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Enforcing higher labour standards within developing country value chains: consequences for MNEs and informal actors in a dual economy

Abstract: The 2013 Rana Plaza disaster led external stakeholders to insist on higher labour standards in apparel global value chains (GVCs). Stakeholders now expect MNEs to take 'full-chain' responsibility. However, the increased monitoring and enforcement costs of a large network of suppliers have been non-trivial. MNEs instead implement a 'cascading compliance' approach, coupled with a partial re-internalization. Elevated costs are further exacerbated in developing countries where the informal and formal sector are linked, and cost competitiveness greatly depends on this duality. Monitoring actors in the informal sector is difficult, and few informal actors can achieve compliance. GVCs have therefore reduced informal sector engagement by excluding non-compliant actors and investing in greater automation. By seeking to strictly enforce compliance, MNEs are *attenuating* some of the positive effects of MNE investment, particularly the prospects for employment creation (especially among women), and enterprise growth in the informal sector. I discuss how these observations might inform other cross-disciplinary work in development, ethics, and sociology. Finally, I note implications for IB theory from the disparities between the ownership, control and responsibility boundaries of the firm.

INTRODUCTION

Sometimes key contemporary real-world phenomena have significant and long-term implications for society. These effects may not be immediately observable in the shorter term, and their direct relevance to international business (IB) not always obvious. However, as Buckley, Doh & Benischke (2017) emphasise, if IB scholarship is to remain relevant to policy it is incumbent on scholars to consider phenomenon-driven topics more carefully, while also adopting a broader, more multi-disciplinary view. The phenomenon that is the catalyst for this paper is the Rana Plaza Disaster in Bangladesh. In 2013, over 1100 workers died when the Rana Plaza building collapsed. Although this was neither an isolated incident nor an unusual occurrence (in Bangladesh or elsewhere in the developing world), it drew global attention to the poor working conditions within apparel global value chains (GVCs), many of which are controlled by multinational enterprises (MNEs). It acted as a 'focusing event', or a 'shock' that mobilised external and internal stakeholders across the spectrum to push for institutional and organizational change across an entire industry, and forced a series of significant policy innovations (Schuessler, Frenkel & Wright, 2019), not just in Bangladesh, but globally.

For this paper, the Rana Plaza incident is significant for what it represents more generally: it is a point of inflection in the public awareness of the ethics of outsourcing, across a broad range of industries. There are now a variety of public and private initiatives (involving buyers, MNEs, local firms, unions, governments, as well as foreign and domestic non-governmental organizations (NGOs)) to address improved working conditions through a number of mechanisms. I focus specifically on the increased monitoring and enforcement of working conditions (particularly those associated with labour standards) in apparel GVCs. The way in which GVCs in the apparel industry (and other similar sectors) are organised across the world has changed, and continues to evolve, with controversial implications as a (multidisciplinary) literature conveys (see e.g., Mezzadri (2014); Lund-Thomsen & Nadvi (2010); Williams, Shahid & Martinez (2016); Nadvi (2017); Giuliani (2017); Short, Toffel & Hugill (2016); Hemphill & White (2018)).

Greater scrutiny has acted to force MNEs (which are the lead firms within apparel GVCs) to address concerns about 'sweatshop' type behaviour by their suppliers, and radically alter the governance mechanisms of labour practices within their GVCs. Prior to the focusing event, lead firms utilized 'direct contract reasoning', taking responsibility only for its immediate (tier 1) suppliers, to whom they are contractually bound (and with whom there was active coordination and control). The new consensus pushes MNEs to accept greater responsibility for the labour practices of all the actors within their associated chain (Schrempf-Stirling & Palazzo, 2014) in what is known as a 'full-chain approach' (Humphrey, 2014) even where there are no direct commercial links to the lead firm.

This is easier said than done. In practice, there is considerable variation in the degree to which MNEs have succeeded in achieving full-chain responsibility (KnowTheChain, 2018).

Applying a transaction cost and internalization theory perspective (e.g., Narula & Verbeke, 2015), I discuss why achieving more effective compliance in GVCs leads to greater *de facto* vertical integration and automation. This reflects a need to balance the potential reputational damage against the rising transaction costs of monitoring and enforcing labour standards across a complex network of suppliers. More significantly, the associated increased transaction costs of such extensive monitoring within a large network of suppliers are non-trivial. MNEs choose instead to implement what can best

be described as ‘cascading compliance’, coupled with a degree of re-internalization. This approach does not require radically altering the structure of the GVC, and the distribution of rents within it, while mitigating the cost of engaging directly with a sprawling network of actors. Cascading compliance permits MNEs (‘lead firms’) to continue to exert greater control over the activities of their immediate (tier 1) suppliers, while also dictating how tier 1 suppliers engage with their own suppliers. Tier 1 firms, in turn, are expected to do exert similar control over their tier 2 suppliers (and their outsourcing arrangements), and so on.

The costs of full-chain responsibility are even higher in developing countries, where GVCs typically rely on actors and resources from both the formal and the (large) informal sector to achieve low costs. Formal suppliers are intricately linked to informal sector suppliers, and also depend on informally employed unskilled labour. The mechanisms by which formal and informal suppliers interact are complex, in part because institutions binding them are also informal, and because the actors themselves in a constant state of flux. This makes full-chain responsibility even more cost-prohibitive (and cascading responsibility more attractive).

