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Insertion of Argentine firms in global value chains not oriented to the mass market: The cases of high-end footwear and the Basso group

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Inter-American Development Bank
Integration and Trade Sector

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Insertion of Argentine Firms in Global Value Chains Not Oriented to the Mass Market:
The Cases of High-End Footwear and The Basso Group¹

November 23, 2012

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Abstract

This paper describes experiences of international insertion of Argentine producers of manufactured goods not oriented to the mass market. Based on these experiences, we develop a typology of potential alternatives of international insertion for this type of goods centered on the role of local agents in design activities. Our analysis follows the global value chain (GVC) approach and emphasizes the links between local producers and buyers in developed countries. First, we analyze experiences of international insertion of producers and marketers of high end footwear. These cases involve high quality products that are intensive in original design. Second, we analyze various forms of international insertion of a single producer of valves for combustion engines, which primarily involve customized products. Despite the differences between these two industries, we find notable similarities in the forms of insertion they both present and in the knowledge requirements they impose on local producers.

JEL: F14, F23

Key Words: Global Supply Chains, International Fragmentation of Production, Suppliers

1. Introduction

International trade has increased at a very rapid pace during the last decades, outweighing the growth rates of world production and income. The growth of world trade is closely associated with the international fragmentation of production. Researchers in economics, international business, politics, and sociology have paid substantial attention to this process, emphasizing its implications for countries' international competitiveness and prospects for economic development. In particular, understanding this process is critical for the design and implementation of public policies that could potentially help firms take advantage of the new opportunities offered by this global process.

The global value chain (GVC) approach provides useful tools to analyze the implications of international production fragmentation for economic development (Gereffi, 1999; Humphrey and Schmitz 2002; Gereffi, Humphrey, and Sturgeon, 2005). In this approach, a *value chain* is defined as the sequence of all activities involved from conception to marketing a product. The chain becomes global if those activities are carried out in different countries. The GVC approach examines the relationships that firms establish within the chain and analyzes how these relationships influence firm performance. The approach pays particular attention to the fact that some activities in the chain add more value and are more profitable than others, and that some actors in the chain have more power than others (Schmitz, 2006). Thus, governance and functional upgrading in the chain are central concepts to this literature, because the position that firms occupy in the chain and the possibilities for upgrading that position determine, at the country level, whether participation in GVCs can act as an engine for economic development.

The GVC literature has documented numerous developing-country experiences of insertion in *manufacturing* GVCs, both in traditional labor-intensive industries such as apparel and footwear (e.g., Gereffi, 1994, 1999; Schmitz, 1999) and in technologically intensive industries such as automobiles and electronics (Humphrey and Memedovic, 2003; Kawakami, 2011; Imai and Shiu, 2011).² A common finding in this literature is that the relocation and international fragmentation of production is initially motivated by the search for cost efficiency

² Our focus on manufacturing GVCs leaves out GVCs for natural resource-based products and services GVCs. For these types of GVCs see, for example, Pietrobelli and Rabellotti (2006).

through the shift of unskilled labor-intensive tasks, especially assembly, to countries with low wages (Abernathy, Dunlop, Hammond, and Weil, 1999; Gereffi, 1999; Humphrey and Schmitz, 2002; Wei, 2009).³ The literature also finds that once firms in developing countries become part of a GVC, the learning and upgrading trajectory can present contrasting dynamics. In particular, while there are successful cases of learning and upgrading within the chain (e.g., Gereffi, 1999; Kawakami, 2011; Imai and Shiu, 2011), there are also important limits and barriers (e.g., Schmitz, 1999; Humphrey and Schmitz, 2002; Sturgeon and Linden, 2011). Theoretical advances in the literature relate the dynamics of upgrading to the degree of explicit coordination and power asymmetry in the chain, in turn determined by the complexity of transactions, the ability to codify them, and the capabilities of the supply base (Gereffi et al, 2005).

Notwithstanding the important debate on the benefits of insertion in GVCs, countries differ markedly in the first place in the extent to which their manufacturing firms participate in those global chains. In Argentina, unlike most East Asian countries, insertion in manufacturing GVCs is notably scarce. This country has wages that are too high for its firms to enter GVCs performing unskilled labor-intensive tasks. On the other hand, its firms do not generally possess the skills and market knowledge to perform more complex activities in the chain such as design and marketing.⁴ In this context, it is natural to ask about the chances of a country with these characteristics to participate in manufacturing GVCs and the form such participation could take.

We study here two potential alternatives of insertion in manufacturing GVCs. The first involves high-quality consumer goods that are intensive in design originality. As an example, we study experiences of GVC insertion in the high-end footwear industry. The second involves customized goods. As an example of this second alternative, we study the case of an Argentine producer of combustion engine valves, Basso, and the various GVCs in which it participates. Although the GVCs for high-end footwear and engine valves are very different, they display fundamental similarities. First, the high-quality, intensive design, and customized features of these goods imply that they possess non-standard attributes and are not targeted to the mass

³ Other important determinants of manufacturing relocations have been trade policies, particularly the now-extinct Multifiber Agreement.

⁴ Abundance of natural resources is a potential explanation for the prevalence of high wages in Argentina relative to its manufacturing capabilities.

market. Second, due to their non-standard attributes, the designs of these goods are seldom fully codified. Hence, even in cases where most of the design activity is completed by firms in high-income countries, Argentine firms that participate in these GVCs primarily as producers also play an important role in product development, the last stage in the design process. This role involves interpreting the non-codified aspects of the original design and often adapting it according to implementation conditions in the local country. This form of participation in a GVC requires fluent communication with designers in developed countries and, at a more profound level, sharing a common language and a common understanding about how product design features affect market performance. Finally, since these goods compete on product differentiation rather than on price relative to mass marketed goods, relatively high wages are not a disqualifying factor.

The analysis of the role firms in developing countries can potentially play in this type of GVC fills a gap in the literature. First, this type of GVC has been understudied relative to GVCs oriented to the mass market. Second, studies of GVCs that are not oriented to the mass market tend to highlight the role of firms located in developed countries. For example, Amighini and Rabellotti (2003) study the insertion of Italian footwear producers in GVCs oriented to premium segments of the market. An exception is Bazan and Navas-Alemán's (2004) study of the Brazilian footwear industry. While most of this study analyzes upgrading efforts by suppliers of mass-market GVCs, it also describes the difficulties of entering GVCs oriented to the high end of the footwear market. Related work by Artopoulos, Friel, and Hallak (2011) analyzes cases of export emergence in design-intensive Argentine consumer goods (wine, motorboats, wooden furniture, and television programs). Although these authors do not use a GVC framework, their description of the relationship that exporters establish with foreign distributors implies that they interact under GVCs similar to the ones analyzed in this study. Here, however, we provide a deeper analysis of the distinguishing features of GVCs, especially characterizing the relationships between participants located in a developing and a developed country.

The Argentine footwear industry provides an interesting example of the potential for GVC insertion in high-quality design-intensive products because there are existing conditions in the country that presumably favor this type of insertion. First, there is a wide availability of

high-quality raw leather in Argentina. Second, Argentina has a long tradition in shoe manufacturing. Third, Argentina possesses latent design capabilities associated with the existence of a critical mass of active designers, design-oriented educational institutions and research centers, and an increasing effervescence in creative industries. These conditions generate latent comparative advantage for the production and export of high-end shoes. In spite of this advantage, however, the export performance of the sector is weak. The industry is primarily oriented to the domestic market and displays only few and sporadic experiences of insertion in GVCs. We study those few experiences to identify the obstacles for this type of global integration and their potential implications for public policy.

The Argentine experiences of insertion in high-end footwear GVCs can be classified into three broad modes of insertion. We describe the first mode of insertion as “contract manufacturing with cooperative product development.” This mode of insertion is the closest to the contract manufacturing relationships vastly studied in the literature (e.g., Schmitz, 1995; Gereffi, 1999; Sturgeon, 2002). Compared to those relationships, in this type of insertion the contract manufacturer is more actively involved in product development. The design capabilities required to perform this role are limited relative to those of earlier stages in the design process, yet they are substantial relative to the requirements for standard contract manufacturing. The second mode of insertion is called “domestic original design.” Here, both design and production are made domestically, so the required design capabilities are much stronger. The key global relationship in this GVC is the one between the domestic designer and the foreign distributor (wholesaler or retailer). This mode of insertion seems particularly promising in the long run, but the knowledge requirements are substantially higher. The third mode of insertion is “adaptive design.” In this case, the domestic manufacturer adapts or just imitates foreign designs. This mode of insertion accounts for most current Argentine exports. However, the GVCs in this case are regional in scope because only nearby countries can value the specific ability of Argentine firms to adapt European designs to regional tastes and production conditions.

We find two major structural obstacles that hinder insertion of Argentine firms in footwear GVCs. The first is that most domestic producers constrain their design activity to

simply imitating or slightly adapting European designs. This behavior is favored by the seasonal mismatch between Argentina and the major design centers of the world, and the fact that consumers place less value on original designs than they do on minor adaptations of successful European ones. As a result, original designing is an underdeveloped activity in the industry. The second major obstacle is that domestic producers operate in an environment that tolerates quality defects and business practices that are unacceptable in developed countries. Hence, producers find it hard to understand the importance of complying with the rigor imposed by GVCs. When they do, they often must sacrifice international competitiveness in the process of incurring the extra costs of finding and developing suppliers, partners, or workers that are also willing and able to comply with that rigor. In addition to these two structural obstacles, the increasing real exchange appreciation of the domestic currency during the last four years is currently an important hindrance to insertion in GVCs.

As an example of insertion in GVCs for customized goods, we study Basso, an Argentine producer of compression engine valves. This company exports 85% of its production to thirty-three countries. Basso supplies original equipment worldwide to automakers (e.g., Peugeot, Ferrari, and Ford), motorcycle producers (Harley Davidson), and farm tractor producers (John Deere). Its clients also include engine builders in competition and high-performance markets and engine rebuilders in the aftermarket. Except in the latter case, valve customization demands that Basso interact closely with its buyers. Those interactions require fluent communication and common understanding between the parties. It is Basso's ability to satisfy those requirements, together with its high quality of customization and delivery services that allows Basso to compete globally.

In contrast to the weak export performance of high-end footwear despite favorable underlying conditions, the case of Basso presents a successful experience of insertion in GVCs in a sector with no obvious comparative advantage. Although Argentina was one of the earliest developing countries to have a car industry, the international competitiveness of its auto part sector is weak. In fact, only a few auto part producers exhibit a clear export orientation. Interestingly, two of the latter producers make the same specific product—combustion engine valves—and both are located in the industrial city of Rafaela. These two producers are Basso

and its eternal competitor Edival (recently acquired by German multinational Mahle). The importance of service quality in customized products explains the opportunity for a firm like Basso (and Edival) to become part of GVCs. Also, the limited—but nevertheless substantial—technological sophistication involved in the production of engine valves explains the possibility of a technology-oriented firm like Basso to keep up with worldwide technological progress in a technologically unfavorable environment.

In the case of Basso, we distinguish three modes of insertion in GVCs. As in the footwear case, we call the first “contract manufacturing with cooperative product development.” In this mode of insertion, Basso provides contract manufacturing services to automakers but participates in the design of the product. Although automakers provide the key parameters of the valves they need, Basso plays an important role in the definition of the materials, optimal coatings, thermal tolerance, and production process. In the second mode of insertion, “customized design,” Basso is the primary designer of the valve. This task requires the ability to understand the customized needs of their clients—builders of competition and high-performance engines. Finally, the last mode of insertion is in “aftermarket” GVCs. Here, the design is completed through a process of reverse engineering from original equipment samples without the participation of their clients. This mode of insertion presents the least optimistic prospect because emerging industrial economies, in particular China, are increasingly able to compete in this market segment.

The high-end footwear and Basso cases show that a middle-income country like Argentina might have an opportunity for export development through participation in GVCs that are not oriented to the mass market. On the one hand, participation in those GVCs can be afforded even in the presence of relatively high wages. On the other hand, it does not necessarily require the amount of knowledge that is usually required for the design and marketing roles typically performed by developed countries in mass market-oriented GVCs. Although some general policy recommendations stem naturally from our study, we hope the description of these insertion experiences in GVCs and the analysis of the main constraints to insertion will indirectly contribute to the formulation of specific public policies.

PART I: FOOTWEAR

2. The Footwear Industry in the World and in Argentina

The footwear industry has experienced a process of drastic worldwide relocation of production since the 1970s that has involved shifting the bulk of shoe production from developed to developing countries (Schmitz, 1995; Hsing, 1999; Bazan and Navas-Alemán, 2004). These changes have also implied drastic changes in trade patterns. Some of the largest exporters in the world are now developing countries. The distribution of footwear production across countries at the industry level, however, masks a different distribution of production in the high-end segment of the market. In this segment, which we focus on as a potential export opportunity for Argentina, high-income countries are still the main producers and exporters. Argentina does not currently play an important role as an exporter. Either in this segment or in any other in this industry, its export participation is negligible. This section provides a brief overview of the footwear industry in the world and in Argentina. First, it uses statistical trade flow data to describe the main patterns of world trade. Then, it uses similar data to describe the limited international insertion of Argentina. In both cases, special attention is paid to the high-end segment of the market.

Patterns of World Production and Trade

Following a process observed in the case of several labor-intensive industries (Gereffi, 1999; Schmitz, 2006), footwear branded manufacturers and marketers in developed countries gradually shifted production to firms in developing countries to achieve cost reductions as the latter acquired production capabilities.⁵ As a result of this process, some Asian countries, especially China, Vietnam, and Indonesia, have emerged as some of the largest world exporters of footwear. In contrast to their increasing importance as producers and exporters, footwear

⁵ Gereffi (1999) defines *branded marketers* as firms that own recognized brands but do not manufacture the products. He also defines *branded manufacturers* as firms that own recognized brands and also perform the manufacturing process. Here, we adopt these definitions. For simplicity, we also sometimes encompass these two types of firms under the term *branded firms* or simply *brands*.

production declined to an almost negligible size in some developed countries like the United States.

Table 1 exhibits the value of trade for the ten largest exporters and importers of shoes in 2010 and their share in the world totals.⁶ In the case of exports (left panel), China occupies first place, accounting for 41% of world exports. Following China, though with considerably smaller shares, is a list that includes both developed and developing countries: Italy (11%), Vietnam (5%), Germany (4%), Spain (3%), Indonesia (3%), India (2%), France (2%), Portugal (2%), and Brazil (2%).⁷

The largest exporter in Latin America is Brazil (2%). Most export activity in this country is concentrated in an industrial cluster located in its southern region (the Valley of Sinos), although some of the firms in the cluster have recently moved production activities to the northeast of the country in search of lower wages. In previous decades, Brazil was one of the few largest shoe exporters in the world. The industry gained a prominent position in the international market by performing contract manufacturing of low-to-medium-quality women's leather shoes for the United States. In the last fifteen years, however, this position has notably suffered the increased competition from China. As a response, some firms in the cluster have attempted, with mixed results, to upgrade quality and perform new functions in the value chain such as design and marketing. Nevertheless, the footwear industry is still vibrant in Brazil, and the country occupies the tenth place in the list of world exporters. Argentina's export participation, by contrast, is notably small (0.03%).

The right panel of Table 1 displays the largest importers. Here, developed countries dominate the list. The list includes the United States (23%), Germany (7%), France (6%), the

⁶ The footwear industry encompasses five four-digit headings of the Harmonized System (HS) trade classification. These are 6401 (waterproof footwear with outer soles and uppers of rubber and plastic that are not stitched together or joined by means of rivets, nails, screws, pins, or similar devices, nor made of different parts joined in this way), 6402 (all other footwear with outer soles and uppers of rubber and plastic), 6403 (footwear with outer soles of rubber, plastic, or natural or composition leather and uppers of natural leather), 6404 (footwear with outer soles of rubber, plastic, or natural or composition leather and uppers of textile materials), and 6405 (other footwear). Although Hong Kong, Belgium, and the Netherlands report export volumes that would place them among the ten top exporters, we do not include them in the table because those volumes are mostly composed of re-exports.

⁷ All figures are obtained from United Nations' COMTRADE database.

United Kingdom (6%), Italy (5%), and Japan (5%). The import share of Argentina, despite important restrictions on footwear imports, is substantially larger than its export share.

Table 1: Top Exporters and Top Importers of Footwear (2010)

Top exporters	Value of exports (million USD)	Share of world exports (%)	Top importers	Value of imports (million USD)	Share of world imports (%)
China	33.665	41	USA	21.531	23
Italy	8.755	11	Germany	6.815	7
Vietnam*	4.071	5	France	5.801	6
Germany	3.444	4	UK	5.529	6
Spain	2.450	3	Italy	4.676	5
Indonesia	2.429	3	Japan	4.468	5
India	1.421	2	Russian Federation	3.769	4
France	1.970	2	Spain	2.817	3
Portugal	1.720	2	Netherlands	2.752	3
Brazil	1.472	2	Belgium	2.555	3
Top ten exporters	61.395	74	Top ten importers	60.713	66
Argentina	26	0.03	Argentina	284	0.34
Total	83.028	100	Total	91.755	100

Source: COMTRADE.

