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Joseph Strasser

Bangladesh's Leather Industry

Local Production Networks in the Global
Economy

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*To Shumon
Deceased on February 2, 2014*

Acknowledgments

When I started the endeavour of a research project on Bangladesh's leather industry, I was unaware of the challenges posed by collecting information in the tanning estate. The language barrier, the pitfalls of intercultural communication, or the complexity of technical processes made the research process sometimes a daunting task. "Hazaribagh is not easy to fathom", I was told. Securing a livelihood there is even less so, as I learned in the course of my fieldwork. There are no words to describe my gratitude for all those people who engaged in either brief conversations or long-winded interviews, providing me with valuable insights into the leather sector while they put their own work on hold. Many of them I met several times, with some of them a relationship grew. One young man in his late twenties I witnessed physically deteriorate from early 2011, when he drove me on his motorbike through the tanning estate to his factory where he processed leather offcuts as inputs into fish and poultry feed, to late 2012 when he was already struggling with an inexplicable disease that had left him paralysed half a year ago. In February 2014, he was dead. It is pointless to speculate whether the daily exposure to highly toxic chemicals had a lethal impact on his health. This tragedy, however, gives reason to demand responsibility from decision-makers to finally commit to improving production conditions and reducing the vulnerability of all workers, entrepreneurs, and residents. Hazaribagh is due for change. This book is therefore dedicated to Shumon.

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March 2015

Joseph Strasser

Contents

1 Introduction	1
1.1 Rationale of the Study	1
1.2 Definition and Objectives of the Study	4
References	7
2 Conceptual Approaches	9
2.1 Global Commodity Chains, Global Value Chains and Global Production Networks	9
2.2 The Role of Middlemen/Intermediaries in Global Value Chains.	15
2.3 Subcontracting in Global Value Chains.	16
2.4 Reconceptualising Informality	18
2.5 Upgrading in Global Value Chains.	22
2.6 Research Questions	26
References	28
3 Methodology	33
3.1 Study Site and Research Methods	35
3.2 Limitations of This Study	39
References	41
4 The Leather Industry in Bangladesh	43
4.1 Historical Outline.	43
4.2 The Organisation of the Leather Industry	45
4.3 The Institutional Framework	46
References	48
5 The Leather Value Chain in Bangladesh—Results of a Qualitative Analysis.	49
5.1 The Organisation of the Leather Value Chain—Dominant Actors and Product Flows	49

5.2	The Leather Processing Subsector	52
5.2.1	Organisation of the Leather Processing Subsector—Dominant Actors and Product Flows	54
5.2.2	Coordination Between Leather Processors and Raw Hides and Skins Traders	59
5.2.2.1	The Procurement of Raw Hides and Skins in Low Season	59
5.2.2.2	Reverse Power Asymmetries in the Procurement of Raw Material—The Role of Intermediaries	62
5.2.2.3	The Modified Leather Supply Chain on the Festival of Sacrifice (Eid-ul-Azha)	66
5.2.2.4	Concluding Remarks on the Coordination of the Tannery-Trader Linkage	78
5.2.3	Coordination Between Leather Processors and (Foreign) Buyers	79
5.2.3.1	Domestic Market Activities	79
5.2.3.2	Access to the International Market	80
5.2.3.3	Informal Practices and Strategies in Global Market Entry—Analysis of Three Areas of Global Impact	86
5.2.3.4	Concluding Remarks on the Coordination Between Tanners and Foreign Buyers	96
5.2.4	Strategies to Improve the Competitiveness of Bangladesh’s Leather Processing Sector	97
5.2.4.1	Public Local Governance: Macroeconomic Development Strategies and Policies	97
5.2.4.2	Private Governance: Process Upgrading	100
5.2.4.3	Private Governance: Product Upgrading	134
5.2.4.4	Private Governance: Functional Upgrading	141
5.2.4.5	Prospects of Inter-sectoral Upgrading—Combining Leather Processing and Manufacturing	151
5.2.4.6	Public–Private Governance: Site Upgrading—Relocation to the New Tannery Estate	154
5.2.4.7	Upgrading and Informal Dynamics in the Tanning Industry	159
5.2.4.8	Concluding Remarks on Scope and Focus of Upgrading Strategies for Hazaribagh’s Tanning Industry	161
5.3	The Leather Goods and Leather Footwear Subsector	166
5.3.1	Organisation of the Leather Goods and Footwear Subsector—Dominant Actors and Product Flows	166