The second contribution of this paper relates more directly to the informal/formal nexus, a defining feature of developing countries. The informal sector represents a paradox for policymakers. On the one hand, high levels of informality can underlay the cost competitiveness of labour-intensive production. Countries explicitly rely on MNEs for employment creation and skills upgrading (Narula & Pineli, 2019). Governments are aware that informal sector, as a source of low-cost inputs, is a significant beneficiary. On the other hand, governments also want to reduce informality, as high levels impede human and economic development. Development policies therefore also seek to effect the movement of actors away from the informal, and towards the formal sector. Governments want FDI because it creates jobs and raises incomes, and greater GVC participation provides such opportunities. While the informal/formal nexus lies at the heart of their cost competitiveness, it also perpetuates underdevelopment.

Drawing from development studies, sociology and business ethics, I consider the consequences for country development from stricter enforcement of labour standards across GVC networks, especially

when networks straddle the formal and the informal sectors. Achieving greater compliance has adverse effects on the participation of informal actors, ordinarily the most economically and socially vulnerable segment of the economy. I discuss how MNEs, by seeking to more strictly enforce compliance throughout their affiliated supply chain (however benevolent their intentions), may *attenuate* some of the positive effects of MNE investment, particularly the prospects for employment creation (especially among women), and enterprise growth from the informal sector.

My contribution is primarily conceptual, but because my intention is to draw attention to a real world phenomenon, I illustrate my arguments on how MNEs have changed their compliance practices using real-world evidence from Bangladesh to provide context to my analysis. I discuss how my observations might inform other cross-disciplinary work in development, ethics, and sociology. Finally, I note implications for IB theory from the disparities between the ownership, control and responsibility boundaries of the firm.

GVCS AND THE INFORMAL SECTOR IN DEVELOPING COUNTRIES

All economies have an informal sector, although its role in developed economies is several orders of magnitude smaller than in developing countries: The share of informal employment in developed countries was 18.3% compared to 69.6% in developing countries in 2016 (ILO, 2018). Indeed, the pervasive role of the informal sector has spawned a significant literature on the 'dual economy' problem in development studies (Lewis 1954; Gollin 2014), because the persistence of high levels of informality (and a correspondingly small formal sector) can have detrimental effects on the prospects of economic growth in the longer run.

At the same time, an informal sector can also be the source of comparative advantage, and a driver of growth in developing countries: it is a reservoir of surplus labour that is a key input to promote the expansion of the 'modern', knowledge-intensive sectors, which are associated with the formal economy. Most governments recognise that supporting the informal economy is important for addressing poverty and inequality (Chen, 2012). Social and economic development depends crucially on the capacity of the economy to effectively redeploy resources from the less efficient sectors

(typical of informal sectors) to more productive activities (more commonly associated with the formal sector). Early-stage industrial competitiveness often derives from the cross-utilization of the formal and the informal sectors, which function as a 'system' (Narula, 2018).

However, while large informal sectors are a reality, when they are persistently large they impede development. The informal sector is predominantly populated by small enterprises or individual actors performing labour-intensive activities. Organizational skills, technological and managerial expertise are weak. The informal sector is often associated with rural populations, but also with the urban poor (Godfrey 2011; Narula 2018). Among the key characteristics of informality are that individuals and enterprises are unregistered, unregulated by the state, and pay no taxes. As a consequence are unable to seek (formal) credit, are largely legally unprotected, and have limited access to social programmes and public goods. They tend to engage in low productivity activities, and few informal actors have access to the financial and knowledge capital to expand their activities or improve productivity. Individuals trapped in the informal sector tend to be undernourished, less educated with shorter lifespans, with fewer opportunities to escape poverty (La Porta & Shleifer, 2008). Estimates of the share of the population in the informal economy are high as 88% in South Asia, with 83.4% of employers and 64.5% of employees being informal (ILO, 2018). Perhaps more than any other region, South Asia has historically had an especially intricate intertwining of the formal and informal sector.

The economic policies of countries seek simultaneously to exploit the cost competitiveness that a large informal sector can provide, while also promoting greater participation of informal actors in the formal economy. This second goal is more challenging: greater formalization requires greater state intervention. Government failure (and regulatory capture) means that in practice, policy initiatives addressing informality are less effective (Chen & Doane, 2008). Nonetheless, it is well known that expanding commercial opportunities for smaller enterprises is key to rapid economic development (Maksimov, Wang & Luo, 2017).

For the purposes of this paper, I emphasise four types of informality. The first is i*nformal employment*, where workers are employed by formal firms (registered commercial enterprises) on a casual, *ad hoc* basis (Perry et al, 2007). The second group are *subsistence actors* who include self-

employed workers such as housewives that undertake *ad hoc* work in their own premises (Banerjee & Duflo, 2007). They play a key role in 'jobbing' by taking on piecework. Informal and subsistence employment (collectively referred to as 'vulnerable employment') can perpetuate poverty (Barrientos, Gereffi & Rossi, 2011). Such employees have no contracts or employee rights. 31.8% of workers in the formal sector are informally employed in Bangladesh, although the proportion is as high as 86% for women (ILO 2018). Informal employees tend to be less well paid, are less likely to receive training, and have limited path for advancement (Das, 2012). Formally employed workers are able to acquire new skills and potentially earn higher wages, with a variety of benefits.