Note: Vietnam data corresponds to 2009.

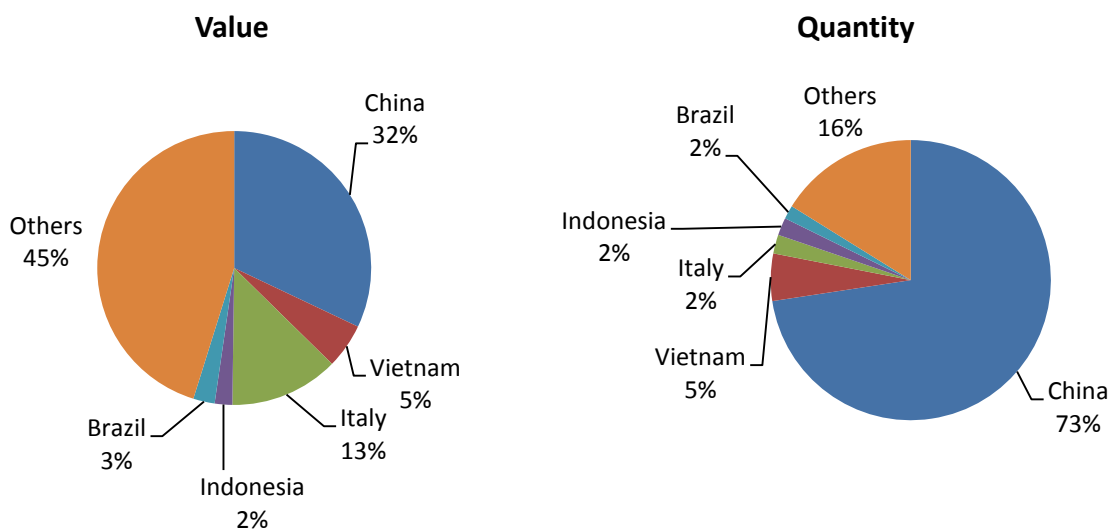
The increasing participation of developing countries in world exports is largely concentrated in the mass market. Higher segments of the footwear market, by contrast, are disproportionately served by producers in developed countries. This fact is manifest in Figure 1, which compares the distribution of export shares in monetary units (value) with those calculated on the basis of physical units (quantity) in the year 2007.⁸ The differences are striking. For example, while China's value share is 32%, its quantity share is 73%. Italy, on the other hand, provides an opposite example. This country achieves a value participation of 13% with only 2% of exported shoe pairs.

Our study focuses on the high-end segment of the footwear market. Unfortunately, the HS classification used to report official statistics does not distinguish shoes according to their

⁸ This is the last year with available data on quantity exports provided by Abicalçados, the industry association in Brazil. We use this source for export quantities because data is notably sparse.

quality or to the market segment of consumers who buy them. Nevertheless, there is consensus among industry experts that manufacturing materials can be used as a reasonable proxy for both. In particular, for data analysis the high end of the footwear market can be mapped, though imperfectly, into the two six-digit HS categories that include non-sport footwear with uppers and outer soles made of leather.⁹

Figure 1: Comparison of Value and Quantity Exports (2007)

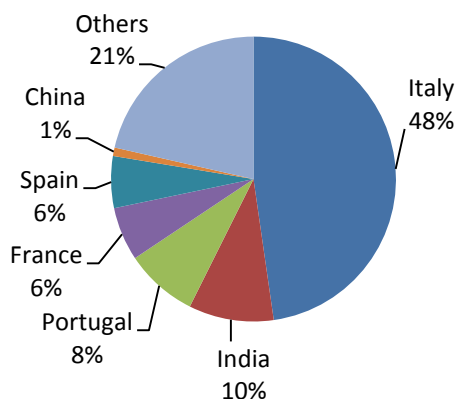


Source: Abicalçados (quantity) and COMTRADE (value).

Total world exports under these two product categories amounted to USD 6.3 billion in 2010. This total represents 7.6% of total footwear exports during that year. The distribution of export shares for high-end footwear is displayed in Figure 2. Consistent with the discrepancy between value and quantity shares exhibited in the previous figure, the distribution of export shares for high-end footwear is drastically different from the export shares that prevail for the industry as a whole in Figure 1. At the high end of the market, the dominant exporter is Italy, with 48% of the market in 2010. Other large exporters are India (10%), Portugal (8%), France (6%), Spain (6%), and China (1%). China’s limited share in the high-end segment of the market contrasts with its prominent participation in total shoe exports. The largest Latin American exporter is Brazil, although this country’s share in this segment of the market attains only 0.2%.

⁹ “Other footwear with outer soles of leather and uppers of leather: Covering the ankle” (HS 6403.51) and “Other footwear with outer soles of leather and uppers of leather: Not covering the ankle” (HS 6403.59).

Figure 2: Share of “High-End” Footwear World Exports (Value) (2010)



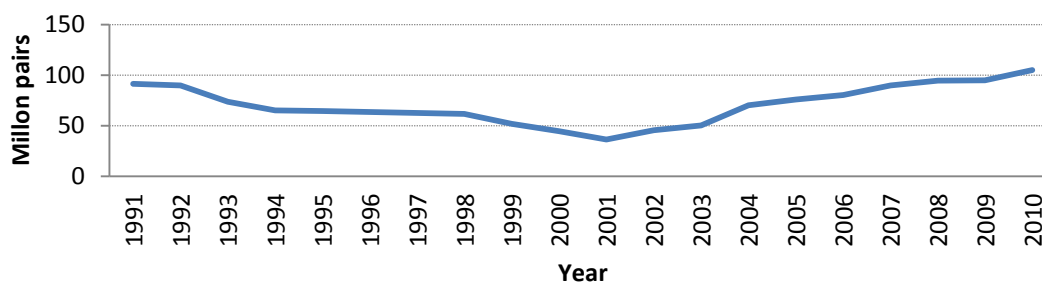
Source: COMTRADE.

The Footwear Industry in Argentina

The footwear industry in Argentina comprises about 1,000 factories that employ approximately 65,000 people directly or indirectly (CIC, 2011). Ninety percent of the firms are located in Buenos Aires, Greater Buenos Aires, Córdoba, and Santa Fe (CEP, 2009). These firms are primarily small- and medium-sized enterprises (SMEs); 77% have fewer than ten employees and only 5% have more than thirty (INDEC, 2006). Sport footwear accounts for approximately one-fourth of total production, while non-sport footwear accounts for the remaining three-fourths. High-end footwear represents 7% of the total production of non-sport footwear (CIC, 2011).

Argentina is the tenth-largest producer of shoes in the world. In the last decade, the sector has experienced sustained growth, reversing the declining trend registered between 1991 and 2001. In 2010, national production reached a production peak of 105 million pairs (see Figure 3). Growth in the industry has accompanied the evolution of aggregate production and consumption in Argentina. Since the aftermath of the economic crisis in early 2002, when the peso/dollar currency board collapsed, GDP in the country has grown at an average annual rate of 7.6%.

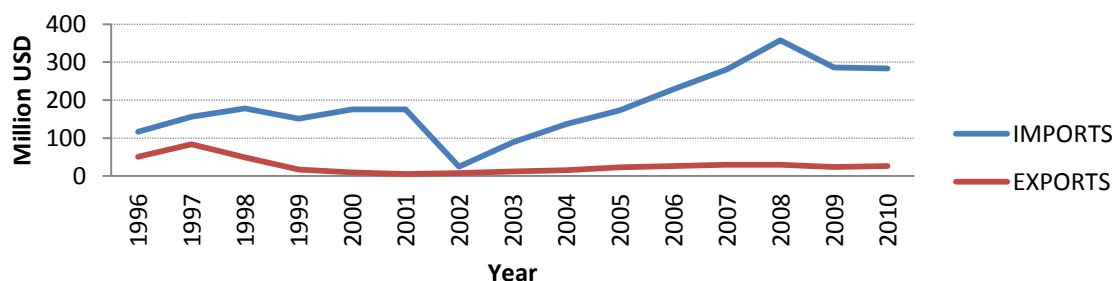
Figure 3: Evolution of Footwear Production in Argentina (1991–2010)



Source: CIC (2011).

Despite the large volume of shoes produced domestically, Argentina does not play a significant role as an exporter in this industry; rather, Argentine footwear exports are scarce and erratic. The total amount of exports in 2010 was USD 26 million, and this total was mainly accounted for by shipments to neighboring countries (85%). Imports, on the other hand, reached USD 284 million during that year, giving rise to a substantial trade deficit (see Figure 4). The main sources of shoe imports are Brazil (59%) and China (15%). Although exports have displayed an increasing trend since the devaluation of the peso in 2002, import growth has been substantially more vigorous.¹⁰ Import growth has occurred despite increasing protection to the industry since 2005 via non-automatic import licenses on finished footwear, minimum import prices, and a special agreement with Brazil to limit shipments from that country to fifteen million pairs per year.

Figure 4: Evolution of Imports and Exports in the Footwear Industry in Argentina (1996–2010)

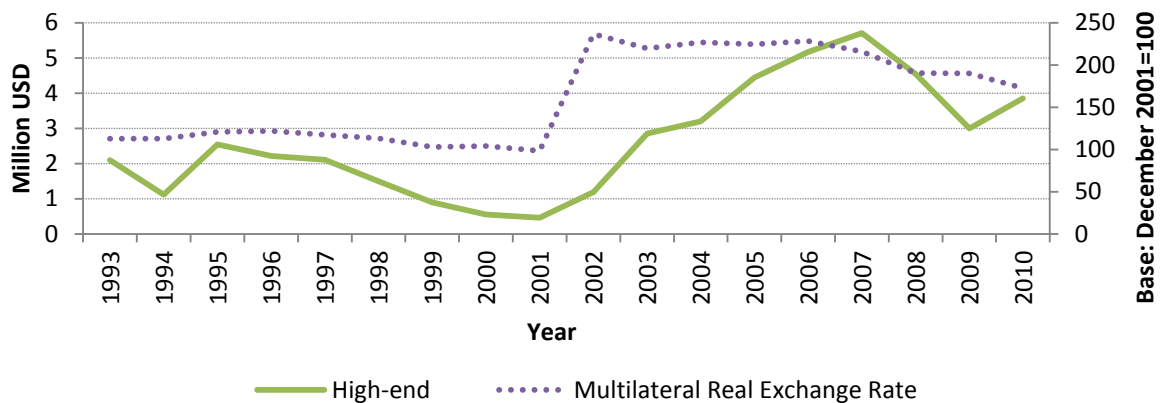


Source: COMTRADE.

¹⁰ The 1990s witnessed a temporary surge in exports to Brazil. Those exports declined drastically after the large devaluation of the Brazilian currency in January 1999. Exports to Brazil did not recover those peak levels in the 2000s.

Most Argentine footwear exports consist of non-sport leather shoes (approximately 60%). Within this category, exports of high-end shoes account for 27%. The solid line in Figure 5 displays the evolution of Argentina’s footwear exports of high-end shoes. Two features of this evolution are worth noting. First, exports of high-end shoes are consistently higher in the last decade than in the 1990s. Exports in 2010 amounted to USD 3.8 million, an increase of 83% relative to exports in 1993. This higher level of high-end shoe exports indicates an emerging export orientation of some shoe producers and designers in this segment. Second, the evolution of exports is strongly influenced by the evolution of the real exchange rate (see dotted line in Figure 5). In particular, while a devalued real exchange rate strongly favored the exporting activity during a large fraction of the last decade, this rate has been appreciating since 2007. At the time of our field work (during 2011), most interviewed firms pointed to the increasing costs of production implied by this appreciation as a crucial factor explaining lack of export activity or exporting efforts.

Figure 5: Argentine Footwear Exports (1993–2010)



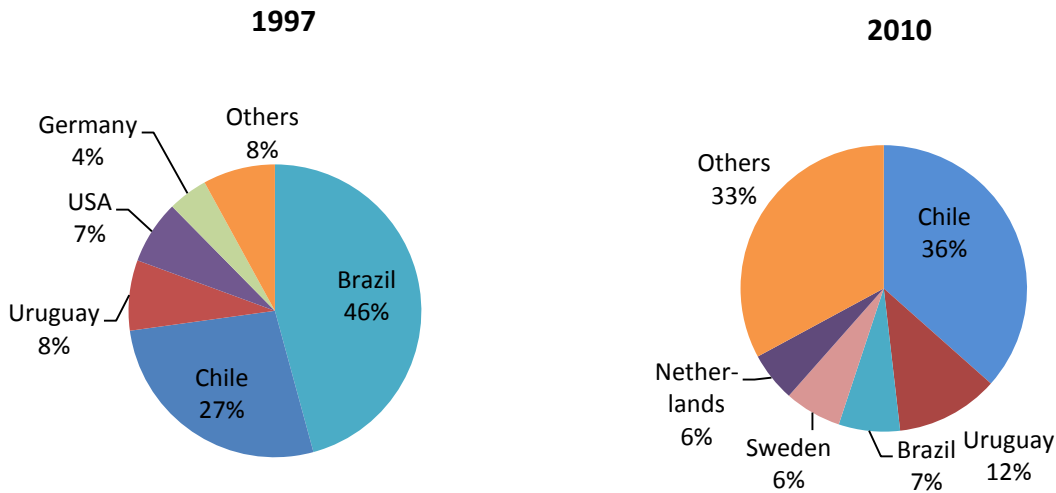
Sources: COMTRADE (exports), own calculation based on Central Bank of Argentina and website “Cosas que pasan” (multilateral real exchange rate).

Note: For the multilateral real exchange calculation we substituted the manipulated official inflation rate with private estimates from the website “Cosas que pasan.”

Figure 6 compares the distribution of export destinations of high-end footwear for the years 1997 and 2010. The most salient fact of Figure 6 is the drastic decline of Brazil as a buyer of high-end Argentine shoes (from 46% in 1997 to only 7% in 2010). In addition, the composition of exports to developed countries displays an unstable pattern. While the most important export destinations in 1997 among those countries were the United States (7%) and

Germany (4%), the most important buyers in 2010 were Sweden (6%) and the Netherlands (6%).

Figure 6: High-End Argentine Exports by Country (Value)



Source: COMTRADE.

Two structural features of the Argentine industry are critical to explain its lack of international insertion. First, since Argentina is in the Southern Hemisphere, the industry operates counter-seasonally to trend-setting countries such as Italy, England, and France. This feature has a strong influence on the organization of the industry. Most footwear producers choose to become trend followers and confine their creativity to the adaptation of European designs to the domestic taste. This choice is founded on the fact that domestic consumers are willing to purchase—though with delay—shoes that mimic fashionable European models rather than shoes with original domestic designs. As a result, the market does not sufficiently reward investments in design creativity. A second key structural feature of the industry that explains its lack of internationalization is the fact that producers are typically unable to take advantage of export opportunities they occasionally encounter because of quality defects and non-conformance to standard business practices in developed countries. Consumers and retailers in the domestic market accept as normal shoe defects that are unacceptable in those countries.¹¹

¹¹ Quality standards involve aesthetic aspects of the product and other aspects related to its wearing resistance. Aesthetic aspects are tied to the precision achieved in each production phase (molding, grading, cutting, process stitching, assembly, seam stitching, trimming and straining, and so on), especially process stitching.

In order to export, domestic producers need to make substantial efforts to improve quality. In addition, the prevailing business practices of producers and retailers in the domestic market are characterized by a high degree of uncertainty and improvisation. While potentially an efficient response to a volatile environment, importers often regard those practices as unprofessional and disruptive.

Firms in the high-end segment of the Argentine footwear market resort to different business models regarding design, production, marketing, and brand management. A first group of firms vertically integrate all of the above functions but confine their design activity to adapting foreign designs to local tastes. Most firms in this group market their products with their own brand exclusively in company-owned stores in Buenos Aires and in multi-brand stores in the provinces (Giorgio Beneti, Saverio Di Ricci, Perugia, Tosone, Mocasines Guido, and Paruolo). A smaller group of firms add franchises as a sales channel in addition to their own stores (Sarkany, Maggio & Rossetto, Prüne). Other firms rely mainly on multi-brand stores to retail their products (Adrian Troncoso).

A second group of firms is mostly devoted to brand management and marketing. While a few of these firms are exclusively dedicated to shoes (Silla Argentino, Bottana, and Cappio), this group is mostly composed of branded apparel marketers (Uma, Vitamina, Etiqueta Negra). Firms in this group make substantial investments in brand development to position their brand in the high-end segment of the market. They use their own stores as a sales channel but outsource the production of their collections. The private-label manufacturers that supply these firms usually work on a non-exclusive basis. In fact, a typical high-end shoe manufacturer works for several apparel firms simultaneously. Manufacturers and branded marketers often conduct design activities jointly, but those activities are limited to adapting European designs. Despite their investment in brand development, for most of these companies, brand recognition is confined to the local market.

