circle of eight highly networked and knowledgeable firms. This limited diffusion has been mapped through social network analysis by Elisa Giuliani. To date, none of these firms is – or is committed to - producing organic wine or biodynamic wine.

Given the fast growing market for environmentally-certified wines, and the climatic chance that Colchagua is dry and therefore relatively free of moulds, it is likely that several of the more dynamic winemakers in the cluster will follow Espinoza's lead, not from personal commitment but from imitation. On the other hand, the more isolated and conservative firms, which do not share much knowledge with the rest of the cluster in any case, are unlikely to follow suit. The cluster might split into two, one producing quality and environmentally-friendly wines for Northern markets, and another cluster producing cheaper wines for Latin American market. This highlights more broadly how clusters can be quite stratified and heterogeneous in their development strategies.

Can a collective approach to silent responsibility make such responsibility initiatives more effective, or does it demotivate individual entrepreneurs? The example of cleaner production in Ludhiana shows that clusters can respond to local challenges in ways that contribute towards the cluster's competitiveness as well as its moral stance.

Ludhiana Knitwear Cluster: process and energy efficiency

Ludhiana, India harbours a vast knitwear cluster that employs over 400,000 people and produces everything from t-shirts and jackets to sweatshirts. While cluster production dominates domestic sales with 95% of the market share, it also makes a mark outside India, with 25% of total production being exported to the United States, Europe, Middle East and Russia. However, many firms recognised that there were productivity issues in the cluster that constrained quality and raised costs.

UNIDO worked with cluster firms over a number of years on achieving greater competitiveness through improved business processes. Workforce development was a major focus, but the cluster upgrading programme also included several environmental initiatives.

Amongst these were two environmental management activities that saw immediate benefits to the firms involved. The first was in garment washing practices, where consultants identified the potential to streamline the number of times a single garment was washed, which reduced water consumption and cut costs on this process by 50%, thus reducing overall production time. The second, around energy conservation, was also simple, but equally efficient. Cheap, inefficient, bamboo-fuelled boilers were being used by most local firms because they were cheap and easy to service. However, these boilers had much higher fuel consumption than more modern boilers. Firms upgrading their boilers could save up to US$6,500 per year. These findings were circulated around the industry and a number of firms adopted the new boilers.

Source: UNIDO. Hosiery & Knitwear cluster of Ludhiana – End of project report, UNIDO, Vienna.

These home grown approaches to social and environmental issues are likely to develop further among self-confident SME clusters. It is difficult to assess the competitive impact of such approaches, particularly as they rely either on individual moral conviction, or business savings that entrepreneurs are reluctant to disclose. But it is clear that in certain cases, particularly where group-based philanthropy is concerned, such strategies can act as a platform for social capital formation.

2.4 Response 3: Compliance with standards

Sometimes evasion is not possible and a home-grown response not adequate: a cluster is forced to address a prominent issue such as child labour or environmental pollution, driven to comply with outside standards by international buyers, regulators and watchdog NGOs. Although there is little systematic data about the uptake of such standards in developing countries, cluster firms are increasingly looking to such standards as SA8000, Fair Labor Association (FLA, www.fairlabor.org), Worldwide Responsible Apparel Production (WRAP, www.wrapapparel.org) and ISO14001 (www.iso14000.com) as a way of maintaining market share, even if obtaining certification is not (yet) a condition of membership of a global value chain.

A strong cluster body is essential to coordinate an effective collective response to external standards. This was made clear when the Surgical Instrument Manufacturer's Association (SIMA) and Chamber of Commerce and Industry in Sialkot (SCCI) drove improvements in response to a quality challenge from US standard-setters.

Sialkot's Surgical Instrument Cluster: a collective response to a quality challenge * (see annex)

Of Pakistan's clusters, the one with most success in exporting has been Sialkot's surgical instrument cluster. The city hosts around 300 producer firms, supported by over 2,000 subcontracted supplier firms. Together, the firms produce over 2000 different types of surgical instruments, most of which are exported to the United States (59%) and Europe (27%), making Pakistan the world's second largest exporter of surgical instruments (Nadvi, 1997). The vast majority of firms in Sialkot's Surgical Instrument cluster are composed of SMEs with less than 20 employees, mostly family-run and with a defining characteristic: a vast social network between firms at all levels. The industry faced a serious crisis in the mid-1990s when the US Food and Drug Administration revealed that Sialkot surgical instruments failed to meet quality standards (under the Good Manufacturing Practice system), and thus prohibited import of its products. The industry had no choice but to adapt.

Under the effective guidance of two existing local institutions, the Surgical Instrument Manufacturers Association (SIMA) and Sialkot's chamber of commerce (SCCI), the cluster achieved rapid quality upgrades, resulting in the US embargo being dropped.

By 1996, the industry more than recovered its market, exporting 10% more than in previous years. The cluster has been able to respond successfully to subsequent quality challenges and a number of firms in the cluster have adopted the ISO9000 quality standard. The surgical instruments sector is now Pakistan's second in numbers of quality certified firms, with the textile sector in first place.

Sources: Nadvi, K. (1999) "Shifting ties: social networks in the surgical instrument cluster of Sialkot, Pakistan", Development and Change, 30, 141-175; Khan, J. H. and Ghani, J. A. (2004). "Clusters and entrepeneurship: implications for innovation in a developing economy", Journal of Developmental Entrepreneurship; http://home.scci.com.pk/csdo_profile.asp.

The pressure that triggered the Sialkot upgrade was on the technical quality of the stainless steel rather than business responsibility, and was enforced by global supply chains. The key to the successful response was the strength of local cluster institutions. More recently, there is evidence that social performance is becoming part of the quality equation for the cluster.

One key issue is child labour, which infamously first came to prominence in the neighbouring sporting goods cluster that produces footballs. The SCCI has now set up a specialist cell (the Child & Social Development Organization) alongside its existing research and quality management cells. Its mission is 'the achievement of child labour free Industry, enhanced implementation of Child Right Convention (CRC) and socially responsible entrepreneurship in Sialkot'.

One sign of the growth of interest in social standards in Sialkot was a recent training workshop on the voluntary labour standard Social Accountability 8000 (SA8000) held in the city and organised by the Lahore-based consultancy Responsible Business Initiative (RBI). According to Ambreen Waheed of RBI, there are only a handful of trained Pakistani social auditors so firms seeking certification have to bear the costs of inspectors coming in from India, Bangladesh and other countries in the region.

'This training will develop a local cadre of accredited inspectors able to serve Sialkot and lead to significant savings of inspection-related costs for the local industry', says Dr. Faiz Shah, former chair of the Sialkot Child Labour Project's Implementation Team. 'As a result, smaller companies would be encouraged to undergo SA8000 certification and become more competitive in the global marketplace'.[9] This heightened awareness has led to Pakistan becoming the country with the 6th highest number of SA8000 certifications.

The Sialkot training was aimed at the textile and sporting goods sectors, which have been under the spotlight for their use of child labour. Even so, two medical devices companies (Accompany Surgical and Arian & Bros) have now gained SA8000 certification, although this is far from being a requirement in the medical devices supply chain at present.

An important issue is whether the ability of the surgical devices cluster to respond collectively and effectively to global standards is beginning to fragment as individual companies go it alone and choose from a growing menu of standards, without the support or sanction of cluster associations. If this happens, it will be good news for local consultants and lead firms but will damage the competitiveness of the cluster as a whole, because already-certified firms will have no interest in supporting cost-effective cluster-wide certification.

However, once again the stratified nature of a cluster does not necessarily mean there will be a fractured response or benefits. Further evidence of cluster heterogeneity facing an external challenge comes from the case of the Mexican brick kilns and tanneries cited above. In these cases, researchers found that:

- The partial adoption of cleaner technologies in both cities was spatially clustered, suggesting *demonstration effects and imitation* were important ways of overcoming ignorance about improved techniques;
- Even where cleaner production initiatives had a significant cost, *early adopters pressurised laggards* to follow suit to minimise their cost disadvantage.
- The uptake of pollution-abatement initiatives was *not size dependent*. In a sample of 170 tanneries, small tanneries were as likely to adopt cleaner technologies as larger ones.

A good example of collective action to an environmental challenge is the leather tannery clusters of Palar Valley in Tamil Nadu, India, racing to set up collective effluent treatment plants in the face of drastic regulation.

'Cooperating for Survival': Palar Valley Tanneries, Tamil Nadu * (see annex)

The 500 plus tanneries in Palar Valley, in Tamil Nadu state in India, are predominantly small enterprises owned by Muslims. The eight or so sub-clusters produce roughly half of India's leather. Through the 1980s and early 1990s they evaded legal requirements to set up treatment plants to deal with serious water pollution - a classic 'Devil's Deal'. In 1995-6, the Indian Supreme Court responded to NGO lobbying, ordering the immediate closure of 155 tanneries and giving the remainder, three months to treat their effluents.

Facing ruin, most firms opted for a collective solution, and, supported by a dense network of local tanners' associations and research institutes, and with government grants, rapidly constructed central effluent treatment plants (CETPs). The CETPs became powerful cluster institutions in their own right, enforcing compliance on members through a judicious blend of trust, peer pressure and technical monitoring.

However, several sub-clusters failed to agree a collective solution, either through geographic or social constraints. As a result, some 75 small, traditional tanners went out of business while 69 larger firms were forced to pay more for individual effluent treatment plants.

The tanneries are far from being considered environmentally-friendly by local NGOs today, and tackling environmental issues has not necessarily led the cluster to embrace other aspects of responsible business practice e.g. labour standards, health and safety, community engagement. But the seven CEPTs set up in 1997 were still in operation in 2003, and some large firms that already had their own treatment plants decided to join the collective systems. The experience of a successful collective solution enhanced the ability of sub-clusters to respond to later environmental challenges, and in some cases provided a focal point for innovations in marketing.