The third type of informality is in the form of *informal enterprises*, which engage in coordinated commercial activity, but are not legally registered as commercial entities (Al-Mataani, Wainwright & Demirel, 2017). A fourth type of informality are a specific type of informal enterprise best described as the *bazaar trader*. These are not simply 'firms' who have no legal status, but are without a discernible organisational structure, regular operations, workforce or facilities (Geertz, 1963; Guha-Khasnobis, Kanbur & Ostrom, 2006). Such enterprises are built around an actor/entrepreneur who organises who engages in a series of frequent spot market transactions with workers, suppliers and customers as and when a market opportunity arises, with each incarnation of the enterprise having a finite lifetime for the duration of the transaction.

Informal enterprises are unable to grow beyond micro-or small size, because they cannot borrow from formal lenders and are unable to do participate in legal contracts (McGahan, 2012). Informal enterprises are unlikely to afford productivity-enhancing equipment, upgrade workers' skills, achieve economies of scale, and have limited access to public goods and services (La Porta & Shleifer, 2008). Informal enterprises often have lower costs than their formal counterparts, as they do not pay taxes, and have few payroll-related costs. All their 'employees' are casual workers. Informal enterprises pay workers considerably less than formal firms. In Bangladesh, workers in the informal sector earn three times less than their formal counterparts (ILO, 2013). They do not engage with regulatory requirements (such as labour standards compliance), because this requires resources they do not possess. The exclusion from regulation is also a source of cost competitiveness. Regulatory costs can

be especially high in locations with weak formal institutions, high levels of bureaucracy, or endemic corruption (Schneider & Enste, 2013).

For the most part, GVCs have been a positive force for economic development (UNCTAD, 2013) because they have created employment and wealth-creation opportunities amongst the more vulnerable members of society. In particular, the engagement of the informal sector by GVCs has been welcomed, especially where actors are located in economically and socially backward locations, helping people escape the poverty trap (Giuliani, Pietrobelli & Rabellotti, 2005). Through GVCs, MNEs have exploited the cost advantages that the informal/formal nexus offers, and have the immediate outcome of expanding job-creation. Any work is better than no work at all, even if it is underpaid and under poor conditions, and new swathes of employment opportunities have arisen, prompting greater participation of women and other marginalised actors. Over the last two decades, GVCs have also been instrumental in creating opportunities for entrepreneurial activity and increased knowledge transfer within both the formal and informal sectors, in addition to greater employment (Pietrobelli & Rabellotti, 2011). The fittest informal enterprises engaged with GVCs often move towards formality, and rising steadily towards higher value adding activity through GVC participation.

APPAREL GVCS IN A PRE-RANA PLAZA ERA: DIRECT CONTRACT REASONING

The structure of the apparel industry in most developing countries has a hierarchy built around three levels[1]. The first of these is the first-tier (formal) supplier, who engage directly with the lead firms. The second layer involves both formal firms and informal enterprises. They are smaller actors who supply a variety of first-tier companies. The third layer is generally always informal, engaging directly with both first and second-tier firms. They are usually single-unit specialised actors doing washing, printing, embroidery dyeing, etc., either in informal workshops, or by workers at home. (Mezzadri, 2014). The third layer includes actors engaged in 'specialist' work. This is normally labour-intensive, while also requiring human dexterity or customisation such as embroidery or lacework. Most of this third layer involves informal/subsistence actors, often women, working from

home on small batches, or at informal enterprises, sometimes in remote locations, paid on a per-item basis (Mezzadri, 2016). The supply of low-cost labour in a developing country is near-infinite, with considerable movement of surplus labour from the rural areas to urban locations, where employment in the informal sector provides opportunities less dependent on the vagaries of small-scale agriculture. When the informal sector is characterised by high unemployment, working below minimum wage is better than not working at all (Günther & Launov, 2012). To paraphrase Lewis (1954), in the absence of labour rights, a near-inexhaustible supply of labour keeps wage costs low, with workers as price-takers.

The majority of apparel GVCs in developing countries are MNE-led, many of which are large-scale retailers with brands and labels. Few, if any, have equity control over their first-tier suppliers, relying on non-equity governance modes to maintain control. The majority of first-tier suppliers tend to be locally owned firms, all of which are formal, and some of which have their own retailing infrastructure. In the logic of 'direct-contract reasoning', how (and with whom) the first tier suppliers choose to engage with is a matter for them to decide. Thus, engagement with the informal sector is removed from the purview of the lead firm, providing 'plausible deniability' for the sourcing decisions of its lower tier (formal) suppliers. Likewise, the internal enforcement of labour standards within tier 1 suppliers is rarely monitored by the MNE as long as the supplier meets with public regulatory requirements. Indeed, the cost competitiveness of the apparel sector in a dual economy relies on the informal economy's exclusion from regulatory requirements. Neither public nor private regulators are effectively able to monitor this wide network of indirect suppliers and pieceworkers.