5.3.2	Coordination Between Leather Goods/Footwear Manufacturers and Leather Suppliers	173
5.3.3	Coordination Between Leather Goods and Footwear Producers and Customers on the Domestic Market.	177
5.3.3.1	Coordination Between MSMEs and Wholesalers	177
5.3.3.2	Coordination Between MSMEs and Large Domestic Companies	178
5.3.3.3	Coordination Between Lead Firms and First-Tier Suppliers on the Domestic Market.	179
5.3.3.4	Coordination of Subcontracting Relationships Among MSMEs	199
5.3.3.5	Concluding Remarks on the Coordination of the Leather Goods and Footwear Subsector	206
5.3.4	Integration of Micro, Small and Medium-Sized Leather Goods and Footwear Manufacturers in the Global Market	207
5.3.4.1	Coordination of Producer-Foreign Buyer Linkage	208
5.3.4.2	Constraints to Market Integration: Low Competences in the Supply Base.	212
5.3.4.3	Strategies to Adapt to Constraints in Market Integration.	219
5.3.4.4	Concluding Remarks on the Coordination of Foreign Buyers and Leather Goods and Footwear Manufacturers.	221
5.3.5	Upgrading in the Leather Goods and Footwear Manufacturing Industry	221
5.3.5.1	Learning from Local Large Manufacturers	222
5.3.5.2	Learning from Foreign Buyers	235
5.3.5.3	Learning from External Development Projects	239
5.3.5.4	Concluding Remarks on Upgrading.	248
5.4	Discussion of the Results in View of the Conceptual Framework	250
	References	253
6	Conclusion	261
	References	270
	Appendix	271

Abbreviations and Acronyms

BCSIC	Bangladesh Cottage and Small Industries Corporation
BFLLEA	Bangladesh Finished Leather, Leather goods and Footwear Exporters Association
BHSMA	Bangladesh Hide and Skin Merchants Association
BLSC	Bangladesh Leather Service Centre
BOI	Board of Investment
BPC	Business Promotion Council
BSCI	Business Social Compliance Initiative
BTA	Bangladesh Tannery Association
CETP	Central Effluent Treatment Plant
CF	Cost and Freight
COD	Chemical Oxygen Demand
COEL	Center of Excellence for Leather Skill Bangladesh Limited
CSR	Corporate Social Responsibility
DA	Documents against Acceptance
DCCI	Dhaka Chamber of Commerce and Industry
DLS	Department of Livestock Services
DE	Department of Environment
EC	European Commission
EPA	Environmental Protection Agency
EPB	Export Promotion Bureau
EPZ	Export Processing Zone
ETI	Ethical Trading Initiative
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FDI	Foreign Direct Investment
FOB	Freight on Board
GCC	Global Commodity Chain
GPN	Global Production Network
GVC	Global Value Chain
ILO	International Labour Organization