2.5 Response 4: Market access through cluster responsibility

In contrast to evasion, with home-grown responsibility or compliance, there are some examples of new responsibility clusters under formation, which have emerged with the explicit aim of branding themselves as ethical. Such initiatives might be driven by statutory action (as in the case of Cambodia, see box below). Alternatively, the cluster might coalesce as a partnership initiative that involves policy-makers but is not driven by them (for example the Vietnam Business Linkages Initiative, VBLI). These responsibility clusters may be as tightly geographical as other clusters, but also include actors dispersed along global supply chains, and a broader range of partners than traditional clusters.

In the four cases below, the notable difference from the responses above is the focus on new markets rather than defending existing markets (see Annex A for a more in-depth analysis of these examples).

Cambodia's Responsible Competitiveness Strategy: Labour Standards as a Competitive Advantage in the Garment Industry and Beyond* (see annex)

Cambodia's garment industry represents 80% of exports and 12.4% of GDP. The country has a reputation of being sweatshop-free in garments, which is borne out of a bilateral trade agreement signed in 1999 with the US. With the end of the MFA, the US-Cambodia Agreement became redundant, and government and the industry, with assistance from FIAS began to re-design the labor standards system away from US Government quota decisions into a market-led strategy.

The first step was to test the assumption that there is an export market niche based on labour standards, combined with the normal criteria of price, quality and speed to market. A survey of Cambodia's key US and European buyers confirmed the existence of this market niche.

The next step involved all stakeholders redesigning the existing monitoring and reporting systems in line with best practice and re-targeting activities to meet the informational needs of international buyers. This suggested seven characteristics: 1) be sector wide; 2) be transparent; 3) have a shared governance structure; 4) involve international buyers; 5) reduce inefficiencies; 6) measure productivity impacts; and 7) achieve market-based incentives.

The purpose was to build on Cambodia's first mover advantage with labour standards, and redirect activities towards meeting the market needs of overseas buyers and their stakeholders. This will mean that activities will be integrated into the way the industry functions and will be overseen by a tri-partite governing body, made up of the Garment Manufacturers Association of Cambodia, the Ministries of Labour and Commerce, and trade unions. The scheme, re-branded by the ILO as Better Factories Cambodia, aims to have one unified labour standards monitoring and reporting system.

Vietnam Business Linkages Initiative (VBLI)* (see annex)

A number of international buyers wished to source products from Vietnam in the late 1990s that were of good quality and manufactured in acceptable workplace conditions. There was a concern that international brands were becoming over-dependent on China. But they needed to compete effectively with China on quality as well as cost.

The initiative arose out of a study commissioned by DFID in 1999 and supported by the World Federation of Sportswear into the use of chemicals in the footwear industry, which employs 400,000 people. The initial programme was supported by DFID and Nike, adidas and Pentland. The second phase now getting under way is being supported by DFID (through their Business Linkages Challenge Fund) and members of the World Federation. This phase takes the learnings and experience in the footwear industry to the garment sector and aims to take both to scale and impact. It also mobilises all 27 participating organisations to play their parts in the sustainable and systemic improvement of the industries. The core elements of the initiative have been the development of a code of conduct and factory inspections; a management support system for implementation; and ongoing analysis of industry needs. Underpinning the initiative was a key additional challenge to achieve systemic change across the industry in Vietnam rather than in just a few selected factories.

There is still some way to go to get all participating companies compliant with the code, but there is great interest and more recently the initiative was expanded to include the garment industry. The benefit of it being a multi-stakeholder partnership is that trust has built up over time thereby increasing its capacity to deliver. The explicit aim is to improve the conditions of health and safety in Vietnam's footwear industry as a competitive advantage.

Cape Crusader: the Wine Industry Ethical Trade Initiative* (see annex)

The South African wine industry faced internal and external pressures: a poor reputation for alcohol abuse, poor housing conditions of workers, low wages. It came under global pressure to demonstrate ethical trade, in particular on the part of retailers such as Tesco, the world's second largest food retailer. So market access was particularly important. There had previously been little collaboration amongst wine producers, and their representative

associations had not been very effective, with no vision for the industry in light of developments in the new South Africa and such policies as Black Economic Empowerment.

Arising from the Ethical Trading Initiative (ETI) project in 2002, WIETA is a multi-stakeholder voluntary association committed to promoting the ethical trade of the South African wine industry through the improvement of labour conditions. The WIETA code, based on the ETI base code and South African legislation, contains a set of principles governing the ethical treatment of employees to which each wine-producing member is required to implement and allow WIETA to monitor. Compliance monitoring is done by WIETA-trained and selected independent social auditors on the principles that cover health and safety, discrimination, training and housing provision.

The WIETA code is a compliance-driven code and to date there has been no research into how it makes the industry more competitive. There is a need to demonstrate the business case for producers, particularly those who don't feel the pressure from above in the supply chain. There is an emphasis on shared learning and use of WIETA as a source of best practice. In addition, the model of WIETA as a 'partnership cluster', is being replicated in other examples, such as the Horticultural Ethical Business Initiative (also driven by the Ethical Trading Initiative) and the Ethical Tea Partnership, and is drawing interest from other agricultural sectors in South Africa.

'Mainstreaming' Fair Trade Markets through co-operative action: the case of CEPCO, Oaxaca, Mexico

The Oaxacan State Coffee Producers Network (CEPCO) was set up in 1989 as a response to the structural adjustment programmes which saw the Mexican government reduce support for the coffee sector. CEPCO was formed to enable its members, spread throughout the region of Oaxaca, gain access to international markets through the sale of fair trade coffee.

In 2002, in response to the growing success of CEPCO, as well as the expansion of the fair trade market, the co-operative entered into a partnership with Starbucks, Ford Foundation and Oxfam, in order to increase sales and improve the livelihoods of producers and their communities. It has since seen volume of fair trade coffee increase year on year.

CEPCO has since moved also into production of organic coffee as a result of the success of fair trade sales. In addition, although costs of certification in fair trade have risen recently, they are relatively low compared to organic production. However, these have now been reduced with the creation of an IFOAM-accredited Mexican body. Comparing returns between fair and organically produced coffee, show that there is still some way to go until organic production is profitable. In addition, as a more strategic level response to a coffee crisis, there are limitations without intervention by the state.

[Source: Calo, M, & Wise, T (2005) Revaluing Peasant Coffee Production: Organic and Fair Trade Markets in Mexico, Global Development and Environment Institute, Tufts University]

2.6 Summary of cluster responses

The table below summarises the four main responses of clusters to the business responsibility agenda, as illustrated by the cases described above. Our analysis of the responsible business initiatives in SMEs in clusters highlights the interaction between individual or collective action and between evasive, home-grown, compliance driven or market seeking responses to social and environmental challenges which can play out in eight main ways:

Cluster responses to emerging responsibility agenda

	Individual	Collective

Evasion	**Ostrich**: individual firms ignore the issue as irrelevant, exposing them to regulatory risk (*Cuidad Juárez brick kilns*)	**Devil's Deal**: cluster uses collective strength with local regulators to evade issue as too difficult. Enhances trust in short term but increases risk (*León tanneries*).
Home-grown responsibility	**Silent CSR:** either personal moral commitment or based on individual business cases (*Colchagua biodynamic wine)*	Expanding the reach of the business case (clean production in *Ludhiana knitwear)*
Compliance driven	**One by one**: Leading firms accept certified standards to maintain market access. Good for standards setters and auditors; costly for cluster *(Sialkot medical instruments)*	**Collective Action**: joint response to regulatory pressure/crisis. Builds trust and reduces cluster compliance costs (*Palar Valley tanneries, Sialkot soccer-ball companies)*
Market Opportunity	**Rogue elephant**: innovator acts unilaterally – either local philanthropy or global branding. How does rest of cluster react? (*Colchagua*)	**Partnership Initiative:** group of enterprises join a partnership formed specifically to improve responsibility in the value chain *(WIETA; VBLI)*

Although we were only able to examine a limited number of cluster experiences, a number of indicative trends and characteristics can be identified from this initial study:

- On the one hand a number of clusters are adopting responsibility practices, but many of these are likely to be poorly focused and un-strategic in terms of cluster competitiveness;
- On the other hand, clusters can use their collective power quite effectively to block action on social or environmental issues;
- In some cases action has been precipitated by a particular event – either a crisis (protest, regulation, market change) or an opportunity (approach by international initiative or donor);
- Recent responsibility initiatives in clusters have tended to be driven by demands from international buyers – whether seen as a matter of compliance to retain existing markets or an opportunity to gain new customers;
- Working with clusters is increasingly popular with governments, donors and civil society organisations, where it is seen as a way to broaden the uptake and impact of CR;
- The difficulties of working with clusters should not be underestimated, where small firms are used to competing fiercely with their neighbours. Local cluster dynamics make it difficult to punish free-riders. SMEs may not know or not be

prepared to share information on business costs to identify cluster-wide savings.