A third group of firms make shoes with genuinely original designs (Mishka, Lucila Iotti, Sofi Martiré, Comme Il Faut, Gretaflora). These firms tend to be young and often carry as their brand name simply the name of the designer to emphasize their original-design orientation. Production is usually outsourced to footwear manufacturers with whom they work closely to

ensure product quality. These design-oriented firms typically set up their own stores in the “design circuits” of Buenos Aires.¹² The characteristics of those stores (decoration, illumination, and ambience) are critical for portraying the brand image, which needs to be consistent with the attributes of the shoes the company designs.

Various international brands with presence in Argentina complete the domestic competition map in the high-end segment of the market. These brands include Italian Salvatore Ferragamo, one of the most prestigious brands worldwide in this segment, and luxury brands like Louis Vuitton, Ermenegildo Zegna, and Hermès, which have their own stores in the Recoleta neighborhood in Buenos Aires.¹³ These luxury brands are diversified into a variety of products but incorporate footwear lines, which they import, into their collections.

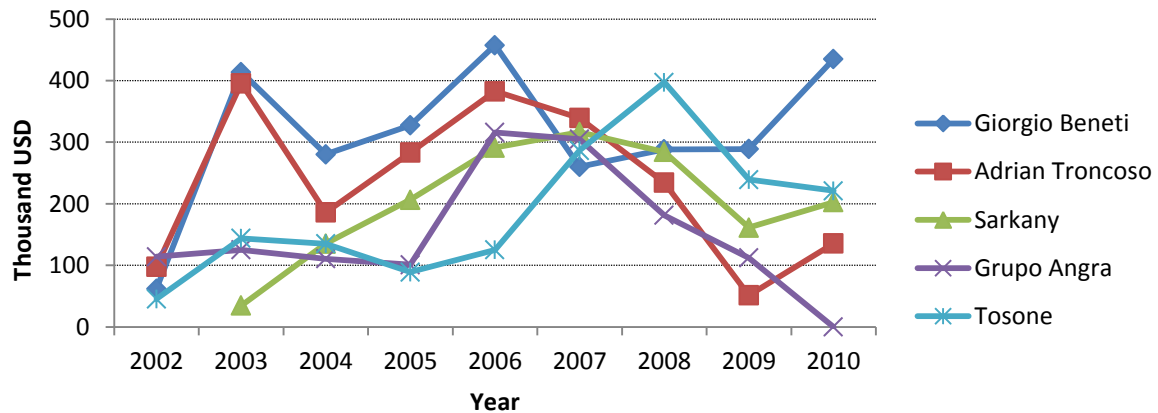
The five major exporters of the period 2002–2010 were Giorgio Beneti, Adrian Troncoso, International Ricky Sarkany (from now on Sarkany), Grupo Angra, and José M. Tosone e hijos (from now on Tosone).¹⁴ These five firms make up 32% of Argentina’s total exports of high-end footwear, while the other 68% is accounted for by approximately three hundred firms. Figure 7 displays the evolution of exports for these exporters from 2002 to 2010. Giorgio Beneti, Sarkany, and Tosone steadily increased their exports during this period. Grupo Angra and Adrian Troncoso, conversely, experienced an uneven evolution of their exports, with a strong decline in the last years due to the peso appreciation in real terms against the U.S. dollar. Giorgio Beneti is the only firm that has exported consistently to the United States, its main export destination during the period 2002–2010. It is also the only firm specialized in men’s footwear rather than in women’s shoes. In the case of Tosone, 49% of its exports went to Europe (mainly Sweden). Sarkany, Adrian Troncoso, and Grupo Angra, by contrast, concentrated more than 80% of their exports in different Latin American countries (primarily Chile). Even though Grupo Angra succeeded in exporting regularly to Spain, which represented 19% of its exports between 2002 and 2008, this company exited the export market in 2010.

¹² Three design circuits may be identified in Buenos Aires, namely, Palermo, San Telmo, and Recoleta.

¹³ The Recoleta neighborhood has two main shopping circuits—Alvear Avenue and Patio Bullrich Shopping Mall—for the highest purchasing-power segment in Buenos Aires.

¹⁴ Figures from 2002 to 2006 were obtained from direct access to customs records. Since 2007 they are obtained from the private vendor NOSIS.

Figure 7: Top Five Argentine Exporters of High-End Footwear (2002–2010)



Source: Argentine customs data and NOSIS.

3. Modes of Argentine Insertion in High-End Footwear GVCs

Footwear GVCs display asymmetrical relationships between their different actors (Schmitz and Knorringer, 2000; Schmitz, 2006). Particularly, there are great asymmetries among those that market the products and those that manufacture them. In these chains, higher-value activities are those related to design and marketing, not production. In general, such higher-value activities are in the hands of multinational firms that either specialize in footwear or own multinational branded marketers¹⁵ that offer a wide range of products. In the high end of the market, the latter are firms that own luxury-goods brands. Developing countries' participation in these value chains is by and large limited to production activities. In Argentina, several companies have become integrated in high-end footwear GVCs performing only the production stage of the value chain. Other companies also participate in design activities and, in some cases, even marketing activities as well. This section presents possible high-end footwear GVCs on the basis of the activities identified in our field research and the insertion modes into such GVCs experienced by Argentine companies.

In every high-end footwear value chain, three activities are identified: design, production, and marketing. Each, in turn, includes various activities that may be performed by different agents. We distinguish two different broad types of chains (see Figure 8) according to whether original designs are created or already-created designs are merely adapted or

¹⁵ The terms *branded marketers* and *branded manufacturers* are used as in Gereffi (1999). See footnote 5, where we also define the use given here to the terms *branded firms* and *brands*.

imitated. We refer to the first as an “original-design value chain” and the latter as an “adaptive-design counter-seasonal value chain.” On the basis of the activities carried out by Argentine companies within these two types of GVCs, we identify three possible insertion modes. We describe the characteristics of each of them below. The first two modes are variants that correspond to the broader original-design type (Mode A and Mode B). The third mode is instead associated with the adaptive-design counter-seasonal type (Mode C).

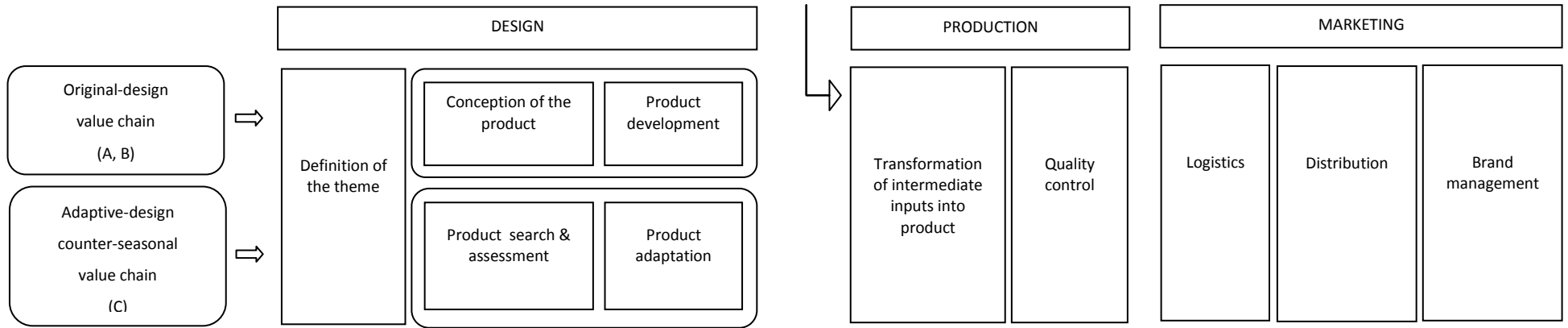
The first insertion mode into a GVC comprises the development of the product based on designs created in developed countries—the last activity of the design stage—and the actual manufacturing. We call this mode of insertion “contract manufacturing with cooperative product development” (Mode A). Among the three modes of insertion we describe here, this is the one that resembles most closely those described in the literature. Nevertheless, a noteworthy difference is our focus on the high end of the market. These GVCs are oriented to supplying consumers in developed countries and are coordinated and dominated by retailers located in those countries. The second mode of insertion involves the participation of the Argentine firm in design and production activities (Mode B). This mode presents two important differences compared to Mode A. First, the original design is done domestically by the Argentine firm. Second, this firm sells footwear under its own brand—not that of the retailer—and has an explicit brand-management strategy. The development of the brand between the Argentine producer and the foreign distributor is often managed jointly. These retailers are usually local, multi-product stores specialized in designed products. The third mode of insertion involves firms that have managed to insert themselves in Latin American GVCs by adapting designs created in developed countries to the regional taste and through investments in various marketing activities (Mode C).

Below we describe in detail each of the activities of the chain—design, production, and marketing—the abilities required to perform them, the outcomes of each activity, the actors performing them, and the relations established between such agents. Except for the different activities at the design stage between the third mode of insertion and the first two, all other activities are common for each of the three modes. Hence, we use the detailed description of Mode A as a benchmark, highlighting in the other two cases only their distinguishing features.

Figure 8. High-End Footwear Value Chain

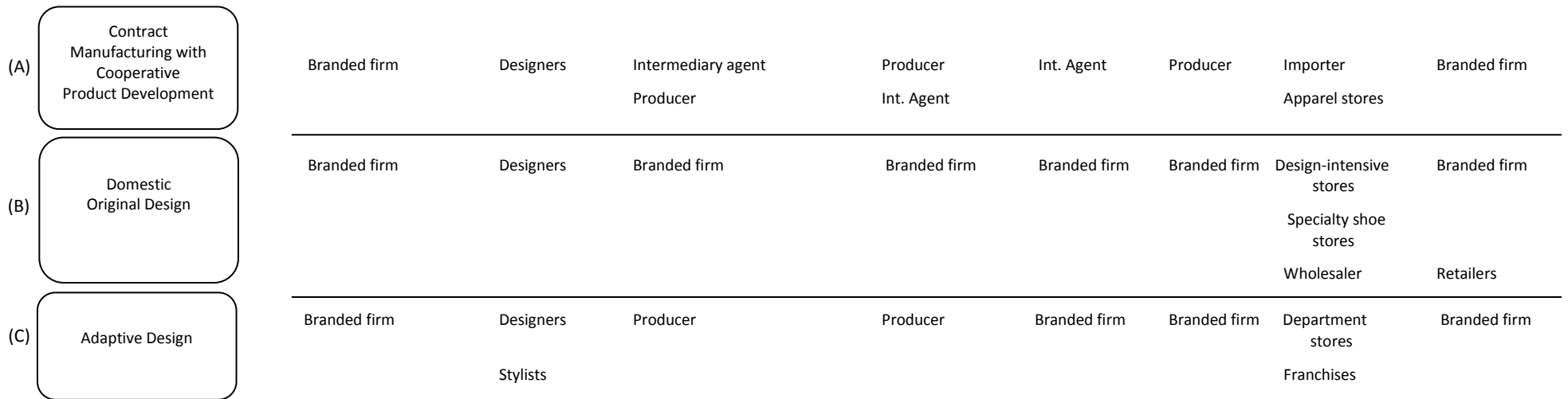
ACTIVITIES

Broad type of GVC

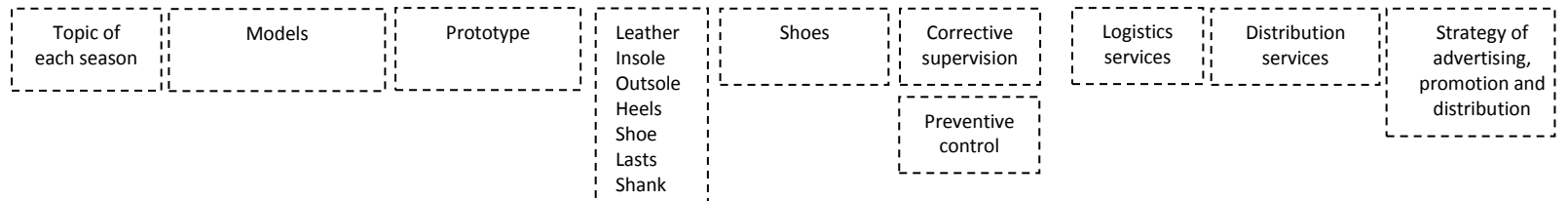


ACTORS

Modes of Argentine insertion in GVC



PRODUCTS



In Figure 8, the three panels show, respectively, the activities, the actors, and the products of each mode of insertion in GVCs. The first panel includes the activities in design, production, and marketing. Two of the types of chains, “original-design value chain” and “adaptive-design counter-seasonal value chain,” are distinguished on the basis of the activities performed at the design stage. The second panel distinguishes the three modes of insertion, denoted “contract manufacturing with cooperative product development” (Mode A), “domestic original design” (Mode B), and “adaptive design” (Mode C). The actors involved in each mode of insertion are shown in this panel. The last panel shows the products resulting from each activity.

Mode A: Contract Manufacturing with Cooperative Product Development

The first mode of insertion in a GVC involves an Argentine firm performing the manufacturing activity and also participating in product development. The participation of the firm in this last stage of the design process is the key distinguishing feature compared to standard contract manufacturing arrangements analyzed in the literature. This activity is developed jointly between the manufacturer and an importer based in a developed country, who acts as an intermediary between the former and the branded firm.

The first link in the chain is the design of the product. This includes the definition of the theme, the conception of the styles making up each collection, and the development of the products (Figure 8).¹⁶ The selection and definition of the theme determines the starting point of the design process. It is one of the activities inherent to brand management. These themes (or concepts) encompass several product lines in a collection that are related to each other, expressing consistency of style. They seek to communicate a brand identity in each of the styles created. Thus, the collection is built from a story that the brand uses to communicate with potential customers. The proximity to consumption and fashion centers recognized as trendsetters (Paris, Milan, Florence, London, Tokyo) is essential for obtaining information regarding trends in people’s behavior and lifestyle. The analysis and interpretation of these trends is reflected in concepts that will be an inspiration for the creation of new products.

¹⁶ In the fashion industry, products are offered to the public organized into season collections.

“Tales to be told” and “Hermès, contemporary artisan,” for instance, were the themes chosen by Hermès, an international brand of French origin, to inspire its designers in 2010 and 2011, respectively.

The conception of the styles making up each collection consists of the concrete design of each product. It is an activity that involves dealing with complex and tacit information and, therefore, requires highly creative people with the ability to translate available market data into ideas for specific products. To the extent that market information is not entirely codifiable, designers need to exchange ideas frequently with market analysts and brand managers. Due to this fact, international luxury brands participating in the segment of high-end footwear—such as Hermès, Louis Vuitton Moët Hennessy (LVMH), Pinault (PPR), Printemps, Redoute, Prada, and Salvatore Ferragamo, among others—usually have an inside design team.¹⁷ In other cases, where firms are headquartered in geographical areas far from fashion centers, they combine an inside design team with freelance professionals based in such centers (Brown Shoe Company, The Jones Group).¹⁸ For Argentine firms, design is still a challenge. In Argentina, firms in the fashion industry only began to adopt a business model of systematic brand construction and management in the mid-1990s.¹⁹ Only by the end of the '90s did they begin to gradually incorporate design professionals into their processes in order to lend an exclusive identity to those brands.²⁰ In the footwear sector, development has been even slower than in clothing.²¹

The final stage of the design process is the development of the product. Product development involves first research and testing of raw materials, components, and processes for the manufacture of footwear and the subsequent selection of suppliers (input and producers). Second, it involves the creation of prototypes (samples). These activities require

¹⁷ The LVMH group owns footwear brands Louis Vuitton, Fendi, Céline, and Berluti. The PPR group owns footwear brands Sergio Rossi, Gucci, Bottega Veneta, and Yves Saint Laurent. The Prada group owns brands Prada, Miu Miu, Church's, and Car Shoe.

¹⁸ The Brown Shoe Company owns, in the high-end segment, Via Spiga and Vera Wang Lavender. The Jones Group owns Stuart Weitzman and Joan & David and holds the license for the brand B Brian Atwood.

¹⁹ Many Argentine brands emerged in the 1990s in clothing apparel (Benito Fernandez, Caro Cuore, Jazmin Chebar, John L. Cook, Kosiuko, Ona Saez, Paula Cahen D'Anvers, Vitamina), leather (Prüne), and footwear (Sarkany).

²⁰ In 1989, the University of Buenos Aires (UBA) launched a program in Fashion Design and Textile Design. In 1994, there were only twenty graduates.

²¹ In footwear, for instance, at the university level only an optional subject is given at UBA—Footwear Design—in the last year of the Fashion Design and Textile Design program. Since 2010, the National University of La Matanza has been offering a technical program in industrial production focused on footwear.

people that are capable of properly interpreting the design of the product to be manufactured both in terms of the possibility of manufacturing it and in terms of the product's ability to express the image of the brand to the consumer. This implies understanding not only the technical specifications of the product but also the reasons that led to choosing its distinguishing attributes. In high-end products, such understanding is key, because it requires the person carrying out the development of the product to have the ability to interpret different types of information. This person needs to interpret basic and codified information about materials and techniques, and she also needs to be able to interpret more complex and tacit information, which demands frequent exchanges of ideas with the designers and brand managers. In general, product development is performed by branded marketers to ensure the quality of materials and processes as well as consistency with what the firm wants to communicate as a brand. The (underdeveloped) ability of Argentina to perform product development for brands in developed markets could potentially allow its firms to competitively participate in high-end footwear GVCs.