ISO	International Organization for Standardization
ITC	International Trade Centre
LC	Letter of Credit
LFMEAB	Leather Goods and Footwear Manufacturers and Exporters Association of Bangladesh
LGF	Leather goods and footwear
LSBPC	Leather Sector Business Promotion Council
LTSE	Leather Technologist SME Entrepreneurs
MDG	Millennium Development Goals
MSM	Micro-, Small-, and Medium-sized
MSME	Micro-, Small-, and Medium-sized Enterprises
NBR	National Board of Revenue
NGO	Non-governmental Organisation
NIE	New Institutional Economics
OHS	Occupational Health and Safety
PRICE	Poverty Reduction by Increasing the Competitiveness of Enterprises
RHS	Raw hides and skins
SCPR	Social Compliance and Producer relations
SEHD	Society for Environment and Human Development
SME	Small- and Medium-sized Enterprises
TT	Telegraphic Transfer
UN-DESA	United Nations, Department of Economic and Social Affairs
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organization
USAID	United States Agency for International Development
US CPSC	United States Consumer Product Safety Commission
WFTO	World Fair Trade Organization

Chapter 1

Introduction

Abstract This section introduces into the dynamics of global production networks from the perspective of Bangladesh's little diversified economy. It puts recent disasters such as the collapse of Rana Plaza in April 2013 into a larger perspective of low-cost sourcing strategies of northern multinational companies. Against the backdrop of the garment industry being the central driver of Bangladesh's economy, the leather sector has been picked as a case study to showcase the coordination of inter-firm linkages in a marginalised but globally integrated industry. This work identifies institutional limitations that constrain competitiveness, points to adaptation strategies of local producers and presents the potential for improvement along the supply chain. Questions are raised as to what enterprises are actively involved in the global leather production network. Different from studies examining trade flows from the Global South to northern consumption markets, this book focuses on power relationships between local lead firms and micro, small and medium-sized enterprises (MSME) supplying and being subcontracted within local production networks. In particular, the conditions under which local MSMEs achieve exports are often overlooked and will be subject to analysis.

1.1 Rationale of the Study

Since the 1990s, Bangladesh's economy has experienced striking growth. Global division of labour, trade liberalisation and western consumer demands have boosted the labour-intensive garment industry in the South Asian low-cost nation to over 80 % of national export earnings (ITC 2014). Other export industries like jute, leather or fish and crustacean have been outshone in Bangladesh's little-diversified economy. Remarkably, economic growth has been accompanied by substantial improvements in other sectors. Bangladesh has already met several targets of the Millennium Development Goals (MDG) such as gender parity in primary and secondary education, under-five mortality and others (UNDP 2014). It has also made major progress in reducing the population living below \$1 a day, although

numbers have been stable in absolute terms (UNDP 2014). Despite promising development in the last decades, neoliberal policies have engulfed progress in social and environmental sustainability. Rampant economic growth symbolised by factories mushrooming at the urban fringe and urban sprawl driven by massive in-migration prompted the destruction of eco-systems by illegal land filling and development projects particularly around Bangladesh's capital (e.g. Jahangir Alam 2014; Islam 2005; SEHD 2002). Today, Dhaka ranks among the largest megacities in the world (UN-DESA 2014). However, housing facilities, public services and livelihood opportunities are lacking for a large part of the population (Hossain 2011).

With the garment industry growing at record rates, Bangladesh became the second largest clothes exporter after China. In particular, female labourers have benefited from employment opportunities in large export-oriented factories. A series of fatal disasters (e.g. Spectrum collapse in 2005; KTS textile fire in 2006; Tazreen fire in 2012; see Clean Clothes Campaign 2014) revealed the vulnerability of a thriving but unregulated industry embedded in global dynamics. The collapse of Rana Plaza in April 2013 epitomises the cynical excrescences of a globalising economy that connects labour-intensive low-cost industries in the South to northern markets at the expense of the most vulnerable. With 1,139 dead workers (and more than 2,500 injured), most of them female, the highest death toll ever registered in the history of manufacturing called worldwide attention to inhumane conditions at the lowest end of global production chains or networks (Clean Clothes Campaign 2014). A calamitous alliance of negligent factory owners, corrupt politicians and profit-seeking multinational companies was held to account for lax compliance with and enforcement of safety standards (e.g. building and fire standards). Non-governmental organisations (NGO) in consumer countries have been pressuring large global brands and retailers (e.g. Aldi, Benetton, Lidl, Mango, Primark, Zara) to meet social and production standards in low-cost countries (Clean Clothes Campaign 2014).¹ Irrespective of the responsibility of local elites infringing upon laws and regulations, Bangladesh's history of deadly industrial accidents is inextricably tied to the North's sourcing strategies and its insatiable demand for cheap consumer goods.