- The examples of donor-assisted initiatives are associated with high-profile formal alliances, while the Cuidad Juárez brick kiln example highlights the role of informal regulators passing under the radar of official agencies.
- The pressures to compete on price and meet tight deadlines to retain export customers are a significant challenge to companies in succeeding in complying with CR standards.
- Clusters have tended to focus on a tight set of immediately material issues (for example in the Cambodia initiative the issues were identified by a survey of buyers, in Palar Valley businesses were responding to a particular piece of legislation). There is limited evidence of a domino effect where clusters move on to address other issues;
- There are winners and losers within clusters and between competing clusters in different countries. The strongest clusters, and the strongest businesses within them, tend to respond well to the challenge of CR issues.
- There is some evidence of responsibility spread, where an initiative in a high-profile cluster is imitated by less high-profile clusters nearby. One example is Sialkot surgical devices firms adopting a social certification first used by textile and football stitching clusters.
- More responsible business practice can enable clusters to break out of their inward-looking mentality, when taking part in a wider partnership, as the cases of wine in South Africa and footwear in Vietnam show.

3 Conclusions

3.1 Revisiting the hypothesis

Advancing responsible clusters as an approach to overcoming the obstacles both to economic development and to more responsible business practise is a real option and, in some instances, already a grounded practice.

The evidence available at the level of desk-based study is patchy but in general it does support the hypothesis that corporate responsibility can help cluster development *and* that working with clusters can help to increase the impact of corporate responsibility in developing countries.

However, as with all win-win opportunities linking commercial and social goals, is not a straightforward outcome, but a contingent one. Whether these synergies can be achieved depends on the strategies, tools, initiatives and signals put in place to influence the direction that clusters take.

The table below summarises the extent to which the findings from these case studies support the premises behind the proposition that corporate responsibility and cluster development can be synergistic.

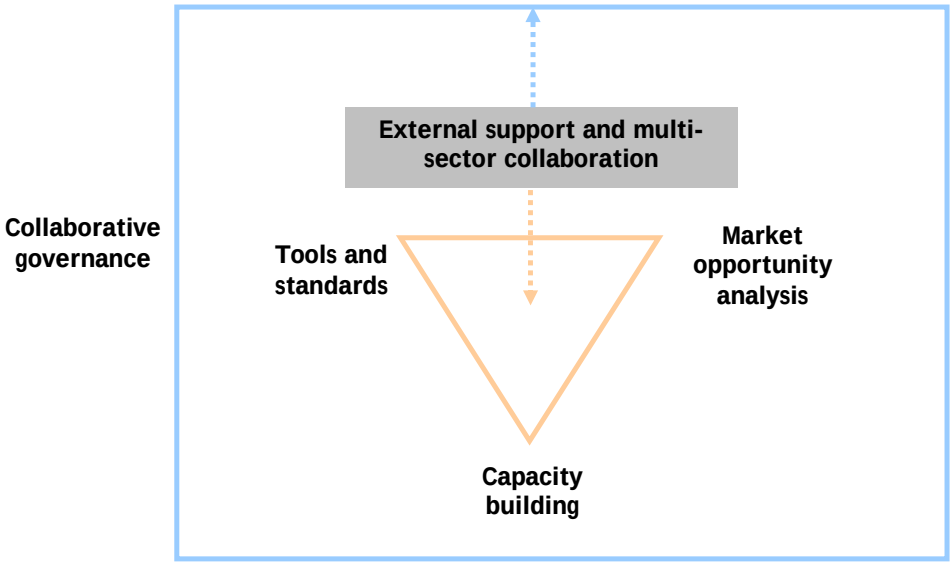
Premise	**Finding**	**Key aspect of responsible cluster initiatives**
Clusters offer a useful entry point for agencies seeking to encourage responsible business practise.	**YES.** Many of the case study clusters involved external agencies in initiating CR initiative (WIETA, VBLI, Cambodia, El Salvador)- although one (Chile-wine) highlighted the role that a dynamic local initiator could play. There is much interest in the area and a significant number of emerging initiatives.	**Linking in to external support.**
Working collaboratively within a cluster, businesses are able to take advantage of market opportunities that they could not achieve alone.	**YES.** In many cases clusters have moved from seeing social and environmental challenges as risks to their survival, to trying to turn them into market opportunities by working to improve their industry's reputation internationally. (FLO-labelled soccer balls)[10]	**Understanding market opportunities linked to social and environmental issues.**
Cluster approaches can reduce the pain barrier of cost and risk, and adapt international tools and standards for local contexts.	**YES.** Many of the case study clusters are working like this (VBLI, Cambodia, El Salvador) concentrating on shared monitoring systems etc.. (Lahore Garment City; Independent Monitoring Agency for Child Labour–IMAC, Sialkot).	**Development and adaptation of standards and tools.**
Responsibility pressures	**YES.** In most cases clusters have worked to	**Trust and capacity**

provide an external challenge which catalyses collective action, dialogue, trust and capacity building within clusters and with other linked organisations and sectors.	build the local capacity needed to raise levels of environmental and social performance. WIETA and Tamil Nadu cases are good examples.	**building.**

3.2 Strategies and challenges for responsible clusters

The case studies included in this study all took slightly different approaches depending on their history and context. They do however, highlight a set of collaborative actions aimed at strengthening companies' ability to respond to social and environmental challenges; we can begin to draw on these as the foundations for a more generic approach to responsible clusters based on three key areas of action within a framework of multi-sector working and collaborative governance:

A framework for developing responsible clusters



Collaborative governance is the process by which multiple actors, including public and private institutions, come together and evolve, implement and oversee rules, providing long-term solutions to pervasive challenges (Zadek, 2005)

Within each of these five key areas there are lessons and model approaches emerging from the experience of the clusters studied here but also outstanding questions, which call both for research and practical trials:

E*xternal support and involvement of actors from outside of the local business sector has been a key factor in catalysing the development of responsible clusters.*

- When should policy makers, donors and others intervene to support cluster initiatives and when is it better to put their influence on the business environment or demand sides and let organic clusters respond themselves?
- How can best practice cluster initiatives support the spread of responsible business through the informal network links within clusters as well as through formal organisational means?

Responsible cluster initiatives have been designed in different ways to respond to the specific challenges and market opportunities that individual industrial clusters face.

- Will the pioneering responsible cluster initiatives be successful in benefiting from first mover advantage and translating corporate responsibility into competitive advantage? Will others be free to replicate their approach or is this opportunity a limited market demand?
- Can responsible business approaches by clusters address locally material issues, which are not directly driven by buyers' concerns (for example skills development and HIV/AIDS)?
- Clusters have always been a dynamic melee of winners and losers. How does *the addition of responsible business drivers alter cluster dynamics?*

Development of local standards has been a key part of the response of local clusters to international pressures to demonstrate responsible business practises.

- Can SME clusters and developing country industries make an input into the new global standards architecture for example the ISO social responsibility standard, or will these international standards undermine cluster initiatives?
- Can responsible cluster initiatives successfully move away from standards and processes developed for company-by-company application to develop systems, which cost effectively make assurance and certification accessible to the whole cluster?

Many responsible cluster initiatives have focused on local capacity development to overcome the obstacles of meeting higher standards of social and environmental performance.

- Are cluster initiatives able to develop effective local capacity (for example in advice and consultancy, monitoring and assurance) and demand for these services to enable long-term and sustainable improvements in performance?
- Will responsible cluster initiatives be able to use the trust and capacity developed to address one set of issues that enable them to respond more effectively to new challenges and market opportunities?

Effective collaborative governance is crucial to allow clusters to seize responsible business opportunities.

- Are pioneering CR clusters able to organise themselves effectively to secure the accountability, legitimacy and resources they need and to facilitate collaborative action between firms and other local and international players?
- What are the best forms of governance for cluster initiatives to meet the demands of accountability and performance?

3.3 Next Steps

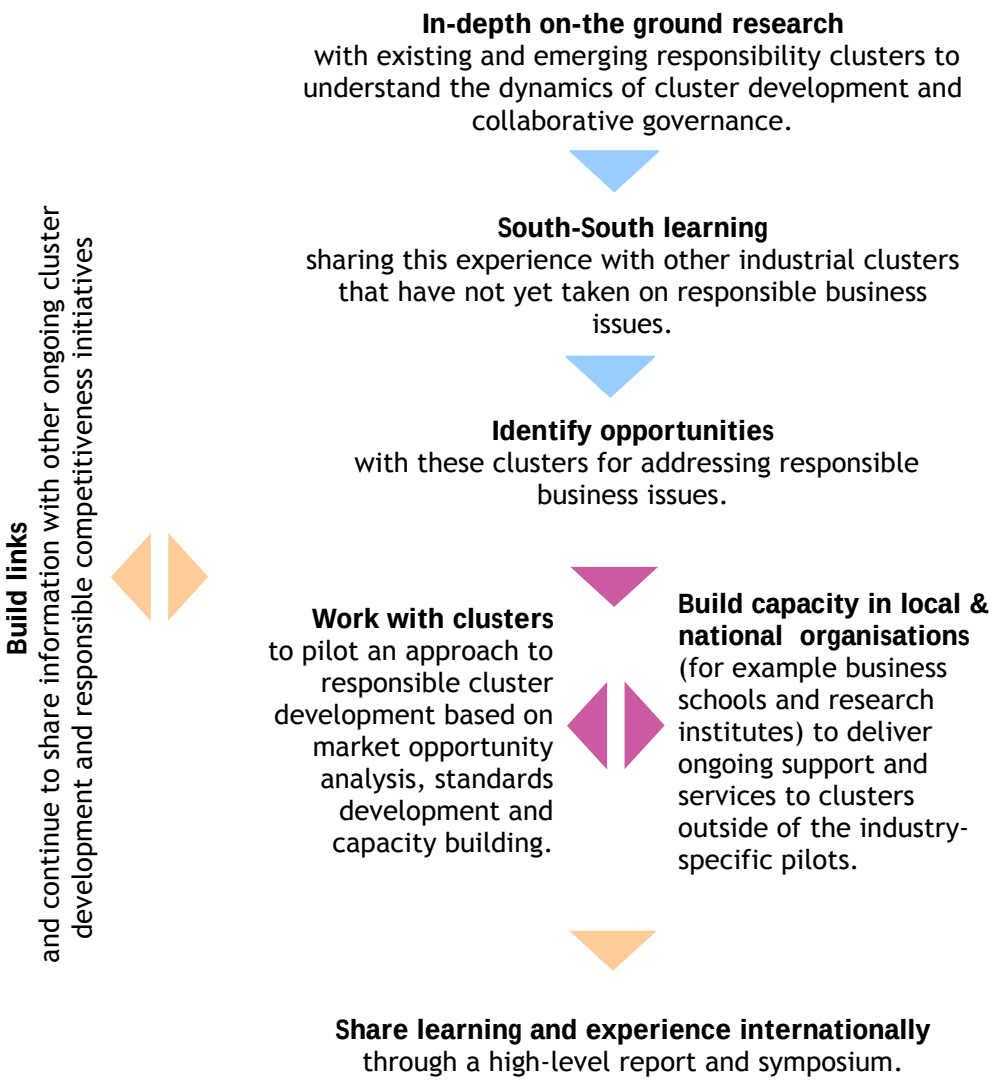
UNIDO through its ongoing work with industrial clusters is well placed to develop an integrated programme to advance the development of understanding and practise in supporting responsible business practise in clusters. This would:

- Support *the development of a series of pilots* based on a combination of market opportunity analysis, standards development and capacity building where opportunities are identified to support new responsible clusters developing. The Table below *(Potential CR activities during cluster upgrading process)* highlights how this pilot approach could be integrated with UNIDO's existing seven-step approach to cluster upgrading.
- Communicate and share learning with the broader international community of practise and research on responsible competitiveness.

Key steps in such an integrated programme are outlined in the box below.

Supporting responsible and competitive clusters

A short integrated programme for advancing the field of responsible cluster development would include research, pilots and communication phases.



Potential CR activities during cluster upgrading process

1. Selection of clusters	In addition to potential for profit enhancement and demonstration effect, are clusters in sectors that have dynamic CR profiles (e.g. where SA8000 is strong) or demonstrable opportunities (e.g. fast growing organic markets)?
2. Diagnostic study	Do CR issues lie at the core of cluster underperformance? Basic data on social and environmental trends can be gathered participatively, e.g. by local students. What issues are prioritised by stakeholders? What 'Silent CSR' is already being undertaken? Who are the 'informal regulators'? What issues are coming up on the international radar?
3. Trust building	Offer one-on-one meetings and then informal workshops or debates on CR issues selected for their convening power – interesting but non-threatening. Share and celebrate good practice to establish an atmosphere of trust among attendees. Later, more formal activities can be planned, and more controversial issues tackled.
4. Identification of an action plan	Identify activities with greatest benefits for collective action. Where possible, calculate cost savings per firm e.g. from shared infrastructure, reduced training costs, peer auditing, joint inspection / certification to social or environmental standards. Find ways to prevent initiatives from being exclusionary of certain firms (e.g. smallest, most informal).
5. Implementation activities	Actions beginning with direct cost savings gradually move towards non-monetary benefits from closer cooperation, e.g. rotating workshop visits by participants, secondments, anonymous benchmarking moving through to awards and incentives.
6. Monitoring and evaluation	Cluster association agrees a core set of social, environmental and economic indicators measurable at cluster-wide level, and a communication plan for results. Some bigger clusters might adopt / adapt Global Reporting Initiative guidelines and consider independent verification of results.

The marrying of responsible business practice with cluster development and economic competitiveness will require the efforts and skills of actors both inside and outside of clusters. It requires them to not only to play to their strengths but also work collaboratively so market rules are realigned to take account of social and environmental externalities, as well as economic competitiveness. Finally, clusters themselves should not be seen as a homogeneous group of like-minded entrepreneurs; but their heterogeneity is both a source of strength and weakness and requires different strategies to initiate upgrading. Responsible business practice as strategy for upgrading clusters should therefore not be seen differently.

4 Annex A: Case Examples of Collaborative Responsible Action

4.1. Wine Industry Ethical Trade Association (WIETA)

About WIETA

Arising from the Ethical Trading Initiative (ETI) project in 2002, WIETA is a multi-stakeholder voluntary association committed to promoting the ethical trade of the South African wine industry through the improvement of labour conditions. The original drivers for the wine industry setting up WIETA were:

- Socio-economic pressures on the industry – these included alcohol abuse, poor housing conditions of workers, low wages. In essence, the industry had a poor reputation.
- Global pressures to demonstrate ethical trade, in particular on the part of the UK retailers. So market access was particularly important.
- The opportunity to be an ETI pilot, which enabled wine producers to learn and share information on best practice.

There had previously been little collaboration amongst wine producers, and their representative associations had not been very effective, with no vision for the industry in light of developments in the new South Africa and such policies as Black Economic Empowerment.

Although WIETA is not a cluster in the strict definition of the term, it includes a cluster of wine producers (mainly cellars, co-ops and estates) based in the western cape region of South Africa. These range from those with a large number of workers (4-500 workers in season), to very small operations, such as the estates. In addition NGOs, individuals, retailers, government bodies and trade unions, make up membership of the Association. The Board reflects this multi-constituency.

WIETA Objectives and Code

WIETA aims to improve labour conditions by:

- Formulating and adopting a code of good practice governing employment standards for those involved in the growing of grapes for wine making purposes and the production and bottling of wine;
- Promoting the adoption of and adherence to the code of good practice amongst all wine producers and growers;

- Educating producers and workers on the provisions of the code;
- Appoint independent social auditors to ensure that members of the association observe and implement the code of good practice;
- Determining ways of encouraging implementation of and compliance with the code and determining measures to be taken in the case of non-compliance of the code.

The WIETA code, based on the ETI base code and South African legislation, contains a set of principles governing the ethical treatment of employees to which each wine-producing member is required to implement and allow WIETA to monitor. Compliance monitoring is done by WIETA-trained and selected independent social auditors on the principles that cover health and safety, discrimination, training and housing provision. The code is monitored under local stakeholder auspices, unlike other codes (such as Eurepgap, HACCP, BRC etc), which are technical requirements for exporting companies to developed world markets, monitored using technical appraisal with no local stakeholder oversight, and as such do not address social development outcomes of employment. Producers that pass the Code are then accredited. As of September 2005, nine sites have been accredited. In all, 33 of the 53 producer members have either been audited, submitted improvement plans, and/or been accredited.

There is no WIETA label as of yet for the products. It has been debated but is felt to be too early in the process to introduce. At this stage, audits only take place at the middle of the supply chain – to date growers supplying the estates have not been looked at. It is felt that it would therefore be misleading to have a certificate if the whole of the supply chain has not been audited. There needs to be an incentive process to go further down the chain, where issues arise such as who will pay for the audit process. If there is a fully implemented monitoring system, then WIETA could begin to look at some form of labelling.

It is however, believed that competitive advantage will be generated from the compliance to the WIETA code. In building human capital WIETA hopes that employees will gain a better understanding of the wine production and will consequently improve productivity.

WIETA's Stakeholders

Retail members of WIETA, and importers of South African wine include UK-based Tesco, Co-op, Marks & Spencers, and Asda. As members they are expected to follow

the compliance process and progress of the supplier, ensuring that member producers are ethical companies.

WIETA has developed strong relations with NGOs and other service providers on issues such as health and safety in order to be in a position to share best practice to producers wishing to be accredited.

The attraction for producers taking up the Code has been to address the above-mentioned issues, but also to share learning and be involved in a multi-stakeholder initiative. There has however, been no in-depth research carried out to date on why producers have become involved and what benefits they have found. Research, funded by NOVIB, is just beginning to understand these issues and to begin to develop a business case for involvement in WIETA on the part of producers. Anecdotally, there has been a mixed response to the implementation of the code by producers; there are those who are really committed and have adopted the ethos of the code – these have tended to be companies where CSR was already an important aspect of business and where places were either unionised or there was a lot of worker participation. Whilst at the same time there are those questioning why they are doing it. At the present time there are a number of wine producers that are not doing well because of the Rand improving against the UK pound.

Competition amongst producers is fierce, so issues of transparency are problematic when perceived as compromising any competitive advantage. WIETA is still a very young organisation but the hope is that if a number of producers join WIETA, the nature of the industry is such that others will follow. In terms of accreditation, there have only been a few accredited to date – a number are sitting on the fence to see what happens. Again, a fully developed business case would enable more to participate.

There has been interest from government, with a member of the Department of Labour on the Board, who is in favour of rolling out the code pilots. WIETA also shares information with the inspectorates, and has done some training of inspectors. There has also been some financial support from Departments such as Economic Development, Tourism, and Agriculture; for example the latter funded a project on Health and Safety, which has been traditionally poor in the wine industry where awareness of such issues is poor. As yet there has been no collaboration with the Department of Trade and Industry, and may be a result of a lack of clarity as to the linkage between competitiveness and compliance.

Other Sectors and Practices

Fair Trade has had more attention paid to it and in some instances in the past it has been easier to be fair trade accredited as the audit processes were not as robust as in ethical trade. For example, it was only recently that Fair Trade began using local auditors. Black Economic Empowerment component has been introduced for Fair Trade, giving it more of a developmental aspect. So that now if a company is Fair Trade-accredited, 25% of its business has to be worker controlled.