The second link in the chain is production. This link involves the transformation of raw materials and intermediate inputs into a product. Transformation activities require skilled labor specialized in different tasks (cutting and stitching, among others). For this reason, several operations in the production process may be performed by external contractors. Quality control must be performed all along the production process. One particular problem at this stage lies in the quality upgrade required to satisfy the higher standards of developed countries. It is often the case that maintaining high quality levels throughout the production process is a challenge for the manufacturer or the external contractor, because it involves changing the organization of production and several production practices in the plant. In addition, another difficulty faced by manufacturers of high-end products is the requirement that they properly interpret from the designs they receive all the technical specifications that could not be codified.

The producer's ability to interpret the specifications established by the developer of the product is subject to customary practices in production techniques. In high-end footwear, the "craft" nature is essential. This implies attention to the details involved in each operation and

the appropriate treatment and handling of materials and components. The productive capability of a firm depends on the possibility of acquiring such “craft” skills. Suppliers of raw materials, components, and skilled labor play an important role in developing these skills.²² For example, the development and sophistication of the leather tanning and component industries (soles, heels, lasts, and accessories) open possibilities for acquiring skills to work with new materials and components and thus increase producers’ ability to interpret more sophisticated styles. In Argentina, there is a sizeable quality leather tanning industry. However, this is not the case for the components industry.²³

The size and underdevelopment of the component industries constrain opportunities to participate in GVCs of high-end footwear. Those constraints can be loosened by importing the necessary components. Importing materials, however, is difficult for two reasons. First, importing requires frequent communication with the overseas vendor, which means time and resources—e.g., trips to the country of origin to look for alternative materials, and discussing alternatives after trying sample materials. Also, component and materials producers overseas are not always willing to spend time and resources developing or finding out the appropriate input for small shoe manufacturers. Second, imports have been increasingly regulated and restricted in Argentina by government measures such as quotas, non-automatic renewal of import licenses, and minimum import values. More generally, the existence of a dense components industry in a country is an important factor taken into account by international branded marketers to choose the location of an overseas manufacturer.

Due to the insufficient ability to interpret foreign designs, an additional intermediary is necessary in high-end contract manufacturing arrangements. The intermediary takes the role of interpreter between the branded marketer and the manufacturer. This player is indispensable when the specifications have a tacit component that is essential to the product but is impossible to codify. The intermediary agent not only monitors compliance with quality

²² In Figure 8, input production is recognized as part of the chain. The relevant relationships established among the suppliers of raw materials, inputs, and intermediate materials with producers are incorporated into the analysis of production activities.

²³ The Argentine Chamber of Industrial Suppliers of the Footwear Industry is the main institution that gathers suppliers of the footwear industry. In 2011, it had 230 members, out of which only two were suppliers of lasts and three of heels.

standards established for each operation but also interprets and translates the product design for the manufacturer. In addition, the agent sometimes shows the manufacturer the appropriate production method to work with the materials. In cases that have achieved this first mode of insertion, two intermediary agents are actually necessary. The first agent, located in Sweden, receives the designs from the branded marketers. This agent makes an effort to maximize quality specifications that might only be implicit in the original design, and communicates all this information to the second intermediary agent, located in Argentina. This second agent translates the specifications once again to the Argentine manufacturer. In order to perform this translation, the intermediary agents are required to have specialized skills in both footwear design and production. One of the main contributions of the second intermediary agent lies in the fact that in case some materials or components are unavailable, or the production process is not sufficiently flexible to manufacture some attribute of the shoe as originally designed, the agent has the ability to identify and develop a substitute.

In value chains related to high-end products, the key relationships are those established between designers, product development managers, and manufacturers. In these cases, the technical specifications are not sufficient for the development and manufacturing of products. The relationship needs to enable a frequent exchange of information and the tacit aspects that cannot be translated into a product data sheet. According to the classification in Gereffi et al (2005), this type of link among players is *relational*. We think there might be a potential for Argentine firms to integrate themselves into value chains that require this type of link.

The marketing activity involves brand management, logistics, and distribution to consumers. Logistics involve product storage, transportation, and inventory management. This activity requires the implementation of information systems and agents capable of maintaining adequate control of product flows to ensure the provision of distribution channels in terms of the quantity, quality, timing, and point of delivery.

Distribution involves the channels through which products reach the end consumer. At the retail level, those channels present various alternatives. For its growing expansion, the retail channel that stands out is apparel stores. In those stores, footwear often complements the core offering of clothing products and is marketed under the same brand (e.g., Diane von

Furstenberg, Gucci). It is important to distinguish large established international brands (Gucci, Marc Jacobs, Prada) from emerging or smaller brands. Large established brands have a network of retail outlets with a wide geographic coverage and are also present in high-end department stores. Due to their large sales volume, they have in-house design teams, but they may hire a renowned freelance designer for specific collections. Emerging and smaller brands own a few retail outlets known as “flagship stores,” usually in their country of origin and in some of the main fashion centers, and also market their products at international multi-brand apparel stores. They have a smaller scale but are recognized by consumers and the specialized press for their design. These firms often hire an independent agent to intermediate the relationship with outsource manufacturers for product development tasks. In this case, the brands provide guidelines for the designs, and the independent agent completes them with more technical specifications.

Another retail channel is specialized footwear stores. Specialized footwear stores can sell one brand exclusively, or they can sell multiple brands. These retail outlets can be managed by independent shoe retailers or, alternatively, by branded firms or franchisees. Independent shoe retailers (e.g., Hu’s) market mostly emerging brands, but they also carry established brands. The retailers select brands by visiting shoe shows and trade fairs, and by evaluating the recommendations of their supplying wholesalers. Branded firms that market their shoes through their own stores or franchises include international branded footwear manufacturers (e.g., Christian Louboutin, Jimmy Choo, Manolo Blahnik, Salvatore Ferragamo) and branded marketers (e.g., Johnston & Murphy, Mephisto, Michael Kors, Stuart Weitzman). Some branded marketers are part of larger corporations specialized in footwear (e.g., Brown Shoe Company) or in a larger set of fashion products (e.g., The Jones Group). The largest branded marketers design their own products and select the outsource manufacturers. For high-end shoes, those manufacturers are usually located in Italy, Spain, and Portugal. Italy is widely acknowledged in the industry as the country with the finest ability to produce high-quality shoes. Shoes with the “made in Italy” cachet command a higher price in the market. Spain and Portugal are also often chosen for the skills of their workforce, the existence of a dense network of component supplies, and the professionalism of its managers in terms of respecting delivery schedules and

responding to unforeseen eventualities. Stuart Weitzman, the upper-end brand of The Jones Group, outsources its production entirely in Spain. Smaller branded marketers outsource production through intermediary agents and usually hire independent designers to help them design their shoes.

Department stores are one additional retail channel. These stores offer products with private labels or carrying the producers' brands. Depending on the market they operate in, such stores may buy from manufacturers directly or through independent purchasing agents or distributors. Some department stores offering high-end footwear are Lafayette (France), Le Bon Marché (France), El Corte Inglés (Spain), Nordstrom (U.S.), Saks Fifth Avenue (U.S.), Bergdorf Goodman (U.S.), Neiman Marcus (U.S.), and Bloomingdale's (U.S.). These retailers primarily market well-established brands.

Distribution channels also differ at the wholesale level. Wholesalers take care of all the promotion, distribution, sales, and payments from customers. When a branded firm chooses to market through wholesalers, it delegates a large fraction of the marketing process. Most wholesalers specialize in one market segment by type of shoe or consumer. They supply specialized footwear stores and department stores. Some of the largest wholesalers in the United States are Iris, Rossimoda, and Schwartz & Benjamin. Wholesalers play a prominent role in the prospects of Mode B insertion, discussed in the next section.

The distribution channels that offer the most promising opportunities for Argentine firms to become part of this type of GVC are those that involve relatively small players. Due to their smaller size, they are more likely to be tolerant to the struggles Argentine firms might initially face and more tolerant to potential non-compliances with quality or timely delivery. Among these channels, apparel brands appear to offer more ample opportunities, because it is a channel currently expanding at a high rate. In either case, the role of intermediaries is crucial because they are the agents usually in charge of selecting the outsource manufacturer. Insertion in GVCs led by larger branded marketers seems more difficult to achieve, because their rigorous requirements imply a larger gap with the capabilities and practices of domestic firms (e.g., quality management, timely delivery).

In the past ten years, a group of Argentine footwear manufacturing firms have experienced this mode of insertion in GVCs. While all cases have involved the same international buyer, a Swedish importer, they involved different branded marketers—among them some of the most recognized Swedish apparel designers—as their ultimate clients. Additionally, the cases also involve different time periods and different reasons why such links have, in some cases, been discontinued. The first relationship of an Argentine manufacturer with this importer lasted less than two years, from late 2003 to early 2005. During this period, the manufacturer produced high-end women’s shoes for this importer. This relationship was discontinued when the manufacturer sold the factory and began to outsource production. The manufacturer failed to guarantee the same product quality through outsourcing that had been achieved in its own factory. Achieving such quality involved a degree of commitment to this objective that neither the manufacturer nor the outsourced contractors were willing to make. The second manufacturer maintained the relationship with the importer for four years, between 2005 and 2008, providing only women’s footwear. In this case, quality did not falter, but the relationship ended due to increased costs resulting from the appreciation of the Argentine peso. The third producer was asked to manufacture by the same importer because she needed men’s footwear. As in the previous case, quality standards were met, but the relationship ended because of lack of price agreement due to the appreciation of the Argentine peso. In 2010, the Swedish intermediary developed business relationships with two new manufacturers. These relationships are currently active. Orders, however, involve substantially smaller volumes than those involved in the earlier relationships.

Argentine firms have the potential to become integrated in high-end footwear GVCs. They can especially participate in original-design value chains based on their abilities to perform activities of production and product development. In the case of high-end products, production processes cannot be fully standardized because technical specifications cannot be fully detailed. Thus, these products require relational links between those who design them, those who develop them, and those who produce them in order to ensure a correct interpretation of the designs and a proper craftsmanship in their elaboration. The ability to forge those relationships could be the basis of the generalization of this mode of insertion in GVCs.

Mode B: Domestic Original Design

The second mode of insertion in GVCs involves, as the main difference with the previous mode, undertaking the function of design in addition to production. This mode of insertion is currently followed by designers Gretaflora, Lucila Iotti, Mishka, and Santesteban, among others. Though in limited amounts, these design-intensive firms have managed to consistently export high-end women's footwear to Europe and the United States. Firms that participate in this mode of insertion also conduct marketing activities. In particular, they carefully manage their brands, and hence are more selective in their choice of marketing channels. In general, their selected channels tend to be specialized footwear stores and stores specialized in design products (Opening Ceremony in the U.S., H.P. France in Japan).

In this mode of insertion, the activities of the design stage are structured around the so-called original-design value chain. Branded firms define the themes of each season and conceive the design of each product consistent with their brand identity. In all cases, product development is performed inside the firm, because this allows them to work with innovations in raw materials, components, and production processes, and ensure consistency between shoe styles and collections in the final selection of each.

These firms organize production in various ways. In some cases, production is integrated into the firm (Mishka). In others, it is outsourced to workshops that work exclusively for them (Gretaflora) or to factories producing for various branded marketers (Lucila Iotti, Santesteban). All designer firms, whatever their selected organizational form, supply producers with the necessary inputs and perform their own quality control. Since the originality of the shoe design is critical, firms that outsource production need to establish close ties with manufacturers, in order to convey to them all aspects of the design and final quality of the shoe that cannot be fully codified in a set of technical specifications, and because the exclusivity value of their designs requires a strong trust relationship with manufacturers to ensure that the designs will not be copied. Thus, designer and manufacturer establish a *relational* link (Gereffi et al, 2005).

In this insertion mode, brand management and distribution present distinctive features. Retailers in developed countries that do not market shoes with their own brand are either specialized footwear stores managed by independent shoe retailers (e.g., Hu's) or multi-

product design stores (e.g., H.P. France, Opening Ceremony). To gain access to independent shoe retailers in the U.S. market, wholesalers play a crucial role, because those retailers buy from wholesalers and are not directly involved in the search for new brands. These wholesalers have showrooms, mainly in Manhattan, and have a continuous presence in exhibition events and trade fairs. In contrast, design stores search for emerging designers on their own to renew and expand their range of brands and products. These buyers maintain the designer brand and collaborate with promotional activities or advertising to build brand recognition. This type of operation offers Argentine firms the chance to have their brands exhibited in cities at the vanguard of design and fashion (London, New York, Paris, and Tokyo). In turn, these operations afford Argentine designers who promote their own brands the possibility of exchanging information about the tastes of potential consumers in highly demanding markets. The relationship between the Argentine design firm and the foreign retailer is also *relational* (Gereffi et al, 2005).

Another interesting example is the case of Comme Il Faut, a women's tango shoe designer. This firm exports to several destinations in Europe and also to the United States and Japan. This case is interesting because the firm interacts intensively with a Japanese global buyer specialized in design goods with whom it jointly designs and monitors its brand-management strategy (other Argentine clothing firms also operate with this Japanese global buyer). As a result of its commercial relationship with H.P. France, Comme Il Faut has been able to export regularly to Japan and maintain its brand there. Japan is a market internationally known as one of the most demanding with regard to design and quality. The ability to perform marketing and brand-management roles stems both from the strategy used by this firm to enter and expand in the Japanese market and from the implications of this strategy in terms of interorganizational relations. The buyer is a group that markets design products from several countries in multi-brand stores in Japan. These stores, called "select shops," are owned either by the group or by third parties. This GVC's distinctive traits are the long-term relationships established by the retailer with its suppliers and the joint brand management it conducts with them. H.P. France acts not only as the importer, wholesale distributor, and retailer of the Argentine brand in Japan, but also as a brand developer in that market. The group's multi-brand

stores offer brands with a strong design imprint from various countries exclusively in the Japanese market. For this reason they strive to make these brands known in Japan (Acuña, 2010).

Other Argentine companies in the clothing sector have also established this type of relationship with H.P. France²⁴ and with other similar Japanese agents such as Nano Universe²⁵ and United Arrows. Participation in this type of GVC goes back to 2004, when this group began to operate in South America after meeting Martín Churba, designer and CEO of the Argentine clothing firm Tramando. These Argentine companies have been able to occupy market niches where brands are valued for what they represent in terms of identity. Consumers value the brands' history and the originality of their designs, and hence are willing to spend more on their products. These are examples of participation in a value chain where control of intangibles—brand, marketing, design, and R&D—is not concentrated in a single link but rather is shared between producer and retailer. Notwithstanding the different forms this type of GVC might take, we believe they offer great potential for export development.

Tango footwear is a niche market that has begun to be actively exploited abroad in the past few years. Tango as a genre—music and dance—has its origins in the River Plate (Argentina and Uruguay). Due to the worldwide acceptance of this music genre, Argentina has a prestigious international image associated with it. This positioning offers a competitive advantage for those who decide to exploit the genre. Young Argentine firms Gretaflora and Neo Tango Arte Para Bailar—in addition to Comme Il Fault—have focused on the tango footwear market niche but provide the shoes with differentiated design attributes. The combination of these two elements has allowed firms to become part of original-design value chains and progressively expand their activities to other segments of the market.

Tango footwear is marketed through non-standard channels. Most distributors of this type of footwear are tango schools based abroad or stores specialized in dance products. However, in the past few years, multi-product stores have begun to offer these specialized products, allowing tango footwear brands to expand into other market segments. Gretaflora, for example, has exported 80% of its production since the start of its activities in 2003. Its

²⁴ Tramando, Juana de Arco, Herchcovitch, Alexandre, and Bouquet by Viviana Uchitel.

²⁵ Pesqueira and Tamara Lisenberg.

products were initially sold in specialized dance stores and then expanded to stores specializing in high-end footwear or multi-product stores. The presence of the brand in these alternate channels led the firm to take advantage of its brand recognition by expanding the range of products to high-end footwear. Consequently, in 2010, the firm launched its lines of dress shoes.²⁶

Argentina is increasingly achieving international recognition as a fashion and design center. In the 1990s, this recognition was promoted by the arrival of numerous international brands and the emergence of national brands that have gradually expanded into overseas markets. This recognition has gained strength during the last decade, in particular for the city of Buenos Aires, due to the existence of a critical mass of active designers, private and public educational institutions, design-oriented research centers, and the explosive growth of activities associated to creative industries such as architecture, fashion design and textiles, accessories and jewelry, visual communication, and urban design.²⁷ Young designers are increasingly managing new firms with a comprehensive view of design. A business model based on brands that convey a unique local identity to consumers and are supported by a product portfolio consistent with that identity seems promising for new designers to become part of, or even lead, domestic original-design GVCs.