Trade is globally organised, but what matters is how it is organised (Sturgeon 2006). Labour-intensive manufacturing industries tend to be embedded in global production and distribution networks or chains respectively, where the position in the latter defines the value-added of the activity. It is generally agreed that global buying companies at the top end of the chain coordinate a sequence of economic activities from least productive activities in low-cost countries (e.g. assembly) to more value-added functions such as research and development (R&D), design or marketing concentrated in northern headquarters (e.g. Sturgeon 2009; Gereffi et al.

¹One year after that, 155 global brands and retailers signed the Accord on Fire and Building Safety for their more than 1,000 supplying factories (of approximately 4,500) in Bangladesh (Clean Clothes Campaign 2013).

2005; Humphrey and Schmitz 2002; Gereffi 1994). However, tragedies such as Rana Plaza highlight a failure of governance as a result of changing coordination and control schemes within those chains: large global retailers either source directly from large producers in developing countries or in recent times increasingly from brokering intermediaries (Silva 2013). In either case, the final producer is often unknown and excluded from the global lead firm's control. Although this sourcing strategy has become a globalised practice, what is frequently overlooked is that large buyers tend to purchase from factories that are able to deliver equivalent quantities. The large supply base in low-cost countries, however, is constituted by micro, small and medium-sized enterprises (MSME), and the conditions under which they achieve exports often remain unnoticed.

In a low-cost sourcing strategy price determines competition. The current pressure on global brands and retailers testifies to the complex reality of labour-intensive, with often-polluting industries from developing countries being unfairly incorporated in global markets. The gains and strains of the corresponding economic activities are unevenly distributed at both global and local level. While NGOs raise awareness of poor production conditions and insufficient wages in large export factories, the conditions under which MSMEs cater to the international market generally escape public attention. Power asymmetries in local production networks and their impact on cross-border customer-producer relations are often missed; particularly, when it comes to industries that play a minor role in a country's export structure. Bangladesh's leather sector is not just a small national export earner and weakly integrated in the world market (see Sect. 1.2); the complexity of leather processing, for instance, encompasses a few intermediate products and the producers of each cannot be traced. Hence, the leather goods or footwear manufacturers might use finished leather as a raw material that has been processed by different tanneries, sometimes even in different countries. Such complexity leads to questions as to who is actively involved in global production networks and chains respectively, and under what circumstances.

Central to understanding global value chains is that spatially disperse buyer-supplier relations underlie an uneven distribution of information and knowledge. Such asymmetries at global level demand weaker actors at the lower end of the supply chain to adapt, often by means of informal practices. With power being asymmetrically distributed in local production networks, the competitiveness and market integration of SMEs is assumed to be affected, too. Such dynamics are strikingly visible in Bangladesh's leather industry, which consists of an export-oriented but ailing tanning industry and a leather goods and footwear sub-sector the export performance of which is picking up dynamically. This study aims to reveal power asymmetries in market integration and resulting (informal) adaptation strategies that serve for market entry. It advocates a holistic view of the local production network embedded in the global economy, analysing structures, processes and power asymmetries at the local level as a result of interdependencies with global dynamics.