From the lead firm's economic perspective, direct contract reasoning in a dual economy can be close to optimally efficient. The network of informal enterprises are engaged with first-tier suppliers without contracts, and are essentially market transactions (although some may be regular suppliers). For tier 1 suppliers, there are several cost advantages of utilising informal suppliers and employees. First, the use of informal enterprises has the benefit of lower unit costs, as they have no outlays associated with regulation, safety, health, and labour rights. Indeed, in the lower layers, piecework lowers costs even further when it is performed by subsistence workers at home. Second, informal-

formal supplier 'contracts' are almost always batch-specific, short-term agreements. By relying on such agreement, the customer have no fixed costs associated with increased installed capacity during periods of surges in demand, or subsequent costs of slack capacity during market slumps. The informal sector is thus an important 'valve' for the formal suppliers. During periods of peak demand, informal enterprises take on tasks for which the formal firm has insufficient capacity (Liddick, 2011; Webb et al, 2014). Third, Tier 1 suppliers can utilise informal employees as a further cost-saving because they are casual workers, often with no minimum wage requirement, working long hours without overtime. The informal economy as a 'reservoir of surplus labour' is especially useful in the apparel industry, where demand is cyclical. Both formal and informal enterprises tend to operate on thin margins (as price-takers within the GVC). At the extreme, they can employ children and women (who are paid even less).

These 'regular' informal and *de facto* suppliers are complemented by buying houses and agents that act as intermediaries or 'match makers' (Labowitz & Bauman-Pauly, 2014, 2015). Buying houses are formal firms that do not have a dedicated supply chain, and accept batch orders from a variety of domestic and international customers, choosing different configurations of suppliers depending upon the order. They provide opportunities for the industry as a whole to maximise efficiency, by placing orders with actors with surplus capacity who are keen to maintain economies of scale.

On the other hand, agents are informal boundary spanners, who have an intricate knowledge of the available actors and prices in the informal economy. Agents are intermediaries, similar to bazaar traders, with no production assets of their own. The informal economy is opaque, and agents help to reduce the search costs for formal firms, further minimising transaction costs for the GVC when they choose to use them. Agents also operate opaquely, making it difficult to monitor if they are compliant (Alexander, 2018; Mezzadri, 2014).

WHY MNES FIND FULL-CHAIN COMPLIANCE DIFFICULT

The aftermath of the Rana Plaza Disaster saw a variety of multilateral, bilateral, public and private initiatives across the world to improve labour standards in the apparel industry (see Sinkovics, Hoque

& Sinkovics, 2016; Schuessler et al 2019; Fontana & Egels-Zandén 2018). Although there is some variation between countries, most public regulatory efforts have ultimately been limited in nature. Developing countries rarely have the capacity to effectively enforce higher labour standards, even when new legislation is created (James et al, 2018). In general, labour standards are rarely a priority for governments, compared to attracting FDI and addressing key economic problems, such as endemic unemployment and poverty. Governments 'soften' the implementation of regulation for investments that may have socially desirable outcomes (Davies & Vadlamannati 2013). However, the widespread media coverage after Rana Plaza placed governments that rely on labour-intensive FDI in a bind: the negative publicity of low standards dilutes the attractiveness of a host country for MNEs (Jones-Henry, 2018), but enforcing higher labour standards reduces their appeal to cost-conscious investors.

External stakeholders have sought to complement weak public regulation with private regulation (Locke, Rissing & Pal, 2013; Fransen & Burgoon, 2017). Private regulation refers to 'soft' institutions that are shaped by private actors, primarily standards developed with or by external stakeholders and NGOs. These are motivated by the notion that the MNE as the dominant actor in the GVC can (passively or actively) improve labour standards across its supplier network (Davies & Vadlamannati, 2013).

It is important to emphasise that full-chain accountability within GVCs has not been driven by its constituent firms for economic or strategic reasons, but by external stakeholders (Schrempf-Stirling & Palazzo 2014). MNEs are aware that there are considerable reputation costs should they not be seen to have ethical sourcing practices, especially for those MNEs for whom reputation is a key FSA (Wang & Li 2019). This is especially so for branded apparel MNEs.

From the MNE's perspective, the shift to greater responsibility flies in the face of the previous dominant narrative that led to the growth of GVCs and trend away from full internalization and hierarchies. The GVC was superior to hierarchical governance modes because it reduced transaction costs through the flexible use of arms-length network of suppliers. The economic logic was fairly strong: quasi-internalization allowed the MNE maintain the *control* boundaries of the firm, even as

the *ownership* boundaries receded. Direct contract reasoning and the modern GVC are inextricably linked – greater accountability and control is normally associated with greater vertical integration.

Full-chain responsibility alters the economic feasibility of the GVC, but it is axiomatic that the long-term sustainability of a GVC depends upon its ability to adapt to its ever-changing environment. Although the benefits of the GVC are reduced through greater compliance requirements, operating efficient supplier networks remains a key FSA of the MNE. Although full-chain compliance increased costs non-trivially, they are still able to achieve greater efficiency than a hierarchically organised, integrated firm (Kano, 2018). Increased costs in buyer-dominated GVCs are mitigated to some extent because returns at almost every stage of the value chain are determined by the lead firm (Kaplinsky, 2005; Kaplinsky & Morris, 2001; Gereffi, 2014).