There has also been interest from a number of other sectors, where there has been pressure to provide services in other areas of agriculture (e.g. fruit, flowers), where there have been a couple of exposés concerning the labour conditions of casual workers in deciduous fruit. WIETA is the only multi-stakeholder initiative in this area, and has started some work with a flower labelling project. But at the moment the association's constitution does not allow it to include other agricultural producers, but this widening of the remit will be put to a vote at the AGM.

Conclusions and Lessons

WIETA is a multi-stakeholder association, which includes a number of wine producers (clustered in the western cape region) from an industry that is highly competitive and has a poor reputation. Pressure from buyers, particularly in the UK, as well as the changing national socio-economic environment, has seen producers seeking to improve this reputation through membership of WIETA in order to maintain market access. The WIETA code is a compliance-driven code and to date there has been no research into how it makes the industry more competitive. There is a need to demonstrate the business case for producers, particularly those who don't feel the pressure from above in the supply chain. There is an emphasis on shared learning and use of WIETA as a source of best practice. In addition, the model of WIETA as a 'partnership cluster', is being replicated in other examples, such as the Horticultural Ethical Business Initiative (also driven by the Ethical Trading Initiative) and the Ethical Tea Partnership, and is drawing interest from other agricultural sectors in South Africa.

[Sources: Interview with Nicky Taylor, CEO of WIETA; WIETA website and newsletters, www.wieta.org.za]

The WIETA Audit and Accreditation Process

The auditing team

WIETA has appointed a team of 16 social auditors, who are contracted to work for the organisation on a part time, independent contractual basis. These persons have been appointed in consultation with the various stakeholders represented on the executive. The social auditors are familiar with the sector, have an excellent understanding of employment legislation and its practical implementation.

The pre audit phase

The lead up to the audit is carefully planned and gives sufficient time to the team to seek information from producers, for the producer to prepare information, and for the inspection team to then digest and use this in planning the actual inspection.

Carrying out the audit

On the day of the inspection, the team will hold a briefing meeting with management and workers, or worker representatives. These could be either union representatives, or where none is active, worker-elected representatives, including at least one man and one woman who should be asked to ensure that their colleagues understand the process. This briefing meeting allows an explanation of the procedures and ensures that, where management did not pre-inform workers of the inspection, they have some understanding of the purpose and process.

Verification of information on conditions at work

All information obtained from management on terms and conditions of employment is verified through:

- A series of private interviews with a representative sample of employees (men and women of different job grades and languages, and permanent and temporary employees),
- A review of the documentation kept by management, and
- An inspection of the workplace and housing allocated to workers.

Reporting back

At the end of this process, the team meets with management and employee representatives to report and agree on findings.

WIETA accreditation

The WIETA audit committee meets on a monthly basis to discuss the accreditation of members. This team comprises one trade union, one producer, one department of labour and one NGO rep on the WIETA exco. The group has privy to blind copies of the audit reports and improvement plan and makes a final decision about the accreditation of the member concerned based on the documentation submitted to it. A member will be accredited where the audit report reveals that it complies in full with the code, or where an improvement plan, signed off by both parties, stipulates the steps that have been taken subsequent to the audit to rectify any non compliance.

4.2. The Vietnam Business Linkages Initiative (VBLI)

Context

A number of international buyers wished to source products from Vietnam in the late 1990s that were of good quality and manufactured in acceptable workplace conditions. There was a concern that international brands were becoming over-dependent on China, however, they needed to compete effectively with China on quality as well as cost.

The initiative arose out of a study commissioned by DFID in 1999 and supported by the World Federation of Sportswear into the use of chemicals in the footwear industry, which employs 400,000 people. The initial programme was supported by DFID and Nike, adidas and Pentland. The second phase now getting under way is being supported by DFID (through their Business Linkages Challenge Fund) and members of the World Federation. This phase takes the learnings and experience in the footwear industry to the garment sector and aims to take both to scale and impact. It also mobilises all 27 participating organisations to play their parts in the sustainable and systemic improvement of the industries.

The motivation for international companies was to try to achieve systemic improvements on conditions in supplier factories through collective action. They had been spending huge amounts on individual audits, and were also looking to reduce costs. But there was concern that the products would not be accepted by the EC because of manufacturing processes in Vietnam. The study on chemicals in factories (on their use, storage, etc.), gave rise to serious concerns including noise, dust and heating within the factories.

The initiative has focused solely Health & Safety issues at this stage as these were the most material concerns. The initial focus of the programme was on improving practice in the use of chemicals (choice, storage, application, disposal etc), on improvement in lighting and on the reduction of heat, noise and dust in the workplace. Over the period of Phase 1 of the programme attention was given to a wider health and safety remit. Underpinning the initiative was a key additional challenge to achieve systemic change across the industry in Vietnam rather than in just a few selected factories. In addition there is as yet not the level of mutual comfort to deal with the other more contentious issues. These are however, being dealt with through individual company codes in their relationships with suppliers.

The Vietnam Chamber of Commerce and Industry was seen to be the most appropriate organisation to manage the process, with the VBLI acting as the Secretariat based in the VCCI.

The VBLI

The initial action programme for VBLI had the following core elements:

1) Drafting of a Code of Conduct to be signed by participating factories,
2) Developing a Management Support System which would provide basic guidelines on health and safety for factory managers,
3) Creating and delivering effective training for factory managers, supervisors and employees,
4) Maintaining a regime of research, information and publication on the on-going needs and challenges of the industry,
5) Carrying out factory visitations (monitoring was carried out by VBLI on an ad hoc basis but it is not a formal audit process),
6) Building the conditions and frameworks within which a regime of national monitoring and inspection could be developed.

In phase 2 of the project, the aim is to have a greater impact in the factories. Phase 1 had lad the ground, with pilots, training, etc., but what is needed now is more consistency and greater take up of practice in health and safety by participating factories. This is seen to be more important than ever as the government, which has now set up a Commission for Sustainable Development across industries, and have looked at the VBLI as a good model.

The factories still have some way to go in implementing the code; they tend to improve for a while but when other pressures to meet deadlines arise, they fall back again. The types of companies which adhere to the code best are state-owned and local privately-owned companies. Those most reluctant to join have been Korean and Taiwanese companies who are quite powerful in the market. There is however, an agreement for the WFS to meet with these suppliers to get them on board.

Key Achievements of Phase 1

a) A Code of Conduct for the industry is in place,

b) A detailed Management Support System has been completed, tested in pilot factories, approved by the Ministry of Industry as a standard and disseminated to over 60% of all footwear factories.

c) Training courses for factory managers responsible for Health and Safety have been developed, tested and delivered,

d) An additional Code of Conduct within which factory visits are carried out has been developed and applied,

e) Some 60% of factories in the footwear industry have participated in the programme to some extent,

f) Research has been conducted into the key issues to be addressed in factories and into the opinions and suggestions of a cross section of workers from the industry,

g) The National Institute for Labour Protection has conducted research to identify key health problems of employees within the industry and ActionAid Vietnam assisted with a study into the health of women workers,

h) Using the outcomes of the programme, the Ministry of Labour, Invalids and Social Affairs (MOLISA) has begun the process of:

   - creating national training courses for professional Health and Safety managers which can serve as a standard for certification,
   - establishing capacity for the monitoring and inspection of factories by trained inspectors.

i) The potential application to the garment industry of the programme developed for the footwear industry has been studied and tested,

j) The garment industry extension has been taken forward by the conduct of 4 workshops for factory management,

k) The World Bank has recognized the programme as an example of good practice,

l) The 23 organisations who formed the original Steering Committee of the programme have largely continued to do so through the life of the programme and have confirmed their support for a Phase 2,

m) VCCI have developed their capacity to manage programmes of this nature,

n) The UK Government's Department for International Development has approved an application for funding a Phase 2 of the programme.

VBLI's Stakeholders and Governance

The VBLI is a multi-stakeholder initiative, with 27 organisations now involved (see below for list of original members). Although the members don't directly include clusters, they are represented by their trade bodies, such as the Vietnam Leather & Footwear Association.

All the organisations sit on a Steering Committee that meets twice a year and receives then discusses proposals for change. From that the Management Committee, meets more frequently and is made up of a representative from each of the main actors (govt, industry, international buyers). The VBLI Secretariat reports to them on a regular basis. Then there are the requirements to DFID the funder, which involves a rigorous quarterly reporting system (they make payments in arrears), which is also submitted to the SC. IBLF has two roles, as the international adviser to VCCI and the fundholder. It is also co-chair, with VCCI of the meetings.

The benefits of such a process are that everyone is fully informed, funds are used for the purposes given (there is a screening system for use of funds). The downside is that the reporting can be a cumbersome process. It does however, create a neutral platform, and a sign of its success is that to date no single organisation has pulled out of the initiative. Trust has been built up over time as partners have got to know each other and their capacities have developed.

The nature of VBLI as a partnership means that you take the competition out of the process, by creating this framework for co-operation. The important thing now is to capture the belief and reality that such a process can improve productivity. Evidence is anecdotal at this stage but positive.

Phase 2 of VBLI

The key objectives of Phase 2 are:

(a) To increase the scale and impact of the improved health and safety standards developed by VBLI in the factories in Vietnam,

(b) To support the institutionalisation of health and safety standards within Vietnam, through government, industry bodies, trade unions and educational establishments,

(c) To transfer VBLI learning and processes to the garment industry,

(d) To reposition VBLI as a facilitator for health and safety promotion in industries - rather than a deliverer of training and other services,

(e) To achieve local sustainability of VBLI by the end of the 3 year period,

The programme does however, recognise a number of key challenges in achieving these objectives. These include the need to find additional private sector funding to enable the initiative to be sustainable beyond the next three years, to include a wider range of factories, and demonstrating the real and measurable impact of the programme before attempting to transfer to other industries.