1.2 Definition and Objectives of the Study

Bangladesh's remarkable economic growth has had little impact on the leather industry yet. Despite a notable effect on employment² and a favourable endowment of natural resources,³ leather products in Bangladesh account for just 2 % of national exports compared to 83 % in garments and rank fifth in Bangladesh's scarcely diversified export economy (ITC 2014). The subsectoral export performance reflects an uneven development however, with the higher value-added leather goods and footwear sectors closing in on the more volatile leather processing industry (see Sect. 5.2.3.2). Despite a quick recovery after the global economic downturn in 2008 and constant improvements since, Bangladesh's leather industry lacks the competitiveness to keep up with some of its dynamically growing South and Southeast Asian neighbours (e.g. India, Vietnam). Its share of leather products in the world market accounts for only 0.36 % (ITC 2014), placing it 29th, one ahead of Pakistan (Fig. 1.1).

The major drawbacks in the leather processing industry in Bangladesh are homemade. Insufficiently developed backward linkages cause chronic shortages of raw hides and skins (see Strasser et al. 2013), or make leather processors reliant on importing machinery and inputs such as chemicals. When it comes to exporting leather, Bangladeshi producers have limited capabilities to acquire international buyers. Thus, tanners and commercial leather exporters⁴ need to rely on the services of powerful brokers (buying agents). These agents carry out important functions to link up buyers and suppliers but also concentrate knowledge and information, preventing leather processors from moving on to more value-added functions.

In contrast, Bangladesh's leather manufacturing industry has experienced dynamic export growth since the beginning of the millennium, though from a very low level. Few large leather goods and footwear producers cater to international buyers, while micro, small and medium-sized manufacturers (MSMEs) lack the capabilities to export on a regular basis. MSMEs represent the large supply base serving the domestic market. However, they do not have direct access to their major source of income as the market is controlled by few local lead firms which integrate MSMEs selectively into their supply chain by subcontracting. Power inequalities in both markets appear to impede a better integration of MSMEs.

In addition to uneven inter-firm linkages, the institutional environment in Bangladesh has not kept pace with the changing requirements of international markets that have started demanding improvements in social, environmental and economic terms (e.g. Human Rights Watch 2012). According to expert interviews

²In 2006, it was estimated that 741,000 people were employed directly or indirectly in leather-related industries (GTZ 2006).

³Bangladesh ranks tenth in livestock (cattle, buffalo, goat, sheep) population (FAO 2014).

⁴Commercial leather exporters do not have their own tanneries but rent facilities to produce leather. Low overhead costs have turned them into serious competitors for tanneries providing the full range of tanning to finishing operations.

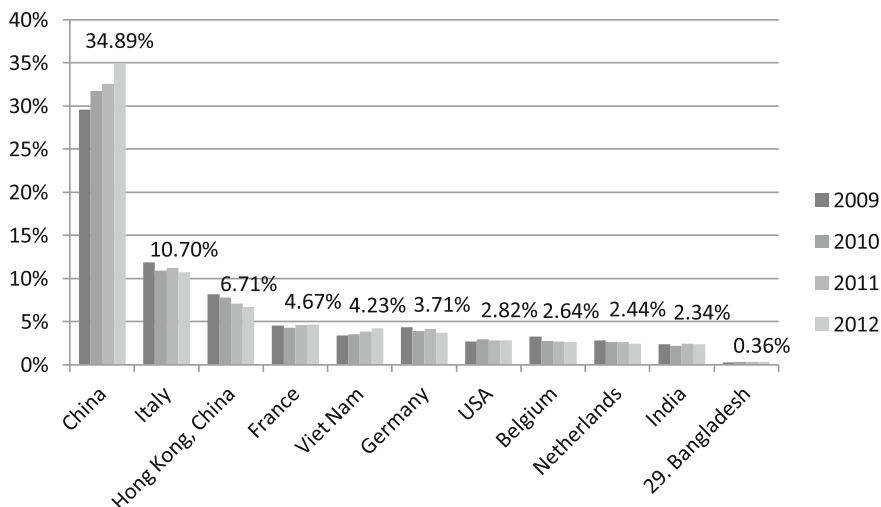


Fig. 1.1 Share of leather product exports in the world market, top ten countries plus Bangladesh, 2009–2012. *Source* ITC 2014; Own illustration