Implementing a truly full-chain approach has a number of challenges. First, monitoring and enforcement requires active engagement, and this is costly across a large supplier network. Private regulatory mechanisms are often in the form of ethical standards/codes of conduct and factory audits, but these are not always reliable (Short et al, 2016), or indeed, affordable. Sophisticated technological solutions are available to MNEs in countries with the appropriate high-tech infrastructure. The small-scale, capital-poor and labour-intensive nature of many actors in a developing country GVC do not allow for monitoring through IT systems integration. Under such circumstance, MNEs may prefer to rely on the cheaper option of monitoring through the certification of standards by third-party organizations (Short et al, 2016). This adds another layer of contractual agreements with such third-parties to undertake the monitoring, and these actors may behave opportunistically (Locke et al, 2013, Schuessler et al, 2019).

Second, it is relatively easy to monitor formal firms that have physical premises, and to enforce changes in practices within these suppliers when they are engaged through contracts. It is much more difficult (and costly) to monitor (or indeed identify) informal actors (which at the limit) potentially include thousands of women who perform piecework in their homes. Private regulation is particularly suitable for supply chains that are predominantly in the formal sector. Informal enterprises'

participation in GVCs is quasi-contractual at best, but pragmatically speaking are essentially market relationships.

Third, MNEs are rarely deeply embedded locally. To take full-chain responsibility the MNE must have an intimate understanding of societal structures, and navigating complex systems dominated by informal relationships means that MNE are even more boundedly rational. The MNE therefore has an incomplete knowledge of potential and current suppliers, even more so where the suppliers are informal.

Fourth, even where MNEs are successful in monitoring the labour standards in the informal network, the MNE is faced with difficulties to enforce, and the supplier has difficulties in complying. The informal actor often has resource constraints that make investment in compliance impossible. Private regulation often requires certification by an independent agency for which there are charges, and informal actors can find that the costs of compliance outweigh the benefits. GVCs do not have the capacity to enforce standards in the absence of a contractual relationship. The MNE can 'push' the informal actors towards formalization by helping it to upgrade financially and technically, but doing so would require investment. In short, this would create a hierarchy of a number of previously-informal actors (Narula, Asmussen, Chi & Kundu, 2019). Increased monitoring and enforcement costs in a pure full-chain compliance model therefore alters the transaction cost logic *towards* greater vertical integration. When margins are especially thin, lead firms may be willing to risk the use of more (reputationally) dubious (and non-compliant) suppliers.

It would be wrong to generalise across the industry. MNEs that compete primarily on price behave differently from those with branded products (Schuessler et al, 2019). MNEs who prioritize low prices over ethical concerns are less concerned about full-chain compliance. Nonetheless, negative publicity matters, even for these firms, and many engage in some degree of compliance as consumers become more aware of these issues. Toffel, Short & Oullet (2015) find that suppliers whose primary customers are located in countries where consumers are wealthy and socially conscious tend to be more likely to maintain higher labour standards.

A PRACTICAL COMPROMISE: CASCADING COMPLIANCE IN DUAL ECONOMIES

In the previous sections I have highlighted how the shift from direct contract reasoning to full-chain responsibility affects the economic efficiency of MNE-led GVCs located in developing countries. My key argument is that this shift towards greater compliance disturbs the intricate intertwining of the informal sector with formal suppliers, a key source of the cost-competitiveness of the apparel sector. GVCs have seen a significant reorganization, as compliance requirements have altered the underlying transaction cost logic, and consequently, the propensity to internalise previously outsourced activities.

True full-chain compliance is cost-prohibitive, and MNEs have instead evolved their GVCs to a 'cascading responsibility model'. The MNE takes the responsibility of directly monitoring and enforcing standards of its contractually obligated (and immediate) formal partners. MNEs monitor first-tier suppliers by regular inspections, in some cases embedding staff in critical factories, and linking their IT systems together. In turn, the first-tier suppliers are responsible for the compliance of their own suppliers. They must orchestrate and monitor all their immediate suppliers, including those in the informal economy. This cascades further, with the second tier actors being expected to take responsibility for the compliance of its suppliers, and so on.

In this section, I further discuss how GVCs have used this cascading responsibility approach, supported by evidence from a fieldtrip to Bangladesh, which arguably has been at the epicentre of this shift. I conducted multiple open-ended interviews with a variety of stakeholders, including MNEs, government officials and firms, originally part of a larger study to understand upgrading in GVCs.

Apparel accounts for well over 80% of Bangladesh's exports, and 16% of its GDP, and has been central to its export-oriented, FDI-assisted development strategy. The majority of the GVCs are MNE-led, most of which are large-scale retailers with brands and labels. The industry specializes in low-value and mid-market price apparel.