Mode C: Adaptive Design

The third mode of insertion differs from previous ones in how design is performed in the value chain (see adaptive-design counter-seasonal value chain in Figure 8). In this mode of insertion, firms design their shoes based on adaptations of existing styles made by other—primarily European—firms. Once the theme of the collection has been defined, the design activity is

²⁶ Examples of specialized dance stores are, for example, De Tango Se Trata in Belgium, Flor de Tango in the U.K., OfficinaTanguera in Italy, Tanzshop Hannover in Germany, and Zapatito de Dama in Spain. Examples of stores specializing in high-end footwear are Florarose in Australia and Mitzukoshi in Japan. Examples of multi-product stores are, for instance, Kahve boutique in the United States and TroisTreize in Japan.

²⁷ UNESCO's appointment of Buenos Aires as the first City of Design in 2005 is a statement of these capabilities. The appointment was obtained in the context of the Creative Cities Network, a program of UNESCO's Global Alliance for Cultural Diversity. This initiative established seven thematic networks that cities can join once they have been appointed. Themes include design, literature, film, music, crafts and folk art, media arts, and gastronomy. Nine other cities were later also appointed as cities of design, namely, Berlin, Montreal, Nagoya, Kobe, Shenzhen, Shanghai, Seoul, Saint-Etienne, and Graz.

limited to searching styles sold in major international fashion centers and selecting those that best fit that theme. Then, the original styles are adjusted to adapt them to local tastes. In general, this search and style selection is performed by agents known as “stylists.” Stylists travel abroad to major fashion centers in Europe, identify the new fashion trends, and take pictures of shoes displayed in specialized stores. On the basis of the styles presented by the stylist through a catalog of photos—sometimes the stylist purchases sample shoes—manufacturers and stylists decide on adjustments to the original products. In many cases, the activity comes down to just copying a particular style. Once the styles are selected, they prepare the molds used to make the prototypes. The work of the stylist requires understanding local consumer preferences and knowing the restrictions imposed by available materials and production capabilities in the local market.

The marketing activity in this mode of insertion is characterized by heavy investments in brand management and the use of multiple marketing channels. To achieve a stronger brand presence and visibility in Latin American markets, firms invest in advertising and promotional campaigns. Often these campaigns seek brand positioning by highlighting Argentine origin as a quality guarantee. This strategy is based on the fact that the quality of Argentine leather is recognized worldwide and that the Argentine fashion industry has been long acknowledged as playing a leading role in Latin America, particularly capable of translating European fashion trends to regional tastes. These two features facilitate marketing of high-end footwear in the region.

The combined use of various distribution channels is another distinguishing feature of this mode of insertion in GVCs. In this type of chain, the usual distribution channels are specialized one-brand stores and department stores. Specialized one-brand stores provide two advantages over branded firms. First, they afford greater visibility to the brand in the local market. Second, they imply direct contact with consumers. This contact allows the branded firm to obtain valuable information about their preferences, habits, expectations, and satisfaction with the brand, which enhances response times to consumers’ evolving demands. These facilities may be owned by the branded firm or may operate through franchises. Sarkany and Prüne are brands of Argentine firms that have chosen to expand throughout Latin America by

combining their own one-brand stores and franchises abroad. Natacha—another Argentine branded footwear firm—has begun its expansion into foreign markets by setting up its own store in Chile.

Selling at department stores is important for firms wishing to enter or grow in markets like Chile and Peru because this type of retail outlet is widely accepted in the population as a place of consumption, even in the high-end segment. This creates a challenge for Argentine firms, which are not used to department stores. Department stores have still not received much attention from Argentine consumers, who prefer shopping at specialized stores.²⁸ The challenges of selling at department stores lie in the necessary investments in infrastructure and personnel. For example, it is key to establish an operation center that allows for an adequate supply of products. Investments in personnel are required to stimulate sales. While sales staff of branded firms is not required at department stores, their presence can help customers select their shoes, assist them in evaluating them, and emphasize their advantages over those of other brands. Only large firms are able to afford these investments. Several Argentine firms have resorted to this distribution channel as a way to expand their foreign presence. However, their success has been mixed. Giorgio Beneti and Saverio di Ricci, for example, abandoned this channel after one or two seasons. Natacha, Paruolo, Sarkany, and Silla Argentino managed to maintain their presence in some Chilean department stores like Tiendas Paris, Ripley, and Falabella. Prüne is the only firm that has seriously committed to this channel by investing in Chile in an operation center and sales force.

This third mode of insertion allows firms to acquire and develop marketing capabilities that add value to their activities. The insertion of Argentine firms into adaptive-design GVCs is recent. In general, Argentine firms limit their exports to Latin American countries to sporadic operations with importers with whom they only establish market relationships. Often this type of relationship cannot sustain the manufacturer's brand because it is substituted by the distributor's brand. However, several Argentine firms are attempting a strategy of expansion in Latin America by investing in the brand, fostering franchises, or opening their own stores. There

²⁸ Falabella is the only department store in Argentina. It was established in 1993, but only in 1999 did it open its first store in Buenos Aires. Currently, it has eleven stores in five provinces (Buenos Aires, Córdoba, Mendoza, San Juan, and Santa Fe).

is potential for these experiences of insertion into GVCs to grow in Argentina's footwear sector. The groundwork for this potential is Argentina's position as a regional fashion center, the recognition of Argentine leather's quality, and the capabilities of brand construction and management being acquired by firms in the past few years.

4. Argentine Experiences of Insertion in High-End Footwear GVCs

This section describes the experiences of three Argentine firms operating in the sector of high-end footwear, each illustrating one of the insertion modes described in the previous section. The firms are Tosone (Mode A), Mishka (Mode B), and Prüne (Mode C).

Quality Matters: Tosone

Tosone illustrates the possibility that Argentine firms participate in GVCs under Mode A, "contract manufacturing with cooperative product development." Below we briefly describe the history and activities of the firm and its experience of international insertion based on its relationship with the Swedish importer Lagartija Industrial.

Tosone is primarily a producer of high-end women's leather footwear. The firm is now owned by Oscar Tosone and his three sons. Since it was founded in 1974, the company has been recognized by consumers for the quality of its products. The products have an elegant and classic design, which are created following the traditional model of adaptation from European styles. The annual production of the firm is between 26,000 and 28,000 pairs of shoes, and it employs thirty-two people. In 2010, Tosone exported USD 300,000, which accounted for 20% of the total turnover of the firm.

In the domestic market, Tosone has combined two businesses for several years. The first business is the manufacture of footwear marketed under the brand Tosone. These shoes are marketed in one-brand and multi-brand specialized stores. The former are entirely owned by Oscar Tosone's brother and are all located in Buenos Aires, in the neighborhoods of Belgrano (1), Palermo (1), and Recoleta (2). The latter are owned by various representatives and are distributed in a network of twenty-nine outlets located in ten different Argentine provinces. The second business is the manufacture of shoes for branded marketers that are either

specialized footwear stores or multi-product outlets. In the past few years, the latter business has increasingly been geared toward production for Argentine branded apparel marketers that have incorporated a footwear line into their product portfolio. In these cases, confidentiality contracts are usually signed between the parties to ensure that the producer's identity is not disclosed to the end consumer. In specific cases, Tosone and the apparel brand agree to market the shoe collection, promoting the joint work of both firms. In such cases, the shoes are marketed under the apparel brand but also have "by Tosone" printed on the sole.

The design activities performed by Tosone differ depending on how their products are marketed. When the products are marketed under the Tosone brand, the firm performs the design activities typical of an adaptive-design counter-seasonal value chain. One of the owners of the firm travels to major design centers in Europe—mainly Italy and London—to evaluate new trends in fashion and choose the shoe samples to be used as the basis for adaptation to local tastes. When production is sold under other brand names, Tosone only performs activities of production. In that case, the branded marketer provides them with the designs and then performs the marketing activities. This business allows Tosone to maintain a constant production flow throughout the year. While both industries, footwear and clothing, are organized around the same two seasons—autumn–winter and spring–summer—branded apparel marketers tend to start each season one or two months earlier than branded footwear marketers.

Tosone has exported shoes to several developed countries. However, Sweden has been its main export destination due to the regularity achieved under a relationship established with a Swedish buyer. This relationship started in 2005 and lasted until 2008. During that period, exports to this destination accounted for 61% of the firm's total value of exports. The experience with this Swedish buyer illustrates the first mode of international insertion analyzed in the previous section (Mode A). Below we present the agents that participated in the chain, the activities they performed, and the type of relationships they established.

Five agents are the main participants in this GVC. The first are various Swedish branded apparel marketers, among them Hope, Rodebjer, and Whyred. In all cases, these brands are internationally recognized for their original design. These firms select the themes of the

different collections, create the styles, and manage the brand. In their business model, product development and manufacturing are outsourced as well as distribution to end consumers. The second agent is an intermediary based in Sweden, to whom branded marketers transfer the responsibility of identifying an outsource manufacturer and of handling this relationship, which includes the task of developing the product. This intermediary agent was Lagartija Industrial. The third is an independent agent whom Lagartija hires in Argentina to conduct the activities of product development and quality control. The fourth agent is the manufacturer, Tosone. The final agents are multi-brand clothing stores located in different countries in Europe, Asia, and the United States that carry those Swedish brands.²⁹

Even though Lagartija is a Swedish firm, its owner and top manager is an Argentine woman residing in Sweden. She has a degree in fashion and textile design and, before moving to Sweden, she provided consulting services in footwear design at CEFOTECA.³⁰ Since she needed to work under a relationship that allowed for a frequent exchange of information on product development and production, Lagartija's owner did not hesitate to contact the manufacturers she knew in Argentina. She thought they would be capable of interpreting the designs she would give them and of discussing with her any matters related to design and quality.

Lagartija worked with two other firms between 2003 and 2005 before starting operations with Tosone. One of those firms, Ferraro, concentrated the bulk of orders, accounting for approximately 5,000 pairs per season. The relationship with this firm initially did not present problems, but the situation changed dramatically in late 2004 when Ferraro sold its factory and began to outsource production to various workshops. The main implication of this decision was the loss of quality in the end products. Ferraro relied on the production ability of these manufacturers but soon found that the outsourced shoes presented quality defects.

²⁹ Products were marketed at the retail level in a network of company-owned stores located in Sweden and in some multi-brand stores in other countries like Belgium, Denmark, Finland, Netherlands, Norway, Russia, United Kingdom, United States, Singapore, Hong Kong, and Japan.

³⁰ CEFOTECA is an Argentine educational institute established in 1989 by the Chamber of the Footwear Industries. It is the only institute that offers technical programs in footwear manufacturing and has the support of the National Institute of Industrial Technology. The aim of the institute is to train human resources for the industry, especially operators and technicians, as well as advise the sector's companies on footwear technology.

These workshops could not meet the quality standards required by the Swedish branded marketers. In addition, these firms failed to meet scheduled delivery times.

In order to continue operations in Argentina, Lagartija decided to implement an external quality control in one of the workshops outsourced by Ferraro. To this end, Lagartija's owner hired an Argentine auditor with technical training in shoemaking with whom she had previously worked at CEFOTECA. The auditor concluded that even if improvements in the performance of each production process were achieved, the main technical problems were rooted in decisions at the product development stage. However, implementing the necessary changes would be complicated by the indirect relationship between the auditor and the outsourced manufacturers. This problem prompted the decision to finish the relationship with Ferraro and the manufacturers. Lagartija decided to hire another producer with whom it could communicate directly. This producer was Tosone.

The intervention of the auditor in the relationship with Tosone was crucial. The auditor had the ability to interpret the designs, identify the type of work they required, convey this information to those involved in production, and even provide them with the necessary training. In high-end footwear with sophisticated designs, the ability to interpret designs and pay attention to every detail at the product development and production stages is essential. Since designs generally incorporate new materials or require innovative production techniques, the auditor had to play a dual role. She had to monitor the various production processes to ensure the required quality standards, and she had to work on the development of the product jointly with Tosone. Working jointly at this stage prevented problems at the manufacturing stage. The exchange of information between Lagartija and the auditor about the design features and technical specifications submitted by the branded marketers guaranteed quality of interpretation. The auditor then conveyed the decoded information to Tosone. Based on their interactions, they reached joint decisions about product development. Thus, even if they needed to introduce adjustments to the designs due to lack of specific materials, they were still faithful to the spirit of the original design.

Certain components or operations in the production process posed another challenge for Tosone in terms of supplier development. Soles and basecoats were the source of one

challenge. Tosone was unable to find a local supplier who could manufacture sole and basecoat models according to the client's technical specifications or that would be willing to make the necessary investments to be able to do so. It was forced, therefore, to resort to a Brazilian supplier. In the case of lasts and leather, in contrast, the firm was able to work jointly with domestic suppliers. It acquired first-rate pieces that the tanneries had assigned exclusively to foreign markets and reached an agreement with the lasts supplier regarding model development. The role of the auditor was important in the search and selection of these alternate suppliers. Tosone also had to agree on quality standards with service suppliers—stylists and workshops. Stylists were faced with a particular challenge because they had to prepare the molds based on drawings sent by the designers, instead of starting their work from a picture or the actual shoe, as was customary. In this sense, the presence of the auditor was critical, because it enabled the stylist to have someone to talk to who could correctly interpret the designs sent from Sweden.

In addition, Tosone had to place special emphasis on the importance of deadlines with all its suppliers, as timely delivery was critical for Tosone to meet deadlines agreed upon with Lagartija. While no contracts were signed between Lagartija and Tosone, Lagartija had signed contracts with the branded marketers that included penalties for noncompliance with delivery schedules. Thus, the manufacturer's professionalism was critical not only to ensure product quality but also timely delivery. Due to their inexperience in foreign trade, Tosone's input suppliers were not aware of the implications of delivery delays and did not internalize the costs of potential penalties.

The relationship between Lagartija and Tosone finally concluded in 2008. The appreciation of the Argentine peso had been increasing production costs and compressing profit margins until they reached a point at which the parties failed to reach a price agreement. Even though this relationship came to an end, the experience made Tosone aware of their ability to supply a demanding market in terms of innovation, flexibility, quality, and timely delivery.

The cooperative experience between Tosone, Lagartija, and the local auditor illustrates the potential of Mode A insertion in GVCs. In high-end products, not all aspects of a shoe design

can be written in a full set of technical specifications. Hence, product development requires a relational link between the parties that allows for frequent communication to discuss the tacit aspects of the designs. Argentine firms seem potentially capable of performing this task in this type of GVCs. Lagartija's decision to work with Argentine firms illustrates this potential. Even having the possibility of outsourcing the product manufacturing to countries with more standardized processes and lower costs, like China, Lagartija prioritized the relational link.

This type of insertion in GVCs can generate additional benefits to the Argentine footwear industry and its supplier industries. Insertion in these GVCs enhances understanding of foreign demand in terms of consumer preferences and expected quality standards. It also forces firms to upgrade quality and become accustomed to a new set of business practices. We believe that a larger number of Argentine firms participating in these GVCs would generate improved competitiveness beyond those directly involved, fostering all modes of insertion in GVCs.

Design Matters: Mishka

Mishka illustrates the Mode B type of insertion in GVCs. Unlike Tosone, this firm prioritizes design and brand management. First, we provide an overall description of the firm's trajectory. Then, we describe its international experience with the U.S. firm Opening Ceremony.

Mishka was founded in 2001. Since then it has designed, manufactured, and marketed women's footwear.³¹ Mishka was the first Argentine footwear firm to implement a business model that integrated brand management with the original design of shoe styles. In the domestic market, both fashion specialists and consumers recognize the brand for its original designs. Mishka's brand identity is associated with a modern, original, and even daring lifestyle, and an aesthetic coherence consistent with that lifestyle. Its designs are sometimes too complex for most consumers, but they are still recognized as comfortable. In the domestic market, Mishka's products are sold in the main design circuits—Recoleta, Palermo, San Telmo—through five retail outlets they own and two franchises. In the foreign market, the firm's products have been marketed in specialized footwear stores and stores specialized in design.

³¹ In this sense, Mishka is a branded manufacturer (Gereffi, 1999). The firm recently expanded its operations to marketing clothing under the name Mishka Couture.

However, as a result of a strategic decision to reposition the firm abroad, since 2011 the products are only sold at Opening Ceremony, a firm specialized in design products that owns four stores in different high-income countries.

The ability to create a brand identity and sustain it with the creation of styles consistent with that identity has been key for Mishka since its beginnings. This ability is rooted in the earlier activities of its founders, Marcelo Canton and Diego Trivelloni, before setting up the firm. Between 1995 and 1998, Canton and Trivelloni provided consulting services in reengineering, brand positioning, and product design to Pigalle, an Argentine producer and retailer of footwear. This experience acquainted them with the common practice in the footwear industry of copying and adapting European styles. Additionally, it gave them the chance to learn about the footwear production process. Nevertheless, the greatest benefit they derived from that consulting job was that they identified an open business opportunity for offering shoes with original design. Coupled with their fifteen-year professional background as partners providing consulting services in commercial architecture, graphic design, brand reengineering, and corporate image, mostly to Argentine apparel brands, this incursion in the footwear industry was the launching pad to start their own brand.