and Human Rights Watch (2012), large international buyers are wary of sourcing (directly) from Bangladesh and prefer to avoid negative publicity. Yet lax enforcement of environmental regulations and comparative advantages in labour costs seemed to have given Bangladesh’s leather suppliers scope in the low-end market as interviews with producers and buying agents suggest. Missing investments in production technology, waste management or R&D on key supply industries (chemicals) constrain the industry’s competitiveness on the world market. In response to these institutional limitations causing coordination problems, producers have learned to adapt, often informally, complementing or even substituting formally set procedures.

Research on global value chain dynamics in the leather industry has been mostly confined to environmental regulation and compliance (e.g. Dietsche 2011; Tewari and Pillai 2005; Lund-Thomson 2009; Hesselberg and Knutsen 2002). As opposed to case studies from Pakistan—and India, which ranks among the top ten leather exporting nations—Bangladesh lacks both a chemical input industry and a central effluent treatment plant (CETP), so global environmental standards have not been able to gain ground yet.⁵ In view of the abovementioned coordination problems, it was considered to be more appropriate to investigate the informal dynamics understood as practices, routines and strategies within a local production network struggling for global market integration. To the author’s knowledge, studies conceptualising informality within a continuum of informal-formal practices have

⁵The functionality of effluent treatment plants in India and Pakistan has been criticised as insufficient, while environmental regulation is weakly enforced (Dietsche 2011; Lund-Thomson 2009).

mostly dealt with trust, networks, self-organisation, non-formal employment and non-registered enterprises (see Sect. 2.4). This research on the tanning industry has uncovered informal and illicit practices that may serve as a strategic resource to overcome coordination problems in asymmetric power relationships. It will be investigated to what extent these practices⁶ have an impact on the firm's and industry's competitiveness. As for the leather goods and footwear manufacturing industry, the objective is to show how MSMEs are enmeshed in subcontracting arrangements in order to adapt to structural constraints and power asymmetries on the domestic market. It will be examined to what extent subcontracting influences their competitiveness or creates new dependencies.

The geographical and organisational fragmentation of production and trade (Humphrey 2004) has been increasingly studied within the Global Value Chain (GVC) framework. Understanding how the leather value chain operates is essential for devising strategies to enhance the producers' competitiveness. Conceptualising informal practices and strategies from an institutional perspective (New Institutional Economics) may help disclose constraints that structure relations in a globally embedded low-cost industry. By linking the GVC (see Gereffi et al. 2005) approach with the New Institutional Economics (see North 1990) and informality (Etzold et al. 2009; Li 2007; Misztal 2000), informal institutionalised practices are analysed in relation to the opportunities they provide for producers in developing countries and in terms of their ability to modify power relations in GVC governance. Considerations of economic upgrading (Bettiol et al. 2011; Ponte and Ewert 2009; Humphrey 2004; Humphrey and Schmitz 2000/2002; Gereffi 1999) highlight the potential for acquiring capabilities that contribute to improving the position within the value chain. Given this framework, the objectives are to:

- Provide an overview of how the Bangladeshi leather value chain is organised and governed.
- Analyse how the Bangladeshi leather industry consisting of the leather processing and leather goods/footwear subsectors is integrated into the global market and to what extent informal arrangements including illicit practices are conducive to global market entry.
- Dissect the power relations along the value chain and analyse how local producers (tanners, leather goods/footwear producers) adapt to uphold competitiveness.
- Emphasise the need to devise upgrading strategies which pay heed to the reality of informal dynamics in a GVC to improve the local producers' competitiveness.
- Put the case study of the Bangladeshi leather value chain in a broader perspective, show research needs and conclude.

⁶For reasons of space and own theoretical considerations, this study will not expand on corporate social responsibility (CSR). For a detailed discussion on CSR, see Campbell (2007), Matten and Moon (2008).