Most suppliers are locally owned firms and enterprises. The apparel sector relies heavily on the use of subcontracting to external, arms-length actors, both formal and informal. The industry formally employed over 4 million workers in 2017-18. No reliable estimates exist of the related informal and

subsistence employment, or those in informal enterprises, but it is likely to be at least equivalent in terms of employment. The majority of new jobs created in Bangladesh's apparel industry since the 1990s have been informal, with a significant share being women. The apparel industry has been instrumental in reducing poverty because many of these women are migrants from poor rural households (Kabeer & Mahmud, 2004). MNEs in Bangladesh have overwhelmingly adopted a cascading compliance approach by taking a series of deliberate actions.

First, MNEs have transferred responsibility (and the cost) of greater levels of monitoring of other upstream actors to its tier 1 suppliers, while maintaining tight control of tier 1. Such a cascading of responsibilities reduces the risks of shirking, and addresses the bounded rationality problem.

To an extent, this has suited the ambitions of many Tier 1 firms, who are interested in moving downstream and developing their own brands. They are therefore also keen to create a (positive) reputation. Besides, switching costs for the MNE are low, so failure by a tier 1 firm to accept the delegation of responsibility can lead to the loss of a client and income. MNEs often have parallel GVCs in several countries, and are able to shift production to wherever the associated GVC is most price competitive, so the onus is on the domestic suppliers to accept the increased monitoring role within the price/performance targets set by the lead firm (Surroca, Tribo & Zahra, 2013).

Second, lead firms have placed restrictions on the use of non-compliant actors by suppliers. Thus, effectively, compliance has extended to second- and third-tier actors, with lead firms expecting tier 1 suppliers to enforce labour standards with their own lower-tier suppliers (Alexander, 2018). Actors or enterprises who are not certified as compliant are excluded from the GVC. There has also been pressure to formalise employees, and use fewer informal, casual employees.

The net effect has been that Tier 1 suppliers have also reorganised themselves in three ways:

(1) They have truncated their supply chains and brought in-house activities that were previously outsourced, and acquired some of their less efficient competitors[2]. First-tier firms have thus achieved greater efficiency through economies of scale and scope, offsetting the costs of enforcing compliance of its suppliers (and the reputational risks of failing to do so effectively). Tier 1 and 2 formal firms

have also increased their vertical integration further by integrating towards fabric manufacture, as well as downstream, to branded apparel[3].

(2) They have eliminated the reliance on non-compliant formal firms and informal enterprises. Informal enterprises do not have the resources or knowledge to invest in safety equipment and organisational upgrading to achieve the various formal certifications required. Those informal enterprises with the resources to do so have moved into the formal sector. Both informal enterprises and smaller formal firms require considerable financial capital and professional management to implement acceptable quality control, IT and logistics systems (most MNEs now expect to be able to exchange information with their suppliers, so as to coordinate deliveries, quality-control and monitor various compliance protocols). About 18% of the formal firms of the garment sector officially registered after 2013, as demand for sub-contracting to informal firms fell (Moazzem, 2018).

(3) First-tier suppliers have sought to reduce their costs (with the technical assistance of lead firms) by increasing productivity through greater investment in (labour-saving) machinery. More modern, automated production methods tend to be compliant with stricter labour standards. This has the knock-on effect of increasing the demand for skilled workers (and reducing the need for unskilled workers)[4]. In a developing country with a comparative advantage in labour, this has effectively raised its shadow price.

Higher automation reduces opportunities for unskilled workers within first-tier suppliers, but also places upward pressure on wage bills as there is a relative shortage of workers with specialised skills to operate and maintain these machines. Sinkovics et al (2016) observe that automation has mainly led to a reduction in female workers, who are also typically less educated than males. Female employment declined from 80% to 61% of all workers in the formal garment sector between 2013 and 2016, thanks to growing automation in the sector (Daily Star, 2018). Overall, female employment declined by 13% in the apparel sector, with a government report noting that 'the major factors behind the declining trend of women employment was the closure of subcontracting in the garment sector after the Rana Plaza building collapse' (Daily Star, 2017). The manager of a firm noted that, 'when

we are under pressure to reduce workers; it is normal that we release women first. Most are employed on a casual basis, and can easily be released'.

Independent factories outside GVCs that rely on buying houses (and focused on clients who are primarily cost-conscious) are also under pressure to follow suit and reduce their engagement with non-compliant enterprises (and informal workers) as an awareness of substandard working conditions becomes commonplace.

DISCUSSION: ADVERSE CONSEQUENCES FOR VULNERABLE ACTORS

The mainstream view on MNEs and development has been that, on the whole, MNEs have a net positive effect on development, through a variety of means including employment, capital and knowledge flows, training, competition and demonstration effects (Narula & Dunning, 2010, Narula & Pineli, 2019). This may be so, but it is important to acknowledge that there are also adverse and unintended consequences (Giuliani & Macchi, 2014). Enforcing strict labour standards and full-chain compliance in a developing country where the economy is an intricate (and delicately balanced) network of informal and formal actors, and where the informal sector is economically and socially vulnerable, may be just such an instance.