Phase 2, also means that the VBLI will now take on more of a facilitation role, building the capacity of others to deliver training, inspections etc. One such role will be taken over by MOLISA, which will eventually become responsible for inspection and monitoring. There are also plans for the certification of factories.

Conclusions and Lessons

VBLI is a multi-stakeholder initiative, with the explicit aim of improving the conditions of health and safety in Vietnam's footwear industry as a competitive advantage. It includes representatives from clusters and is high level as well as wide ranging in those participants involved in the initiative. The governance process, enables a neutral platform on which views can be shared and lessons learned collectively. There is still some way to go to get all participating companies compliant with the code, but there is great interest and more recently the initiative was expanded to include the garment industry. This industry is different to footwear as it is more fragmented, made up of a greater number of SMEs.

[Sources: Interview with Peter Brew, of the International Business Leaders' Forum; VBLI Phase 2 Report; website material, www.vcci.com.vn/sub/vbli/default.htm]

4.3. Cambodia's Responsible Competitiveness Strategy: Labour Standards as a Competitive Advantage in the Garment Industry and Beyond

Cambodia's garment industry began in 1994, and grew from a mere US$20million, to US$1.6 billion in just ten years. Although Cambodia's production is only 1% of global exports, it represents 80% of exports and 12.4% of GDP. The end of the MFA (see above) offered the prospect of a serious reduction in exports. The country however, has a reputation of being sweatshop free in garments, which is borne out a bilateral trade agreement signed in 1999 with the US, where in exchange for a secured annual quota of exports to US, the country would demonstrate improvements in labour standards.

With the end of the MFA, the US-Cambodia Agreement became redundant, and the Ministry of Commerce requested FIAS assistance to assist the Government and the industry to re-design the labor standards system away from US Government quota decisions into a market-led strategy.

The first step was to test the assumption that there is an export market niche based on labour standards, combined with the normal criteria of price, quality and speed to market. A survey of Cambodia's key US and European buyers confirmed the existence of this market niche. Not only did buyers rank compliance as a top priority, but a large majority stated that auditing of labour standards would remain crucial. This labour standards advantage was the only issue on which buyers surveyed believed Cambodia outperforms its regional competitors.

The next step involved all stakeholders redesigning the existing monitoring and reporting systems in line with best practice and re-targeting activities to meet the informational needs of international buyers. This suggested that best practice involved seven characteristics: 1) be sector wide (aspire to 100% of firms); 2) be transparent; 3) have a shared governance structure; 4) involve international buyers; 5) reduce inefficiencies; 6) measure productivity impacts; and 7) achieve market-based incentives. The first phase of the Cambodia Garment Sector Project met the first two characteristics, and possibly the third but not the remaining four.

The next phase is thus designed to include all seven characteristics, build on Cambodia's first move advantage with labour standards, and redirect activities towards meeting the market needs of overseas buyers and their stakeholders. This will mean that activities will be integrated into the way the industry functions and

will be overseen by a tri-partite governing body, made up of the Garment Manufacturers Association of Cambodia, the Ministries of Labour and Commerce, and trade unions.

The scheme, re-branded by the ILO as Better Factories Cambodia , aims to have one unified labour standards monitoring and reporting system that: a) meets the labour standards information needs of all suppliers and buyers; b) triggers market responses –positive and negative – and industry self-regulation; c) dramatically reduces the current duplicate monitoring and inspections in the garment industry; d) allows the Ministry of Labour and Vocational Training to refocus its own inspections in the export garment industry on enforcement, compliance, and complaints-based work.

Finally, an analysis of the applicability of such a system in the other main sectors in Cambodia (tourism, agribusiness, forestry, and oil and gas), found that similar processes could be established in those industries. In essence, setting national standards, putting in place credible monitoring and certification structures and institutions; facilitating access to finance; recognizing international certification schemes as equivalent to public sector inspection; monitoring; working under shared governance systems; etc. are among the common tools that can support the Government's vision of a country committed to labor and environmental standards, building on the existing structure and experience gained from the garment sector.

[Source: FIAS (2005) Cambodia: Corporate Social Responsibility in the Apparel Sector and Potential Implications for other Industry Sectors. FIAS, Washington DC; Better Factories website www.betterfactories.org/default.aspx].

4.4. Responsible Competitiveness as a Development Strategy in El Salvador

Based on a deliberate private sector growth strategy, the Government of El Salvador has promoted exports and foreign investment, most importantly to and from the U.S. While the strategy was successful during the 1990s, many believe that growth took place at the expense of environmental sustainability and social cohesion. Also, economic growth and exports, previously propelled by the apparel industry, began to stagnate after 2000. Similarly, the agro processing sector has struggled with increased competition, falling market prices, and large lay-offs.

Several trends reinforce the notion that attention to labor and environmental issues are of great importance. Market forces are giving greater priority to production that incorporates good labor and environmental content. In some cases, especially in the agriculture sector, new markets based on these supply chain factors are being created and are gradually expanding. Trade agreements, bilateral, regional and otherwise, are steadily including more requirements on labor and environment. In this context, there are opportunities for El Salvador to enhance its competitiveness through efforts to strengthen labor and environmental performance and reporting.**"**

El Salvador's Responsible Competitiveness Strategy

FIAS and others are working with the Government of El Salvador, a country with only 6 million inhabitants and a GNP of US$ 13,6 billion, in order to establish a national CSR framework that enhances Salvadoran competitiveness and contributes to national sustainable development.

The basis for the project is that through increasingly accountable social and environmental practices, Salvadoran products would reach international market standards, becoming more lucrative while enhancing its own development.

- operationalised standards on labour and environmental issues, drawing on national laws and international principles;
- capacity building amongst producers to ensure awareness of and ability to implement these principles;
- information resources to enable the spread of good practice;
- dialogue with key actors, e.g., workers, communities, workers' representatives, and NGOs, to promote collaboration in pursuit of these goals;

- transparent and efficient mechanisms to assess and verify good practice in a manner that enhances use of public resources and the creation of market opportunities.

[Source: FIAS, IFS and The World Bank (2005). Unpublished. "Building a framework for Corporate Social Responsibility as a Development Tool in El Salvador". Washington D.C., United States.]

4.5. Colchagua Valley wine cluster, Chile

Environmental action spreads through a cluster, pioneered by a single enterprise

Overview: Colchagua is one of several successful wine-growing areas in Chile that has dramatically improved quality and increased exports in the past ten years. In the 1990s, wine exports grew in excess of 25% a year. In the 2000s, firms started to look for additional competitive advantage in the face of a tightening world market. One dynamic firm invested heavily in organic and biodynamic wines. Uptake of organic approaches appears to be spreading in the cluster, but is currently restricted to an inner circle of networked and knowledgeable firms.

Background: Colchagua is a long-established wine growing cluster, with some 100 wine producers in the valley. The production structure exhibits 'considerable horizontal specialisation and competition, and there are several types of vertical supply link' (Giuliani & Bell, 2004). Among the leading winemakers, 21% are vertically-integrated, local firms. Another 7% are local subsidiaries of national wineries, while the remaining three quarters are vertically integrated bulk suppliers that do not bottle under their own brands.

Supported by export agency ProChile, university wine departments, and visits from European and US experts, the cluster invested heavily in the mid to late 1990s, doubling the area of vineyards, improving viticulture techniques, upgrading production– often by importing equipment from Europe and California. As a result, wine output trebled.

The challenge: By the late 1990s, facing the risk of overproduction as global wine sales faltered, Colchagua wineries began to look for a new round of innovations to go upmarket.

The response: Chilean wine-maker Alvaro Espinoza had studied in Bordeaux and worked in California in the 1990s with pioneer organic wine-makers. Colchagua's dry climate minimises the risk of leaf mould and therefore makes organic farming more feasible than in many other areas. Espinoza was determined to produce organic wine, and was increasingly interested in the most stringent, holistic approach known as biodynamic agriculture too.

In Colchagua, he found a traditional vineyard, Santa Emiliana, ready to back his idea. 'The challenge was not minor', according to Espinoza, 'but Emiliana Vineyards believed in me, giving me the support necessary to carry out the project.' The result

was Viñedos Orgánicos Emiliana (VOE), now internationally recognized by one of Latin America's best organic wine producers. VOE has distributors in Chile, Ecuador, New York, UK, Ireland, Belgium, Italy and Malaysia. The organic wine market worldwide is growing fast. 'The current shooting star in the organic wine sky is Chile,' according to Biofach, the organic wine trade fair, held annually in Germany.

Timeline:

Early 1990s: Alvaro Espinoza works at organic winery in California

1998: Viñedos Orgánicos Emiliana begins the process of certification with Swiss IMO (Institute fur Marktokologie).

2001: first fields certified organic; ISO 14001 certified.

2003: first VOE wines certified Demeter Biodynamic.

2005: 100 % of VOE vineyards certified by IMO.

Cluster dynamics: an in-depth study of the Colchagua cluster in 2002 (by Elisa Giuliani of SPRU Sussex) used social network analysis to understand the dynamics of the cluster. Giuliani assessed the cluster's knowledge transfer capacity and found that performance was very mixed between firms within the cluster. Based on a sample of 32 leading winemakers, she found four main types of firm: knowledge sources, mutual exchangers, absorbers and isolated firms. Core firms had higher absorptive capacity and 'tend to transfer knowledge more often within the core. As expected, they were also identified as sources of knowledge by peripheral firms.'