Mishka's focus on design is based on its founders' belief that only the generation of original styles can preserve and develop the identity of a brand by offering consistency of styles across successive collections. Traditionally, brand owners in the Argentine fashion industry limited their brand-management activities to advertising and promotional events. In the 1990s, partly as a result of the appearance of shopping centers in the Argentine market, some apparel firms started to conduct brand management in a more comprehensive way. In addition to advertising, they adopted a view of brand management that encompassed the maintenance of a brand image primarily manifest in the design of the product but also, for example, in the aesthetics and general ambience of retail outlets and the specific characteristics of the sales force. Few brands, however, offered original designs; most products were mere imitations or adaptations of European items. Only in the last decade have the so-called "author" apparel brands begun to emerge, and only in the past few years have they started to gain consumer

acceptance.³² A similar process is taking place in high-end footwear, though with some delay, with the appearance of an incipient number of firms (Mishka, Santesteban, Sofi Martiré).

Mishka focused its activity on design during its first two and a half years. This included the selection of themes, the creation of styles, and the development of the products. Manufacturing was outsourced to various local producers. The relation between Mishka and these manufacturers went through some difficulties associated to working with original styles. One of them was that they failed to keep confidentiality on the designs. Local manufacturers, accustomed to working with imitations, often did not respect the exclusivity of the designs and would manufacture those same styles and offer them to other retailers. Thus, the value of a unique style was greatly eroded. Another important difficulty was that manufacturers did not meet the quality standards expected by Mishka. The main shortcomings were the lack of craftsmanship and poor attention to details. Given these difficulties, in 2003 Canton and Trivelloni decided to integrate production into the firm.

In order to manufacture its own designs, Mishka rented a facility and set up a workshop that was active until 2010, when Mishka bought a larger property where it concentrates all the activity of the firm (production, design, logistics, brand management, and administration). Vertical integration allowed Mishka to define production techniques, establish quality controls, and ensure a regular exchange of information between the designers and factory workers. The quality of their products thus reached the expected levels.

The originality of its designs allowed Mishka to export to developed countries since its beginnings. Between 2001 and 2003, 60% of its production was exported to France, England, the United States, Japan, and other countries. For five years starting in 2004, the firm participated in various promotional activities at international events such as London Fashion Week and other activities set up by the British Consulate in Argentina. In 2008, Mishka was part of a delegation of Argentine designers invited to participate in exhibit initiatives at the French department store Le Bon Marché. However, in the past four years, exports have decreased because the firm's priority has shifted to expansion in the domestic market. In this sense, under

³² For example, in the case of Maggio & Rossetto, only in 2007 did they make the first efforts to create a collection of original designs. To this end, they established an alliance with a renowned Argentine clothing designer, Mariano Toledo, and launched an advertising campaign based on the slogan "the first collection of author design."

the firm's strategic growth plan for the next five years, its international expansion is projected to take place through the future establishment of its own stores abroad (candidate destinations are New York and São Paulo).

A relevant experience of international integration in terms of brand management is the marketing of Mishka's products at Opening Ceremony stores. Such outlets are distribution channels specialized in design products. Since its foundation in 2002, Opening Ceremony has promoted the dissemination of new brands and information about new designers among consumers in developed countries. They market the products while respecting and promoting the original brand. Mishka and Opening Ceremony often exchange information about market trends and about consumers' expectations, their reception of Mishka's products, and their perception of the brand. Thus, Mishka and Opening Ceremony have established a *relational* link (Gereffi et al, 2005) that contrasts with the *market* relations that characterized Mishka's previous exports. Only a small number of Argentine firms have managed to forge long-term relations with this type of distribution channel in developed markets. These are the few that have managed to create a brand with a comprehensive approach to design that allows them to offer original products consistent with a defined identity.

The relation with Opening Ceremony allows Mishka to be present and develop its brand in two of the most important fashion centers. Opening Ceremony has two stores in the United States—Los Angeles and New York—and one in Japan (Tokyo). Access to this channel originated in Opening Ceremony's initiative to recognize Argentina as a design country and hence include brands and designers of Argentine origin. Since its beginnings, Opening Ceremony has selected one new country every year to incorporate in their offerings. In chronological order, the countries were China, Brazil, Germany, the U.K., Japan, Sweden, and Argentina.³³ Mishka views its presence at Opening Ceremony stores as a stepping stone for opening its own stores in New York. This experience gives it exposure to U.S. consumers and allows it to obtain valuable market information.

Mishka's experience illustrates the potential for Mode B type of insertion in GVCs for Argentine firms that choose to create original design in their products and communicate it

³³ In high-end footwear, only Mishka and Chicco Ruiz have been selected. In clothing, brands include AY Not Dead, Maria Pryor, Nadine Zlotogora, Pesqueira, and Vicky Otero, among others.

coherently through a brand that conveys a defined identity. While this type of insertion is relatively new, various visible cases in apparel are generating a demonstration effect in the fashion industry. In the footwear sector, this type of insertion has been growing, though at a slower pace. We believe Argentina can more broadly achieve this type of insertion in GVCs to the extent its footwear industry incorporates professional designers who can guide the conception of original design as a systemic activity in the value chain.

Regional Fashion Leadership Matters: Prüne

Prüne illustrates Mode C insertion in GVCs. Unlike Tosone and Mishka, Prüne conducts design activities according to the adaptive-design counter-seasonal value chain type. This mode of insertion is based on adapting to regional taste the original styles designed in major fashion centers and on investments in marketing initiatives aimed at building and managing a brand.

In Latin America, Argentina is recognized as a fashion and design center. In the 1990s, two phenomena reinforced the country's position as fashion leader in Latin America. First, beginning in 1991, numerous internationally prestigious brands set up shop in Argentina, including Ermenegildo Zegna, Escada, Hermès, Kenzo, Louis Vuitton, Polo Ralph Lauren, Versace, and Zara. Second, in the same period, a new set of Argentine apparel brands began to emerge, which in a few years started to export and in some cases open franchises in Latin America. Among those were Jazmin Chebar, John L. Cook, Kosiuko, Ona Saez, Paula Cahen D'Anvers and Vitamina. Chocolate, a brand created in the 1980s, was one of the first apparel brands to export in the 1990s by adopting a system of franchises for its expansion in South America. In addition to the emergence of new brands, the organization of numerous fashion and design events strengthened Argentina's position as a fashion and design leader in Latin America. For example, Buenos Aires hosted fashion and design shows with internationally renowned models, fashion conventions, young art exhibitions, and exhibits of young designers at events in leading fashion centers such as London, New York, and Paris.

The ability to adapt European designs to the local taste has been developed by Argentine producers of apparel, footwear, and leather products for a long time. For decades until the late 1990s, when design specialists started to be hired by apparel firms, design was

limited to the practice of traveling abroad, taking note of existing styles, and choosing the ones that would be adapted to the preferences of local consumers. Based on this capability, and leveraging the recognition of Argentina as a fashion center, many apparel, footwear, and leather-product firms focused their efforts on building a brand with which to market their products in Argentina and Latin America. The experience of the Argentine brand Prüne emerges in this context.

Since its creation in 1999, Prüne has primarily sold women's handbags and small leather goods (wallets, belts). This branded firm added footwear to its product portfolio in 2002, and this line of products accounted for 24% of total sales in 2010. While the manufacturing of handbags and leather goods is done in-house, footwear production is outsourced to more than ten suppliers. In 2010, the firm ordered a total of 150,000 pairs of shoes from these suppliers. Consistent investments in marketing campaigns since the launching of the brand have allowed Prüne to achieve brand recognition in Argentina and then expand to Latin America. Part of this strategy was based on being present in Argentina's major shopping centers and expanding into the country interior by combining franchises and own stores. The firm has a total of five hundred employees including personnel at the factory, retail outlets, and administrative offices. Exports in 2010 totaled USD 260,000. Chile is the main export destination, accounting for 55% of exports. The other most important destination markets for the firm's exports are Bolivia, Paraguay, Peru, and Uruguay. Footwear exports in 2010 were still small, accounting for 20% of the firm's total exports.

The Farrells, through their Argentine company Cuerex, are the owners of the Prüne brand. The creation of the brand should be understood as a result of an evolutionary process the Farrells have experienced throughout a number of decades. Cuerex was founded in 1971 when the family decided to venture into the manufacture of leather products after being involved in Argentina's salted leather tanning sector. For about thirty years, the firm manufactured leather handbags, belts, and accessories and sold them as a wholesaler, sometimes under licensing agreements with international brands such as Kenzo and Cacharel. During the Argentine crisis of 2002, the family decided to launch its own brand, Prüne. The

creation of its own brand required investments in marketing but generated higher returns and growth in the long run.

The firm has chosen a strategy of differentiation through the Prüne brand to market their products. This choice implied a more careful selection of channels to maintain a tighter control on the brand image. The firm combines its own stores, franchises, and spaces in department stores and multi-brand stores in order to reach consumers. Multi-brand stores are generally used to increase geographical coverage in Argentina. Currently, the firm has thirty of its own stores and thirty franchises, while also being present in department store Falabella and in 150 multi-brand stores. In the foreign market, the firm commercializes its products through its own stores, franchises, and department stores.

The Farrells, a married couple, are the founders of the brand. They are the creative directors, and they define the general guidelines of each collection for every season. They define the theme of the season jointly with an in-house design team. The design team conducts the assessment of trends and preselects the original styles to be adapted for the local and regional markets. Based on this assessment, product managers carry out the business study and define the structure of each collection, which consists of defining the different product lines and determining the number of styles in each line. The product manager makes the final choice of specific styles for each collection. Outsourced manufacturers may suggest styles. However, ideas about design adaptations are only exchanged with manufacturers that work exclusively for Prüne. The firm currently works with twelve manufacturers, only three of which are exclusively dedicated to the brand. Adaptation of styles to local tastes requires knowledge of consumers' preferences. In this sense, having their own stores allows the firm to have direct access to consumers and, consequently, know their tastes and preferences regarding materials, colors, and styles of products.

At the stage of product development, Prüne conveys the information on consumer preferences to the producers. Manufacturers, in turn, provide Prüne with suggestions on the basis of their expertise in technical feasibility. In all cases, once the styles have been defined, the materials to be used and the investments to be made are agreed upon with the

manufacturers. The latter is particularly important in cases in which production involves the development of new inputs (lasts, molds, and bases).

Brand construction and positioning requires consistent investments in advertising and promotional activities, and the development of their marketing channels. For its insertion into the foreign market, the firm has opted for channels that allow it to market its products under its own brand. It opened its own stores and franchises in various Latin American countries. In 2011, it also introduced the brand in department stores. While the firm has opened seven franchises in Bolivia, Paraguay, Peru, and Uruguay, in Chile it has opened two stores in major shopping centers in Santiago and operates corners at department stores.³⁴ The firm currently has two corners in Falabella and two in Tiendas Paris.

The multiplicity of retail channels in foreign markets has imposed on Prüne the need to develop new marketing capabilities related to logistics and administration. Marketing at department stores in Chile provides a good example. The choice of this distribution channel required building a distribution center in Chile to maintain the stores properly supplied. It also exposed the firm to new commercial practices. One is that department stores delegate to suppliers the burden of stock management, confining their activity to evaluating the restocking proposals they present. This practice imposed on Prüne a higher commercial and administrative workload. In addition, having the option to hire employees on their own to push brand sales at department-store corners exposed Prüne to a new type of hiring decision. Although Prüne is also present in Falabella Argentina, the scale of operations of this department store is drastically smaller than in Chile and hence does not always impose on suppliers the same business practices it follows in Chile.

In the case of franchises, opening stores in different countries has required the firm to design an international pricing policy and to digitalize the operation of different areas to improve its resource management. The creation of an international pricing policy has been a major challenge, especially due to the importance the firm places on the maintenance of an appealing price-quality relation in all of its products. To this end, in recent years Prüne has

³⁴ The term *corner* is used to denominate a space within a department store that is exclusively dedicated to a brand.

implemented an enterprise resource planning (ERP) system. This system forces all franchisees to use the same billing system and thus allows the franchise firm to better monitor prices.

The firm's main challenge lies in the design activity. While the adaptation of European models to local tastes has allowed Prüne to expand in South America, it has also been an important constraint for insertion in other markets, even Latin American ones. In particular, this has been a constraint to operating in countries that work counter-seasonally. The opening of the store in Mexico was Prüne's first international franchise experience. The franchise began in 2004 and lasted until 2008. The main problem was that the franchisee was supplied with styles from the previous season, which were already adaptations of styles that had been fashionable in Europe one season earlier. Hence, the styles that were offered were often based on outdated fashion styles. This experience helped the firm to rethink its international expansion strategy, and Prüne eventually decided to prioritize the position of the brand in South America.

The case of Prüne illustrates the possibility of participating in adaptive-design counter-seasonal GVCs oriented to South American markets. Latin American consumers regard Argentina as a fashion center and Argentine leather as quality material. This favors the insertion of Argentine firms that manage to leverage their brands with the prestige that consumers attach to the products' country of origin. Nevertheless, we believe it is those Argentine firms that build brands with a local identity based on original designs that can maintain the position of Argentina as one of the leading fashion centers in Latin America. Other countries in the region, such as Brazil and Colombia, have been working in the last years to build a recognized position as fashion centers and hence are eroding Argentina's leadership position.

PART II: BASSO

In this part we discuss the case of Basso, an Argentine producer and exporter of combustion engine valves located in the city of Rafaela. The first section presents the firm's most salient traits. It also describes the main features of the combustion engine valve industry and selected features of the recent evolution of the automotive industry in the world and in Argentina. The second section discusses the firm's three modes of insertion in GVCs, and the third section presents the most relevant events in the firm's business trajectory. As a mode of conclusion, the last section analyzes the determinant factors of the firm's international success.

5. Basso and Its Related Industries: Combustion Engine Valves and the Automotive Industry

Basso S.A., together with Motor Parts S.A. and Motor Parts Internacional S.A., makes up the Basso Group (henceforth Basso). Basso is a family company dedicated to the design, production, and marketing of combustion engine valves. It has three industrial plants in Santa Fe Province and a marketing and research center in Buenos Aires Province. It has a staff of approximately 950 people. The company manufactures nearly 2,500 models of valves designed to operate with different types of fuels and engines, reaching a volume of twenty-two million parts per year. It exports around 85% of its production to thirty-three countries. The largest buyers are Brazil, France, the United States, and Mexico.

Basso serves different market segments. First, it provides valves to engine manufacturers in the original equipment market. These are mainly assemblers of motor vehicles. It also participates in the competition market, supplying valves to builders of race engines, and in the high-performance market, supplying valves to distributors and engine builders specialized in tuning. Lastly, it participates in the aftermarket with a wide range of standard valves. Ninety percent of its production is evenly distributed between the original equipment market and the aftermarket. The other 10% is accounted for by the competition and high-performance markets.

Basso is recognized for its technical capacity to carry out design and production of a wide variety of pieces. In the original equipment market, it is actively involved in the co-design

and development of the valves for its automotive vehicle customers. This activity involves continuous innovation to develop solutions in terms of optimal materials, thermal tolerance, and proper manufacturing processes. For this task, it has technical staff specialized in engines and engine parts. The firm also sells customized valves for competition and high-performance engines, which are subject to greater demands and require the use of more sophisticated materials and specific thermal treatments. For the aftermarket, Basso manufactures a wide variety of valves, each specifically designed for a particular engine.

Due to the quality of its products and its just-in-time service, Basso has been repeatedly recognized by its original equipment customers through various prizes awarded to the firm. Such prizes include the Ferrari Podium and the PSA Peugeot-Citroën International Trophy for Quality. The firm is also part of John Deere's Hall of Fame because several times it was chosen Supplier of the Year by this company.

Engine Valves

The valve is one of the pieces that make up the internal combustion engine.³⁵ It transmits the intake (intake valves) and exit (exhaust valves) of gases to the cylinder. The latter are subject to great thermal and mechanical demand.³⁶ Due to their role in the working of the engine, and the fact that they can cause engine failure, valves are an important piece. The most common problems a valve may present are burns, corrosion, pitting, and wear. These may be caused, among other things, by inadequate materials or fuels in its use.

Valves are designed to operate with different types of engines, which in turn are designed for different vehicles such as standard automobiles, heavy equipment, competition or high-performance vehicles, motorcycles, and stationary engines. Additionally, valves can operate with different types of fuels such as gasoline, gases, organic mixtures, and alcohols. Valves can be used to equip new or used engines.

³⁵ Other parts and components are the block, crankshaft, connecting rod, piston, and cylinder head.

³⁶ The engine operates in four stages: intake, compression, expansion, and exhaust. In the first stage, the intake valve opens, the piston lowers, and the cylinder is filled with air mixed with fuel (air in diesel engines). In the second stage, the intake valve is closed, and the piston goes up to compresses the mixture of air and fuel. In the third stage, the compressed mixture is ignited and the heat generated by combustion expands the gases, which exert pressure on the piston. Lastly, the exhaust valve opens and the piston moves toward upper deadlock, expelling the burned gases.

Valves are sold in different markets. In the original equipment market, valves are sold to leading engine manufacturers in the automotive sector. In the competition market, they are sold to distributors and engine builders, who use them to equip engines that compete in different racing categories. In the high-performance market, they are sold to distributors and engine builders, who use them to boost the engine's performance. In the aftermarket, they are sold to distributors and engine rebuilders, who use them to repair the engine when the valve has suffered wear, tear, or failure.