MNEs and their domestic suppliers are rarely hybrid organisations (Kannothra, Manning & Haigh, 2018). They pursue social objectives only secondarily to financial goals. Practically speaking, achieving full-chain compliance is costly and MNEs have opted for a 'cascading' compliance as a cheaper alternative to full-chain responsibility. However, delegating enforcement to suppliers has been met with varying degrees of enthusiasm, given the associated costs. External stakeholders who monitor labour standards compliance (e.g., KnowTheChain, 2018) in GVCs find that few achieve effective full-chain compliance, especially in the lower tiers of their GVCs. As Sinkovics et al (2016) note, formal, lower-tier suppliers comply reluctantly. This is particularly so when it comes to the use of informal employees and subcontracting to informal enterprises. Undertaking the kinds of audits required for full compliance erodes their margins, even when they have the managerial capabilities to do so (Sinkovics et al, 2016). For informal enterprises, their 'factories' are so far removed from

oversight and operate on such small margins that compliance requirements crowds-out these informal enterprises (Posthuma & Nathan, 2010). Even when firms move to compliance, there can also be unintended negative consequences. Sinkovics et al (2016: 643) note that informal employees who have been 'upgraded' to formal status are not always pleased with the outcome:

'…at face value workers now receive a higher minimum wage, due to the abolition of overtime their total monthly income is reduced...Furthermore, workers still have to perform overtime to finish their often unrealistic daily quotas, but now without additional pay…As a result of the high cost of compliance …firms had also been forced to discontinue services such as free cooked lunches and prayer facilities that had been highly valued by the workers... there are no contingency plans for unskilled workers who have not only lost their jobs but are now excluded from the labour market.'

The crowding-out of informal enterprises and informal employees from value chains has consequences for gender imbalance and development. The considerable growth in female employment in Bangladesh has been a positive outcome of the growth of the apparel industry. Although women working from home on small batches, or at informal enterprises are often exploited through long hours, unstable work, no benefits, and exclusion from union representation (BSR, 2017; Sikdar et al, 2014), these jobs have also lifted many out of absolute poverty. Formal firms employ armies of female workers as both formal and informal employees. At the same time, females are paid less than males, even in the formal sector, at the same levels of education and experience. Thus, while female access to employment has had considerable transformative potential for the welfare of women, this potential remains untapped because of the relative lack of more secure opportunities through formal employment and skills upgrading (Kabeer, 2016). Unskilled female workers are less likely to be offered formal employment, and are laid off first (Sinkovics et al, 2016).

In sum, the drive towards higher labour standards has not been an unambiguously positive outcome for the most vulnerable actors in countries such as Bangladesh. Instead, it has restricted access for small-scale producers, informal enterprises and informal sub-contractors (and the largely female unskilled workers they employ) to GVCs, and effectively prevented smaller, informal firms from upgrading to higher value-added segments of industrial production. MNEs want to enforce labour

standards through mechanisms and audits based on internationally recognised codes, but these are most appropriate for factories mainly employing a formal, permanent and educated workforce (Mezzadri, 2014; Oxfam, 2010).

THEORETICAL IMPLICATIONS

From an IB theory perspective, it is worth noting that there is an inherent instability of GVC relationships. There is also a power asymmetry within MNE-led GVCs, where the lead firm is the orchestrator of the various actors, but its ability to orchestrate diminishes the more peripheral the actor is within the GVC. Full-chain compliance requires re-exerting control that the MNEs had previously relinquished. First tier suppliers, by virtue of their organisational proximity are more amenable to this, not only for obvious transaction reasons, but because the lead firm may provide access to FSAs, both technological, organizational and reputational (Kano, 2018). Lower tier firms do not have a similar expectation.

Although the analysis offered here is tentative and is primarily intended to prompt debate, the reorganisation of GVCs towards full-chain accountability has implications for our understanding of the nature of the firm, and internalisation theory. The move from full vertical integration towards GVCs over the last 30 years reflected a shift in our conceptual understanding of the MNE as a firm where ownership and control were synonymous. The rise of the GVC and the growing use of non-equity modes sparked a realisation that an MNE might engage in active control of offshore activities *without* ownership, suggesting that the *ownership boundaries* of the MNE did not have to reflect the *control boundaries* of the MNE (Buckley 2009; Strange & Humphrey 2019). By divesting ownership within the buyer-dominated GVC, but not control, MNEs reasonably expected that they had reduced (or no) culpability for the actions of their affiliated (but legally independent) GVC suppliers. This was all the more so in developing countries, where a large reliance on informal sector, means an even larger supplier network. The failure to achieve full-chain compliance demonstrates that there are limits to the MNE's ability to control, because suppliers – both formal and informal - will act in their own self-interest when their relationship is purely economic. When the distribution of costs and rents

primarily benefits the MNE, with the supplier absorbing the greater part of the increased costs, it weakens the MNE's capacity to control. This is counteracted when the supplier accrues non-pecuniary benefits from the MNE to compensate for the greater costs (for instance, knowledge transfers, or strategic opportunities to expand). Suppliers are boundedly reliable (Verbeke & Greidanus, 2009), which is to say, they are willing to cede control as long as their interests align with the MNE. Informal enterprises are in purely transactional, non-contractual, pecuniary relationships with the MNE or its formal suppliers, and thus the control boundaries of the MNE become even more tenuous and frail. The case of the Bangladeshi apparel sector indicates that while MNE ownership boundaries may have receded, there are limits to maintaining greater control boundaries. From an internalization theory perspective, the increased costs of full-chain responsibility erodes a key benefit of defragmenting the value chain, and the use of non-equity modes of internationalisation (Narula et al, 2019).