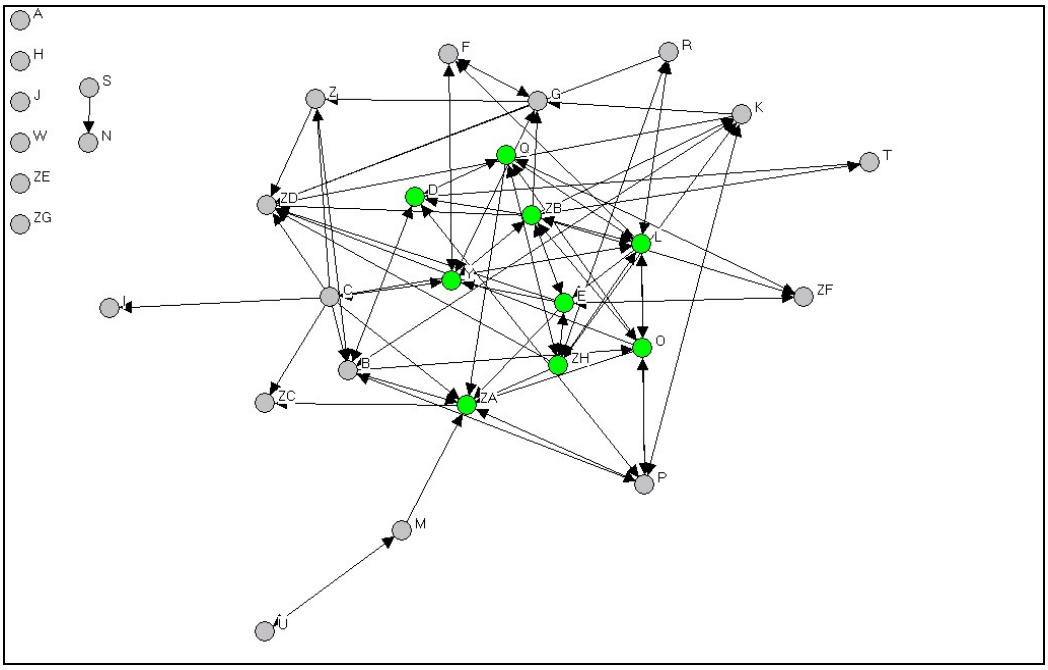
Giuliani and Bell (2005) described the handful of firms that were knowledge sources as well as having a high degree of openness as 'technological gatekeepers'. Conversely, they called firms that were equally open but mainly absorbing knowledge 'external stars'. Many firms in the cluster were isolated, however.

	Low openness	**Medium openness**	**High openness**
Source			*Technological gatekeepers*
Mutual exchanger		*Mutual exchangers*	
Absorber			*External stars*
Isolated	*Isolated firms*		

Source: Giuliani & Bell 2005

There is no central institution in the cluster promoting organic wine. Yet when asked about their adoption of organic techniques, nine firms responded positively. All of these firms were located clearly in the centre of the knowledge transfer map, as shown below. VOE was an early pioneer in the late 1990s and early 2000s, but by 2003 an inner circle of dynamic and knowledgeable firms were also investigating in organic production, as well as other environmental management techniques such as integrated pest management.

Diagram: Firms investigating organic standards (green) are predominantly cluster 'technology gatekeepers' at the centre of knowledge transfer



Source: Elisa Giuliani, October 2005

What the case shows: VOE actively sought organic and biodynamic status to gain market access, rather than as a response to external environmental pressure. After a delay, some of the most dynamic wineries within the cluster then began to investigate organic viticulture, though by 2005 they had not achieved organic status. Will the remaining more isolated firms in the cluster follow suit, and if they do, in what sequence?

[Sources: Giuliani, Elisa (2005); Giuliani, E & Bell, M (2005); http://www.voe.cl/ingles/home.html; www.biofach.de/press]

4.6. 'Cooperating for Survival': Palar Valley Tanneries, Tamil Nadu

Overview: The tannery clusters of Palar Valley are a rare example in the literature of a cluster that successfully responded collectively to an external CSR challenge. One success is no guarantee that a cluster will remain competitive – or responsible, but it must help.

Background: The 500 plus tanneries in Palar Valley, in the north of Tamil Nadu state in India, produce roughly half of India's leather. The Indian leather business remains quite competitive, with exports worth $2.4 billion in 2004-05, up from $2.2bn in 2003-04. India accounts for around 2.5% of the world trade in leather, behind China (22%), Italy (16%) and Brazil (3%).[11]

The five tannery clusters of Palar Valley have been heavily regulated for decades. First, they were expected to contribute foreign exchange, then to provide employment for disadvantaged groups (especially Muslims). As a result, government regulated to keep businesses small, and although individual firms tried to find ways to grow around the regulations, the clusters continued to be a dense network of very small and small (80% of the total), medium and larger firms even as they moved up the supply chain from raw hides to finished leatherware. The clusters benefited from a number of strong research and marketing associations.

Town	*Population (2001)*	*Number of Tanneries 1998*	*Percentage Very small ≤1000 kg/day*	*Percentage Small 1001-1500 kg/day*
Ambur	99,855	67	43	16
Melvisharam	36,675	37	24	38
Pernambattu	41,323	18	33	28
Ranipet	47,236	202	80	9
Vaniyambadi	103,841	136	89	8

Source: Kennedy (2006)

However, tanning is a polluting industry. In the late 1980s and early 1990s, firms were slow to respond to pollution control standards, and local regulators did not enforce them. It was a classic 'Devil's Deal'.

The challenge: In the mid-1990s, environmental crisis struck the tanneries. In 1995 the Supreme Court of India ordered the closure of hundreds of tanneries for failing to treat their effluents. This was the result of campaigning by a small but vociferous local NGO, the Vellore Citizens Welfare Forum, which mobilized farmers concerned that tanning effluents were contaminating their fields. Muslims dominate the local

tanning industry and Kennedy (2006) reports there was an ethnic as well as environmental component to the Hindu-led protest.

The response: Facing imminent ruin, local producers 'opted overwhelmingly for a collective solution', and rapidly began to construct central effluent treatment plants or CETPs. In her influential paper, Loraine Kennedy showed how cooperation, facilitated by community ties and shared local identities, enabled the clusters to weather the storm. In some cases, the managers of the CETPs became respected figures coordinating joint action within newly configured cluster groupings centred around the new effluent plants. Some CEPTs are now more dynamic than the traditional tanners' associations.

Kennedy's work has been widely interpreted as showing that an external challenge can enhance cooperation in the cluster and increase the potential for future collective action. Most firms in the clusters responded successfully to a later crisis when German buyers with little warning banned PCP and other tanning chemicals. With technical help from the nearby leather research institute, replacements were rapidly identified. According to Kennedy, 'the direct involvement of lead industrialists in the CETPs means that environmental issues are more likely to be integrated into line management in their respective firms, hence into the overall business strategy, a factor that could favor environment-friendly innovations.'

It is important to note that the cluster did not respond uniformly to the crisis:

- separate sub-clusters in the valley responded very differently, with the least technologically advanced sub-cluster in Pernambattu failing to set up common effluent treatment systems. In contrast, 22 of 25 firms in Melvisharam joined the CEPT;
- success relied on judicial coercion, NGO campaigning, government grants and technical assistance as well as strong social ties within clusters – and geographical proximity.
- some firms in the wrong locations could not join the CETPs and were faced with either an expensive individual plant – or closure. Other larger firms saw the opportunity to pull out of CETPs and so reduce the viability of a collective solution. Today 69 firms have their own treatment facilities.

- High status managers are crucial for the success of CEPTs but serious difficulties arise from collective action in clusters, notably identifying free-riders and monitoring and enforcing compliance in a small community;
- the CETPs are arguably no longer an adequate solution to tannery effluents. Local farmers and environmentalists continue to call for the clustered tanneries to be closed unless they further reduce effluents - and also tackle the problems of sludge and animal wastes. There has also been widespread dissatisfaction among farmers about the way compensation payments for contamination were handled.[12]
- there is no evidence that the clusters have embraced other aspects of the CSR agenda – eg labour standards, health and safety, community engagement.
- pollution control is not a one-off challenge but a continual process. One current possibility is using biotechnology to treat wastes, proposed by the Technology Business Incubator at nearby Vellore Institute of Technology.[13] Will such technologies be made available on a cluster basis, or to individual firms?

What the case shows: Joint action can promote the competitive position of small firms – if the stakes are high enough. Most small firms in the sub-clusters responded successfully to the environmental crisis: 356 firms of the original 500 are today members of CEPTs, and their ability to act collectively has been enhanced. On the other hand, the tanning cluster remains reactive rather than proactive on CSR issues. For example, recent efforts to establish an eco-label for Indian leather goods have so far failed, both in the market and within the industry (Ghayur, 2005).

[Sources: Alam, Ghayur (2005) 'A Study of Ecolabels in India and the European Union and their Impact on the Export of Leather Products from India', for Consumer Unity and Trust Society (CUTS), Centre for Sustainable Development, Dehradun; Kennedy, Loraine (1999) 'Cooperating for Survival: Tannery Pollution and Joint Action in the Palar Valley (India)', World Development 27 (9) pp. 1673-1691; Kennedy, L (2006) 'Improving Environmental Performance of Small Firms through Joint Action: Indian Tannery Clusters' in: Blackman, Allen (ed), 2006; Tewari, Meenu & Pillai, Poonam (2003) 'Negotiated Collective Action and Adjustment in Tamil Nadu's Leather Industry', University of North Carolina at Chapel Hill & World Bank. mtewari@unc.edu]

4.7. Sinos Valley, Rio Grande do Sul, Brazil

Situated in Southern Brazil in the Sinos Valley in the State of Rio Grande do Sul this is the single biggest leather footwear cluster in the world and the most significant exporter of the product in Brazil. The cluster comprises of 25 settlements in the Sinos Valley and includes over 400 companies of varying sizes, but most of which are family-owned SMEs.