The greatest challenge in valve production is to select the proper materials and heat treatments for each type of piece under different working conditions of the engine. This task is performed by engineers specialized in the design and operation of engines with specific knowledge of the materials used, such as electromechanical, mechanical, and metallurgical engineers. According to the type of engine and its expected use, valves are designed with different materials and thermal treatments. Competition engines, for instance, require materials other than ordinary steel and special heat treatments to ensure optimal performance. In heavy equipment, reinforcements are made in areas of friction. The standard car valve must constantly respond to engine developments. To keep up with advances in the engine industry, it is necessary to continuously design new valve models and try non-conventional materials and thermal treatments to gain knowledge of their special mechanical properties.

There are two methods of producing valves, extrusion and electro-upsetting. The first method is more efficient for large-scale mass production and requires greater investment in machinery. It begins with thick steel rod, the main raw material over which the piece is worked. Then, the piece is stamped and the stem is highlighted. The second method is used for short series because it is more flexible. It is used to produce a large variety of models and is more labor intensive. It begins with a thin steel rod. Then, a forging process shapes the valve.³⁷ After a machining process, the valve is subjected to different chrome and nitride processes as well as different treatments like tempering, annealing, and solubilization. Either of the two production methods requires technical personnel trained in the machining of pieces.

We can distinguish two types of valve-manufacturing firms worldwide. The first are

³⁷The valve is made up of a flat steel disc at one end, and the head and the stem at the other.

firms that supply parts and engine component sets on a large scale. The most important ones are TRW, Eaton, and Mahle. The first two firms are American, and the third one is German. The combined worldwide production of Eaton and TRW supplies around 80% of the world's consumption of valves, which reaches 1,200 million pieces per year. The second type of valve-manufacturing firms are smaller firms. Such firms, some of them new, are located in China, Korea, India, Israel, Italy, Japan, and Turkey. Two valve-producing firms operate in Argentina, Mahle (previously Edival) and Basso. Their combined production reaches around forty-five million pieces per year.

The Automotive Industry

Customers of combustion engine valves are engine manufacturers, builders, and rebuilders. In the original equipment market, engine manufacturers are leading companies in the automotive industry. Nine automakers assemble cars or trucks in Argentina. In decreasing order of units produced, these are General Motors, Peugeot Citroën, Ford, Fiat, Renault, Volkswagen, Toyota, Mercedes Benz, and Iveco. A few of these automakers also produce engines: Peugeot Citroën and General Motors, joined by Ford and Mercedes Benz in 2011. Toyota assembles engines from imported component kits. Engine manufacturers outside of the car industry are John Deere and International Trucks.

The nine automakers that produce in Argentina employ approximately 29,500 workers (MTEySS, 2010).³⁸ In 2010, they exported 447,953 units (13.1% of the total value of manufacturing exports, 37.5% of manufacturing exports of industrial origin) and imported 435,017 units. Brazil is virtually the exclusive importer of cars produced in Argentina. This country accounts for 85% of Argentine exports. Mexico is the second-largest importer, with a 5% share. The main origins of Argentine car imports, as in the case of exports, are also Brazil (75%) and Mexico (13%) (ADEFA, 2010). These figures highlight the close commercial relation between Argentina and Brazil. These countries have had trade links since 1994 through various preferential trade agreements specific to the automotive industry, signed with the purpose of

³⁸ Argentina's automotive industry is composed of almost 1,600 companies. In terms of number of employees, 91% are small- and medium-sized firms and 9% are large businesses (MTEySS, 2009). This industry occupies more than 84,000 workers, approximately 7% of industrial employment (MTEySS, 2010), and generates nearly 5% of industrial value added (INDEC, 2004).

fostering production complementarity to promote a region-wide integrated industry and thus be able to compete internationally (Arza, 2011). The nine Argentine assemblers are affiliates of multinationals that also produce in Brazil, all of them except Toyota operating on a larger scale than in Argentina (ANFAVEA, 2010). In Brazil, unlike Argentina, almost all automakers are integrated into engine production.

Since the 1990s the automotive industry has become more global. One salient feature of the globalization process in this industry is the growing importance of developing countries, which have been large receivers of foreign direct investment during the last years. The top ten vehicle assemblers had sixty-two assembly plants in the leading developing countries (Mexico, Argentina, Brazil, Malaysia, Thailand, Indonesia, the Czech Republic, Slovakia, Poland, Hungary, India, and China) by the late 1990s, significantly up from twenty-eight at the beginning of that decade (Humphrey and Memedovic, 2003). The shift in global production is a result of a significant organizational change, especially with regards to the relationship between assemblers and suppliers.³⁹ The Fordist system was replaced by the Toyotist system, which prioritizes production flexibility, quality, and speed. Assemblers started delegating more design responsibilities to component suppliers, urging the latter to supply them with efficient technological solutions (Humphrey and Memedovic, 2003). Component firms thus became relevant players in car manufacturing in their role as co-designers. Assemblers, however, maintain control over the design of new models, brand management, and customer relations.

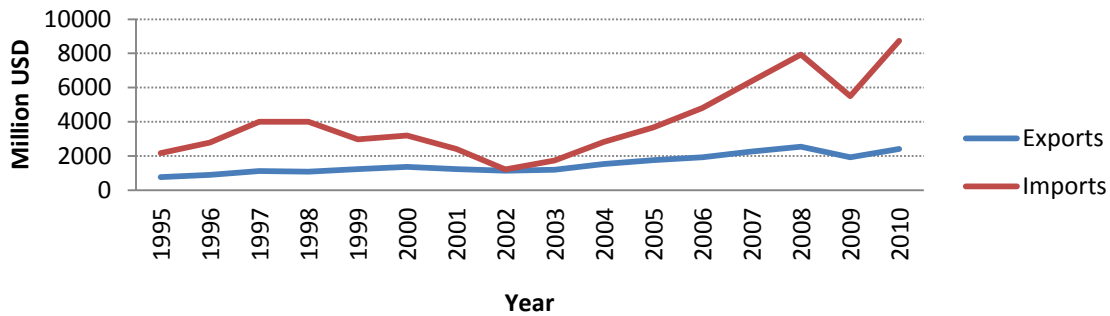
The automotive industry was vertically integrated in Argentina until the end of the 1980s. Automakers used to machine most parts used for assembling. These were supplied by local producers who were protected—along with the rest of the industry—from international competition. The automotive industry's new global trends in the 1990s, which enhanced global efficiency through the international fragmentation of the production process, implied an increasing cost of protectionist policies. In this context, Argentina opened up to foreign cars and parts under a special regime that regulated international trade in the industry.

International competition hit local producers of auto parts harder than it hit car assemblers. Automakers discontinued a large fraction of their production of machined

³⁹ Currently there are forty car-manufacturing countries worldwide that total an annual production of 77.8 million units (OICA, 2010). Argentina represents approximately 1% of this total with 716,540 units produced.

components, substituting them with imported ones. As a result, while in the last fifteen years exports have grown steadily, import growth has been considerably larger (Figure 9). In 2010, Argentine auto part exports amounted to USD 2,422 million, while imports reached USD 8,731 million.⁴⁰ Brazil is the main trade partner for auto parts, accounting for 65% of exports and 49% of imports.⁴¹

Figure 9: Evolution of Argentine Auto Part Exports and Imports (1995–2010)



Source: AFAC (2010).

Only ten product categories account for more than 80% of Argentina’s auto part exports (Table 2).⁴² Engine valves make up 6.5% of this total. Out of 533 exporting companies, ten account for 70% of total exports. Seven of those ten exporters are carmakers that also produce auto parts. Of the remaining three, two produce combustion engine valves: Basso and Mahle.

Auto part firms can be classified according to the type of product they make and the type of relationship they establish with assemblers. According to Humphrey and Memedovic (2003), component suppliers may be divided into global mega, first-tier, second-tier, and third-tier suppliers. Global mega-suppliers provide assemblers with the major systems. First-tier suppliers provide them directly with parts, and must incorporate design and innovation capabilities. Second-tier suppliers are component manufacturers whom assemblers furnish with

⁴⁰ There are 1,400 auto part producers in Argentina. They employ 55,000 people and are mostly based in the Provinces of Buenos Aires (48% of plants), Santa Fe (18%), Córdoba (17%), and in Buenos Aires City (12%) (INDEC, 2004).

⁴¹ The main exported auto parts are transmission equipment (40%), engine components (13%), bodies (10%), and engines (5%). Auto part imports include transmission equipment (24%), engine components (13%), electric equipment (12%), bodies and their parts (11%), and engines (10%) (AFAC, 2010).

⁴² The total is computed for 2007 using the product positions of the HS classification that corresponds to branch 343 of the ISIC classification (manufacturing of parts, basic products, and accessories for motor vehicles and their engines). Since engines are in branch 341, they are not included in the total.

part designs. Finally, third-tier suppliers provide standardized components. Basso, the Argentine auto part firm which is the focus of this section, is a first-tier supplier.

Table 2: Main Exports of Auto Parts (2007)

HS trade classification	Parts	Exports*	Share (%)
87.08.40.90.900G	gear boxes	199.9	19.6
87.08.40.90.300Z	gear boxes	181.6	17.8
87.08.29.99.990J	other parts and body accessories	128.4	12.6
87.08.99.90.999J	other parts and accessories for motor vehicles	101.2	9.9
87.08.99.90.990P	other parts and accessories for motor vehicles	83.1	8.2
87.08.99.90.910N	other parts and accessories for motor vehicles	33.3	3.3
84.09.91.14.000R	intake and exhaust valves **	33.1	3.3
84.09.99.14.000M	intake and exhaust valves ***	32.6	3.2
84.09.91.12.100G	Blocks	25.2	2.5
87.08.80.00.100G	shock absorbers	21.6	2.1
Most exported headings		840.1	82.5
Others		178.3	17.5
Total		1,018.4	100.0

Source: Argentine customs data.

* In USD million

** For spark-ignition engines

*** For compression-ignition engines

6. The Participation of Basso in Combustion Engine Valves GVCs

Basso supplies valves to various markets. This section describes in detail the GVCs that organize design, production, and marketing of valves to these markets and the role Basso plays in those chains.

Figure 10 shows activities, actors, and products taking part in each value chain. The activities involved in the chain may differ according to the GVC. In particular, in the upper panel we distinguish two broad types of value chains according to the design activity. These are the “co-design value chain” and the “reverse engineering value chain.” In the first, Basso is involved in the design of a new valve. In the second, it replicates an existing valve design through a reverse engineering process. According to the different markets it serves and the activities it performs in the GVC, we identify three modes of insertion into GVCs. The first two modes are variants of the “co-design value chain” (Modes A and B). The third is a mode of insertion into a “reverse engineering value chain” (Mode C). The second panel of the figure presents the actors

that carry out the activities in each of the insertion modes in which Basso participates. The last panel of the figure shows the resulting products.

In the first mode of insertion, Basso supplies valves to engine manufacturers in the original equipment market. In this mode, Basso co-designs the functional plan of the part with those companies and subsequently manufactures them. This insertion mode is denoted “contract manufacturing with cooperative product development” (Mode A). In the second insertion mode, Basso supplies valves to engine builders in competition and high-performance markets. Basso also takes part in design and production activities in these GVCs. Here, Basso provides customized valves designed for more demanding engines. These parts are marketed through distributors and specialized repair shops, in some cases under the Basso brand. We call this insertion mode “customized design” (Mode B). Finally, Basso supplies standard pieces in the aftermarket. In these GVCs, the firm decides what to produce and how to do it. These valves are marketed through distributors, in some cases under the Basso brand. We call this mode of insertion simply “aftermarket” (Mode C).

Next, we describe Basso’s participation in the first mode of insertion. This insertion mode is used as a benchmark. Therefore, we use it to describe in full detail the design, production, and marketing activities involved in the value chain, the actors that perform them, the capabilities required in each case, and the resulting products. The description of the other two insertion modes makes use of this benchmark, highlighting only the main differences.

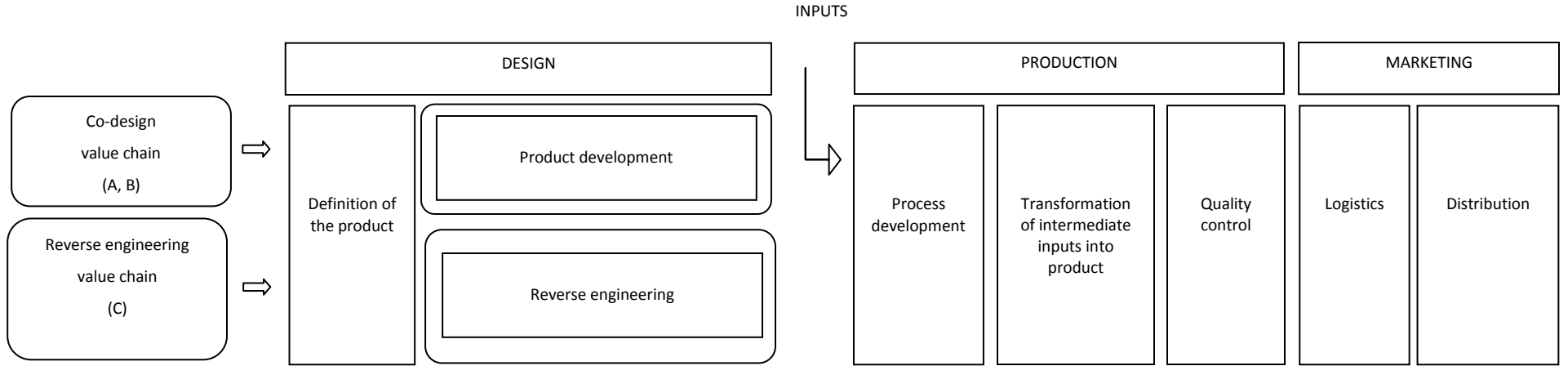
Mode A: Contract Manufacturing with Cooperative Product Development (Original Equipment)

The insertion of Basso in this type of GVC involves mainly its relationship with automotive vehicle assemblers that manufacture engines. Peugeot Citroën is its largest client. Basso is also the exclusive supplier of valves for Ferrari’s line of street automobiles. Other clients include Fiat, General Motors, and Ford. Additionally, it supplies other manufacturers of heavy equipment engines (Mercedes Benz and John Deere), motorcycles (Harley Davidson), aerospace, and small displacement engines used in lawnmowers and small tractors.

Figure 10: Engine Valve Value Chain

ACTIVITIES

Broad type of GVC

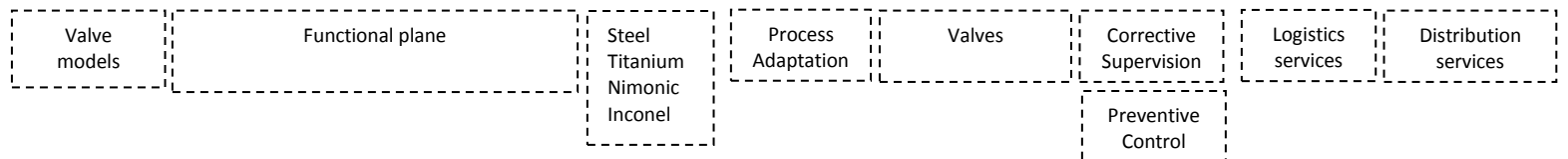


Modes of Argentine insertion in GVC

ACTORS



PRODUCTS



Basso carries out the design activity based on the demand for a new development by its original equipment customers. The design activity is carried out in collaboration with those customers. This participation begins when the assembler searches for a supplier by sending the product plans and requesting a quote. At that point, the interrelation between Basso's engineers and those of the assembler starts to take place. Basso receives the information and may propose variations to the original order, such as variation in the materials proposed. The quote request not only includes prices, types of materials, time frame, and delivery, but also all kinds of additional information that might help the assembler select the supplier, like productivity projections over time. The extent of contractual formalization of agreements depends on the volumes involved and on the implied level of investment by the supplier.

Once Basso is chosen as a supplier, customers send a functional plan of the valve that specifies the main parameters and the peripherals of the valve and the engine working conditions. Based on these parameters, Basso has to develop solutions for the optimal materials to use as well as the optimal coating, thermal tolerance, and manufacturing process. All these variables have to be chosen according to the fuels that will be used and the engine requirements.⁴³ In the innovation activities, Basso tests current products or future developments, considering new valve models, non-conventional materials or heat treatments, and gaining knowledge of special mechanical properties in order to work with new engines.

The firm has a testing room where various activities are performed, such as checking how a particular solution works with a certain coat, material, or fuel. On the basis of these tests, it generates new solutions of its own to apply both in the original equipment market and in the aftermarket. Basso uses special software for testing through simulations; otherwise, testing would be very expensive. For this task, Basso has mechanical, electromechanical, and metallurgical engineers specialized in engines and parts, who continuously receive training by attending specialized courses and visiting the engineering departments of clients and suppliers.