Egels-Zandén (2017) proposes that in addition to ownership and control boundaries, we need to consider the importance of *responsibility boundaries* of the firm. The backlash in the wake of Rana Plaza indicates that stakeholders view the firm's responsibility boundaries as stretching much further than either its ownership or control boundaries. These three boundaries have different spans (Narula et al, 2019). Mudambi & Puck (2016) argue that being accountable beyond its legal boundaries is part of the MNE's role as the GVC orchestrator.

Full-chain responsibility may only be achievable in an economy where the majority of the actors are formal, and state institutions are effective. In a dual economy, full-chain compliance means that what are essentially market relationships are also included within the responsibility boundary of the MNE. Can an MNE credibly orchestrate literally thousands of spot-market transactions, especially when they involve informal actors, and potentially the suppliers of those enterprises as well? It would seem that extended responsibility boundaries may accrue such high costs of monitoring and enforcement of such a large community of suppliers that it can potentially push MNEs and their key suppliers towards (higher) levels of vertical reintegration, and (at least a partial) realignment of ownership, control and responsibility boundaries. However, given that GVC lead firms have few sunk costs in the host country and are therefore 'footloose', it is more likely that, as compliance costs rise, they will seek

alternative locations that require lower compliance (or offer other cost-savings that compensate). Expanded responsibility boundaries require greater control, but how does MNEs achieve this in a GVC located within imperfectly functioning markets, and without legal recourse? A growing and renewed discourse around quasi-internalization (Narula et al, 2019) raises new questions of the yardstick by which we regard the 'firm' as a useful unit of analysis, with its multiple boundaries. The issues of shifting and multiple boundaries, and the propensity for MNEs to seek alternative configurations and locations deserve closer attention in future IB research.

The ethical issues associated with locations offering low labour costs coupled with lax labour standards (and compliance requirements) as a primary location advantage are by no means novel, but have also largely been ignored (Maggioni, Santangelo & Koymen-Ozer, 2019). Most developing countries have multiple development goals, and few policy initiatives are without some adverse consequences. Governments prioritise certain preferred outcomes (such as reduced unemployment, or knowledge flows) and implicitly overlook negative 'side effects' on the principle of 'the greatest good for the greatest number'.

Full-chain responsibility requires regulation. MNEs are opportunistic by nature and are unlikely to effectively self-regulate. States are faced with twin challenges in enforcing hard regulation: resource constraints, and state capture. The capacity of civil society to effectively engage in this regulatory void by coercing firms to apply near-mandatory private regulation is a significant phenomenon in its own right, worthy of further study. It is not immediately obvious that private regulation can be a substitute for credible hard regulation, rather than complementary to it, given that NGOs do not have the capacity (or the authority) to audit or enforce.

Private regulation also increases costs for actors within GVCs significantly, albeit unevenly. In most developed economies, the auditing and enforcement of labour standards are a public good. Should MNEs absorb the cost of public goods when institutional voids predominate? Hillemann & Verbeke (2016) feel that such engagement needs to be limited to where the MNE possesses the relevant FSAs, and to activities that further the strategic objectives of the MNE. It is not clear that the MNEs have the necessary FSAs in the apparel sector, evidenced by the fact that most rely on third parties to monitor

their suppliers. Outsourced monitoring further indicates that doing so internally is not aligned with MNE strategy. Public sector organisations and private investors answer to different stakeholders, and the interests of the latter rarely align with the former, and where they do so, this is through state capture. King & Lenox (2000) argue that opportunism eventually tends to overcome powerful self-regulatory institutions and that effective industry self-regulation is difficult to maintain without explicit sanctions.

That MNEs – whether intentionally or not – exacerbate significant socio-economic problems such as informality is worthy of greater scholarly interest. The lack of analysis reflects the paucity of data on the informal sector, and without reliable statistics it is hard to determine the net effect of MNE activity. Understanding social hierarchies and structures is a complex task, and a subject of considerable interest to sociology and development studies. MNEs have an outsized role as a source of employment, income and linkages in developing countries. How MNEs create opportunities for those locked into chronic poverty is surely worthy of closer and more systematic analyses by IB scholars.

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[1] This discussion is based on experiences particular to South Asian countries, and there may be some variation in other regions, reflecting different social and cultural networks.

[2] Weaker and less professionally managed firms have been acquired by those that are better managed. A BGMEA official (an industry association) interviewed felt that in a few years' time the apparel sector would have about 1000 firms.

[3] An interview with a BGMEA official suggested that about 200 have expanded towards yarn. Another 500 to 600 produce fabric, not yarn. About 100 have forward integrated towards design.

[4] From an interview with a tier 1 manager: '…skilled people are needed. What we did was pick some from the existing labour force who were a bit more educated and impart them with in-house training to…operate the automated machines. But there were some boys and girls whose education was below a certain level…not adequate to train them for the new machines. They had to go.'