The cluster is characterized by low investment in technology and in sales, where most firms are restricted to the production process. The buyer is therefore responsible for the branding, design, distribution and subsequent sales decisions. Additionally, given that 80% of Sinos Valley's production is exported, the extent to which responsible practices are disseminated throughout the cluster is proportional to the requirements of the buyers. The key driver for the adoption of responsible practices is therefore the need for compliance to ensure market participation.

Background

Since 1983 the Brazilian footwear industry has been overseen by the Brazilian Association of Footwear Industries, the Abicalçados, which is situated in Novo Hamburgo, the largest town in the Sinos Valley. Abicalçados members were responsible for a total production of 700 millions pairs of shoes in 2004, of which more than 200 million were exported to over 130 countries, the main markets being the US, Argentina, the UK and Canada, generating a revenue of US$1.8 billion. It is estimated that 300,000 people work in the Brazilian footwear industry (statistics from Abicalçados Online, 2005).

The Sinos Valley footwear cluster started in the early 19th Century and enjoyed a period of wealth and stable product flow towards the United States in the 1970s and 1980s. With the inception of a new national currency, the *Real*, in 1994 and competition from the rising Chinese footwear industry, Sinos Valley's success was shaken and hundreds were left unemployed. Although the industry saw a brief return to the days of growing exports from 1998-2003, it is again facing difficulties.

Once again, 2005 sees the threat of the strengthening of the *Real* and the apparent consolidation of the Chinese as well as the Indian and Indonesian footwear industries. From January to July 2005 the industry had already seen a decrease of 9% in relation to the previous year. Moreover, according to statistics of the Democratic Federation of the Workers of the Footwear Industry of Rio Grande do Sul, from January to 30

July 2005 alone 12.434 workers were made unemployed in the Sinos Valley. Given the exchange rate crisis and the direct competition with China and India, and on the higher end, Italy, the Brazilian footwear industry is struggling to find its competitive advantage, which admittedly is not price. "We want to avoid the custumers to whom the variable 'price' is most important" says Heitor Klein, Executive Director of Abicalçados. Klein and others know that the *Made in Brazil* brand is still important to some buyers, especially if the label is associated with quality products and superior labour conditions, than those enforced by Asian employers.

The State of Corporate Responsibility

There are few revealing studies on responsible practices by Sinos Valley companies (IPEA, 2002; Pasa, 2004; and Fundação Semear, 2003). However, the main findings of these point towards an increasingly responsible cluster, driven by the need to comply with buyer social requirements. Certifications such as SA8000, often serve as guidelines but are by no means common within the cluster. Through interviews with a number of Sinos Valley SMEs, Pasa (2004) found that although buyers do not require certification, their requirements are often higher than those of standards, and these are assured by internal and external assurers. Labour standards have supposedly improved to such a degree that an executive claims that "the competitive advantage of the Brazilian footwear industry over the Chinese is in its scale of production, its agility and in the social conditions granted to employees and the logistical chain".

Sinos Valley companies are known for their investment in education, of employees and their families, and to the health benefits that these employees receive. An extensive executive survey (Fundação Semear; 2003) supports this notion by indicating that the priorities for Sinos Valley companies are primarily around social assistance, education and health care.

The *Novo Hamburgo Letter*

This commitment to improving regional labour and social standards was reinforced recently by executives in the *Novo Hamburgo Letter*. From Novo Hamburgo, the unofficial capital of the Sinos Valley, on 17th August 2005 the five most important footwear associations signed a commitment letter to be distributed to Brazilian government and civil society. The letter represents a testament to how, collectively, they could increase Brazilian footwear industry's competitiveness in relation to the four challenges:

1. The increasingly competitive Asian market, in particular, China. These are slowly dominating global markets through costs, practices and labour conditions that are impossible to replicate elsewhere.
2. Disloyal competition from illegal products.
3. The so-called "Brazil Cost", such as poor infrastructure and high taxes.
4. The exchange rate problem.

Calling for a dramatic change to Brazilian laws and society, the associations present a 12-step practical solution process amongst which are:

- *Piracy*: The need to stop illegal products being made in the country as well as being brought into the country.
- *Informality*: The need for a greater monitoring at all government levels to ensure the elimination of informal labour around this area, which would consequently lower taxes on the products.
- *Labour regulation*: A modern, more just labour regulation system that maintains jobs and stimulates the creation of new jobs, as well as reinforcing employee-employer relations.

Child Labour: A Threat to the Valley?

In order to become more competitive in cost the sweatshop-style industry is replicated to a certain degree. In the form of *ateliers*, family houses where workers, women and children, work for lower salaries than that of factory workers and often are not under adequate nor safe work conditions in *ad hoc* work areas.

The region has since seen a movement developed by firms, government and international organizations, as well as with the aid of local organizations towards increasing the levels of education received by the average worker in the Sinos Valley, whether young or old, and to eradicate child labour.

Since 1996 the ILO, through their International Programme on the Elimination of Child Labour (IPEC), has been running a project with local NGO ASBEM to combat child labour in the industry. This project aims to:

- To increase the capacity and impact of local fora in Vale dos Sinos to promote labour inspection, withdrawal of children from shoe production and their (re)insertion into formal schools or education centres;

- To negotiate with the shoe industry in the region concerning a commitment to eliminate child labour in their production chain;
- To withdraw at least 120 children from work in the shoe industry in the municipalities of Novo Hamburgo and Dois Irmãos, as an initial measure to be extended to other municipalities and regions;
- To mainstream (ex)working children in schools or education centres.

Early on in the project a multi-stakeholder forum, entitled the Permanent Forum for the Elimination of Child Labour was established, composed of representatives from worker's unions, municipal government, local organizations and the Regional Office of the Ministry of Labour. The Forum has successfully lobbied for an adoption of a "Terms of Commitment" by the industry for the elimination of child labour in the entire production chain. Through seminars and meetings the project seeks to raise awareness around child labour and to prevent it from happening. These efforts have led to the withdrawal of 149 child workers from work. The project's success in the Sinos Valley has raised interest in the adoption of similar projects in other shoe producing regions of Brazil.

This attitude has been further enforced by demands of buyers. Brazilian shoe producer, Dilly has been Nike's only Brazilian supplier since 1999, and as such been forced to adopt codes of conduct and rules that match that of the American giant, including prohibiting the hiring of workers under the age of 18. Nike's attitude in Brazil receives approval from Instituto Ethos chairman, Oded Grajew "It is not only about worrying about your employees. It is necessary to cover exploitation of your supplier and of your supplier's supplier".

Conclusions and Lessons

The Sinos Valley cluster is being forced into a more responsible culture by buyers. Handling the most labour-sensitve part of the process (the production), these firms are not yet held to compliance by the adoption of standards, instead the export-oriented cluster is assured by internal and external assurers. Responsible practices for compliance and to increase the competitiveness of products comes into contradiction when irresponsible practices are adopted. A*teliers* with poor conditions, and child labour are used. But the leap in responsibility as the potential to increase competitiveness is sought by associations representing the cluster and wider industry. Finally, collective action is sought for business, civil society,

government and international organizations to successfully reinforce policies, monitoring and regulations so the Brazilian products can successfully compete against the increasingly competitive Asian industry of unique labour conditions, costs and practices.

5 Annex B: People consulted

Person	Organisation
1. *Barrientos, Stephanie	IDS, Sussex
2. *Engels, Reiner	GTZ
3. *Tomlinson, Peter?	ILO
4. Ananthpur, Kripa	Madras Institute of Development Studies
5. Brew, Peter	IBLF, London
6. Cotič Svetina, Anja	Slovenia
7. Davidson, Paul	UNIDO Nicaragua
8. Falkiner, Matthew	Exchange/Simplemente Madera, Nicaragua
9. Finkel, Thomas	GTZ Vietnam
10. Gereffi, Gary	Duke University
11. Giuliani, Elisa	SPRU, Sussex
12. Jaklic, Marko	Slovenia
13. Kennedy, Loraine	CNRS/Université de Bordeaux
14. Ketels, Christian	Institute for Strategy and Competitiveness Harvard Business School
15. Knorringa, Peter	ISS, The Hague
16. Kumar, Ritu	TERI Europe
17. Lund-Thomsen, Peter	Copenhagen Business School
18. Meyer-Stamer, Jörg	MesoPartner, Duisberg
19. Nadvi, Khalid	IDPM, Manchester
20. Nagpal, Sarita	Total Quality Management Division, Confederation of Indian Industry
21. Peglau, Reinhard	Umwelt Bundesamt
22. Phillips, Jennifer	Cluster Navigators, NZ
23. Richard, Frédéric	UNIDO Research
24. Sachdeva, Ashima	Research Associate- CSR UNIDO Cluster Development Programme India
25. Schmitz, Hubert	IDS, Sussex
26. Sandino, Pastora	UNIDO Nicaragua
27. Taylor, Nicky	WIETA, South Africa
28. Vives, Antonio	IADB/BID, Washington DC
29. Yawichian, Suriya	Labor Standards Advisory Service, Kenan Institute, Asia
30. Ivanka Mamic, Charles Bodwell, Max Iacono	ILO Thailand
31. Maggie Burns	Ethical Trading Initiative
32. Lynda Yanz	Maquila Solidarity Network
33. Ambreen Waheed	Responsible Business Initiative, Pakistan

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[2] The authors are grateful to Ambreen Waheed of Responsible Business Pakistan for her inputs to this section.

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