Production involves process development, production, and quality control. Process development involves activities aimed at adapting the production processes to the characteristics of the piece to maximize efficiency. For example, research about inputs is

⁴³ Basso is also obliged to supply the aftermarket for a stipulated number of years.

performed jointly with input suppliers to acquire specific knowledge of materials attributes. Additionally, each stage of the process is carefully evaluated to identify potential failures.

The production activity involves the transformation of inputs into the final product, the valve.⁴⁴ The production of the valve is done through the process of electro-upsetting. This method allows for small series and can be used to produce a wide variety of models. For this activity, Basso has technical personnel specialized in machining of parts. After the machining process, the valve is subjected to different processes of chrome plating and nitriding, as well as to various treatments of quenching, tempering, and solubilization. Basso produces different types of valves according to the demands of the engine. Bimetallic valves are constructed with various metals and used as exhaust valves. Martensite plate valves have a hardenable steel plate welded to the extreme of the valve stem to provide greater strength and prevent distortion and crushing. Nitrided valves are covered by a layer of nitride to furnish higher wear resistance. Valves with stellite on the seat are resistant to wear and high temperatures.

Finally, quality control aims to minimize defects along the production process and ensures defect rates below established limits. Quality control involves special equipment such as vacuum gauges, controls on size and shape, and tolerance of parts based on selected samples. Other parts of the quality control process are done simply with visual checks.

Marketing activities involve logistics and distribution. Basso is responsible for the logistics of its products. The firm is strongly committed to supplying the product in a timely manner. Hence, it coordinates storage, transport, and inventory in order to deliver the product just in time. The valves depart in trucks from Rafaela to neighboring countries or to the port of Buenos Aires. These goods are already verified and approved by a customs dependency, located in Rafaela, which allows for faster delivery.⁴⁵ The goods are transported by ship to ports in the United States, Belgium, and Italy, depending on the location of the customer. In many cases, original equipment customers have their own logistics centers and pick up the goods directly at the port. In other cases, Basso transports the goods to warehouses they own or rent, from where they distribute them. Basso subcontracts this latter service.

⁴⁴ In addition to valves, Basso also produces some of the machinery it uses.

⁴⁵ This dependency was opened in 2000. It allows Basso to clear every export and import operation in Rafaela without any extra administrative burden at the Port of Buenos Aires.

To ensure timely delivery against possible eventualities, the firm keeps a permanent stock of goods on ships and in warehouses. When there is any delivery urgency, shipment is done by plane—which is five times as expensive as by ship. Logistics is key to the firm’s business. Its customers appreciate its just-in-time delivery service, which is one of the firm’s main distinguishing attributes. Basso can provide this service despite the distances that separate it from its main customers. It orchestrates the logistical system to make customers feel that such long distances are not relevant. In particular, it anticipates any adverse eventuality outside of the firm’s domain, such as roadblocks or strikes at the ports. Distribution, in all cases, is performed by the assembler through authorized distributors. In such cases, the valve is sold under the brand name of the engine manufacturer.

Following the classification of Gereffi et al (2005), the link Basso establishes with its customers in this type of value chain is *relational*. Customers send their plans with the valve’s main parameters and ask Basso, which has its own know-how of the part, to complete the design. Then, the customers try out the engine with the valves sent by Basso. This requires a continuous exchange of information between Basso’s engineers and those of its customers, done by teleconferences, intranet, and in person. Basso makes frequent visits to each customer. In the event difficulties arise, they immediately send technicians to help solve the problem. The firm’s remarkable service in those relational links allows Basso to compete in the original equipment market with firms that supply valves and produce parts on a much larger scale such as TRW, Eaton, and Mahle.

Mode B: Insertion in Customized Design GVCs (Competition and High Performance)

Another mode of insertion is in “customized design” GVCs. In this case, the firm supplies valves to the competition and high-performance markets. In the competition market, the valves are used to equip engines of vehicles competing in different racing categories. In the high-performance market, the parts are used to enhance vehicles’ engines with the purpose of improving their performance. The main customers in these two markets are large engine builders for competition and high-performance vehicles and distributors of smaller engine builders. Sometimes, the largest builders are also distributors. In some cases, distributors sell

the product under the brand Válvulas 3B, Basso's main brand. In some other cases, they sell them under their own brands, such as Edelbrock, Perfect Circle, Federal Mogul, Milodon, Brodix, Supertech, and Trick Flow. In this chain, Basso designs customized pieces for each customer. Its main competitors are Mahle in Argentina, Sinus in Israel, and Tetik in Turkey.

In the case of valves for competition engines, Basso's main customers are distributors and engine builders. The latter are part of competition teams that prepare engines to race in categories like Nascar, Dragster, Top Fuel, Pro Stock, Funny Cars, Prototypes, Touring Cars, Rally, Fórmula 3 Sudamericana, and Indy Cars. In this market, Basso provides its clients with customized services. Each engine and race requires a different product. Valves for the competition market operate in engines subject to very demanding conditions and require the use of more sophisticated materials like stainless steel, nimonic, inconel, titanium, and combinations of them, other than specific thermal treatments. In these valves, unlike in other cases, new materials are always used. This market operates with small volumes, but it is the one with the greatest profit margins. A small fraction of Basso's production of competition valves is supplied to the competition departments of international assemblers like Ford Racing, Toyota Racing Development, and Peugeot Sport.

In the high-performance market, the valves are utilized to enhance the engines of standard cars. These valves are sold to distributors and engine builders, who are generally manufacturers of engine cylinder heads. Engine builders have one or several specialized repair shops where tuning services are provided. For example, car builders equip large V8 engines and turbo engines, which also require special materials and treatments for greater engine efficiency. Once the piece is designed, it is used to equip the same engine. The ultimate clients are typically motor-racing enthusiasts who want to enjoy an enhanced engine but rarely have the opportunity to actually participate in a competition. Valves for the high-performance market are primarily destined for the U.S. market. In the United States there is a long tradition in the practice of tuning. The development of this market is facilitated by legislation—which does not exist in all countries—that allows for modifications in the original engine without the need for legal approval.

Despite the differences between the competition and the high-performance markets,

we classify Basso's insertion in the different value chains that supply them under the same mode because the activities and relationships are similar. The development and design of the valve is done jointly between Basso and the engine builders. In this case, Basso has greater leeway to work on the valve designs because there is a larger asymmetry in the technical knowledge of the product. This is different from Mode A insertion, where automakers have large design centers and can determine the main parameters of the valve. Basso performs the activities of product development, production, and quality control. The firm has an industrial plant just to manufacture this type of valve. For this market, Basso produces valves with higher mechanical resistance, such as titanium-alloy and sodium-filled valves, which allow faster heat transfer from the head to the top of the valve.

In competition and high performance, the product is not standard. Therefore, Basso must maintain a fluent communication with its customers to determine product specifications, which are not easily codifiable. In the case of the competition market, the exchange of information is continuous. Each engine and race requires a different product. In some cases, based on the importance of the race, Basso does not completely finish the design of the valve. It produces an incomplete piece that is then finished by the engine builders to prevent other drivers from having the same valve. In the case of high performance, the valve needs to be customized to operate in the specific environment of an engine that has undergone substantial change. Basso must exchange information with its customers to be able to properly carry out the final design of the valve. Following Gereffi et al (2005), the link Basso establishes with its customers in this type of value chains is also *relational*.

Mode C: Insertion in Aftermarket GVCs

The firm's third mode of insertion in GVCs is the aftermarket. In this market, the firm offers a wide variety of pieces mostly aimed at street car engines. Such valves are sold to distributors and engine rebuilders. In this market, Basso sells the part with its name or through the distributors' brand names. Its main competitors, presenting similar characteristics as Basso's regarding scales and type of product, are Nittan, Fuji, Oozx, and Aisan (Japan); Gieffe (Italy); Supsan (Turkey); Huaiji (China); Shin Han (Korea); Rane Group (India); and German

multinational Mahle.

The design activity as well as the decision of what to produce in this mode of insertion is carried out by Basso alone. This differentiates this mode from the previous two in which the customer takes part in the design and definition of the product. In this case, Basso determines what type of valve to produce based on its own study of the aftermarket needs. For this study it takes into account the useful life of each type of engine, the replacement requirements, and the potential orders from its customers. Once it determines the valves to produce, Basso carries out a reverse engineering process. From a sample obtained and used as reference, engineers at the plant identify the main attributes of the piece for its reproduction. Once this is done, they make a sketch that serves as a functional plan to produce it. This sketch specifies measurements, materials, and thermal conditions that the valve must withstand to perform correctly. Basso can carry out this task because it has staff with technical knowledge in valve design. Also, it has a flexible production process that can be adapted to produce any type of valve. In this market, the firm offers a wide variety of standard valves, mostly focused on street car engines. These are pieces prepared to work under normal operation of vehicles. They use ordinary steel and they are the least expensive.

Following Gereffi et al (2005), the relationship established between Basso and its customers is a *market* one. The valve is standard, and its function is to replace a used one with similar characteristics. Customers do not determine technical specifications of the product. Basso is the one that decides how to produce the piece; it has the ability to do so without any explicit coordination with its customers. While in all other modes of insertion the firm prioritizes a direct relationship with its customers, in this type of insertion the firm sends sellers, not technicians or engineers, to visit customers. In this case, Basso does not require a technical exchange with its clients to carry out the product design and development. Instead it prioritizes the necessary skills to negotiate prices and sales volumes.

7. The Business Trajectory of Basso

This section describes Basso's business trajectory from its origin as a small workshop in Rafaela to its current status as a global supplier of valves for the original equipment market, competition and high-performance markets, and for the aftermarket.

The Firm's Origins

Basso began its activities in 1963, when Juan Basso, Dante Beninca, and Italo Bottero partnered to manufacture valves for internal combustion engines. The division of labor between the three partners was clear. Basso was in charge of the commercial part of the business. He was an exceptional seller, an ability he previously applied to selling furniture. Bottero was in charge of production. He had mastered the production of valves in his previous work as a technician at Edival. Beninca provided the financing. He managed a diverse set of businesses, among which was a job venture with Edival's owner in a leather tannery.

The firm's activities started in a small workshop. The initial technology was incorporated through the technical knowledge that Bottero acquired at Edival. The inputs were imported. The production method employed, still in use, was the process of electro-upsetting. This type of process allows for short series and has the flexibility to produce a wide variety of pieces. This allowed the firm, in the course of time, to supply the international market, offering customized products adapted to the needs of each customer.

During the first years, sales were exclusively focused on the domestic aftermarket. The international insertion of Basso began in 1971, when it started selling valves in the aftermarket of neighboring countries. Uruguay was the first market, followed by Chile, Paraguay, and Bolivia. None of these countries had valve-producing factories. These first sales abroad were facilitated by the joint action of businessmen in Rafaela. In particular, Basso participated in several trade missions organized by the Chamber of Foreign Trade.

In 1974, José Luis—Basso's elder son—joined the firm. José Luis graduated as an engineer cum laude from the University of Córdoba, where he worked for a while in the Department of Metallurgical Research. Juan Basso wanted José Luis to gain international experience and especially bring up-to-date knowledge about production technology and materials to the firm. Hence, soon after José Luis graduated, Juan arranged that his son worked

in France as an electromechanical engineer at the steelworks Aubert & Duval. This company was Basso's steel supplier. José Luis worked for seven months at Aubert & Duval and then was recommended to Renault France. At Renault, he worked in the company's valve plant for the first month and then transferred to the main car-assembling plant where he worked for four more months. After a year in France, he went back to Argentina to work at Renault as the head of the engine division in Argentina. In this position, he had approximately one thousand workers under his supervision. These experiences allowed him to acquire critical technical knowledge about valves, engines, and materials. In addition, he learned about the organization and business practices of leading international firms and the expectations of an automaker with respect to its relationship with suppliers. At a deeper level, he acquired familiarity with best international practice. For the years to come, this knowledge served José Luis as a benchmark to guide his business decisions and to gauge the firm's growing status as a world-class producer.

After two years at Renault Argentina, José Luis joined Basso. This was precisely the year when Basso built its first industrial plant. The arrival of José Luis did not go unnoticed. He brought a new professionalism to the firm and provided it with a different view of production and organization methods. Also, he led a series of technological improvements at the new plant through the acquisition of imported machinery from Italy and used machinery he acquired with the purchase of a local valves factory.⁴⁶ During this period, the Bassos consolidated their control of the firm by buying Bottero's shares. In 1978, Juan Carlos, Basso's second son, also joined the company; he is the firm's current vice president.⁴⁷

Insertion in the Domestic Original Equipment Market

The firm had long aspired to enter the local passenger car original equipment market. Although Basso had the necessary technical knowledge and capability, it had found this market inaccessible. Automakers were generally supplied by leading companies or firms that operated under licenses from international firms. This changed with the acquisition in 1982 of the valves

⁴⁶ In 1971, the firm bought the valve factory Van der Ghot. Basso used Van der Ghot as a second brand for several decades.

⁴⁷ In 1985, the Bassos acquired full ownership of the firm by purchasing Beninca's holding.

division of Thompson Ramco Argentina S.A., an affiliate of U.S. firm TRW.⁴⁸ This acquisition was a landmark in Basso's history. With this purchase, Basso inherited the supplying relationship that Thompson Ramco had with Ford Argentina.⁴⁹ Also, the firm incorporated new knowledge and technology through the technical exchange between the engineers of both firms and the indirect acquisition of their machines.⁵⁰ In particular, Basso incorporated machines to make bimetallic valves, which were the type of valves required by local automotive assemblers.

Insertion in the U.S. Market

Various reasons led Basso to place the firm's insertion into foreign markets as a top priority. One of them is that the size of the domestic market imposed a tight limit on the firm's growth prospects. Another was that since Basso depended heavily on steel and machinery imports, exports would help the firm be hedged against exchange rate risk. The objective was regarded as ambitious but feasible because the firm had become increasingly aware of its ability to compete internationally. In this context, in the early 1980s José Luis began a series of business trips to the United States to find new customers.

The choice of the United States as a target market was not coincidental. At the time, the firm only produced valves for the aftermarket, and the United States was the largest market for this type of pieces. In particular, the European aftermarket was relatively thin because used cars were sold to Africa rather than repaired. In addition, Basso had clients in some Latin American countries (e.g., Colombia, Venezuela), and José Luis took advantage of his trips to visit those customers to also visit the United States in search of customers. José Luis had an advantage over his father in doing this job because he could speak and understand English. A final reason to target the U.S. market was related to the fact that Rafaela had organized the 300 Indy Car competition in 1971. This was a historic event for the city, and this event gave Basso

⁴⁸Thompson Ramco Argentina SA had begun its activities in 1960 under the name of Ramco Piston Ring, a subsidiary of TRW. The company initially manufactured piston rings for internal combustion engines. In 1962, it started manufacturing engine valves and steering and suspension components. When it sold 100% of its valves division to Basso, the firm kept its piston ring, suspension, and steering businesses.

⁴⁹Initially, Ford bought intake valves from Basso while it imported exhaust valves. Intake valves do not have to be treated to resist temperatures as high as exhaust valves. Suppliers generally start a relationship with an automaker by supplying valves with lower failure risk.

⁵⁰Thompson Ramco was located in Córdoba Province and was twice as large as Basso. Basso moved all the equipment to Rafaela's industrial plant.

two advantages to try the U.S. market. First, it gave Rafaela visibility among U.S. drivers and preparers of racing cars. Second, Basso took advantage of the opportunity to establish direct contact with various U.S. car builders and other agents in the industry, some of which even visited the plant. Edival had also taken advantage of the organization of this competition to start selling valves for race cars and street vehicles in the United States.

José Luis traveled to the United States more than ten times to make his first customers. Since his objective was to sell valves for the aftermarket, he concentrated his efforts on engine rebuilders. He did not make substantial sales during those initial trips, but they were not in vain. José Luis was convinced that he was offering a competitive product in terms of quality and price. To this end, he built a list of potential customers based on recommendations or simply browsing the yellow pages. On each trip, he visited his potential customers. He discussed with them different technical issues and made joint experiments with his valves. José Luis's background as an electromechanical engineer ensured that they could "speak the same language." His background as a former manager of a leading international automaker gave him a broader vision of the type of relationship large firms established with their suppliers. He knew it would take time to convince his clients that what he was offering was good and that there were people in Argentina capable of making it. On every trip, they tried the valves José Luis carried with him in the clients' engines and analyzed changes that would improve the engine's performance. On the next trip, Basso would bring the modified valves. Thus, José Luis gradually gained the rebuilders' trust and their confidence in his technical ability. At some point, he started getting the first orders.

The U.S. aftermarket was growing, and the acquisition of TRW's valves division in Argentina had helped Basso as a letter of introduction to reach new customers. Basso was gaining recognition in the U.S. market. In this context, the firm set forth to enter the competition and high-performance markets. José Luis had established a good relationship with one of his main customers in the United States, who was a large distributor in the aftermarket. Together with this distributor he made his first incursion in those markets. Some builders of high-performance and competition engines had been aware of Basso since the time of the 300 Indy car race in Rafaela and had visited the plant. José Luis got the first orders from them,

which included low-series competition valves in the aftermarket for old engines. As Basso gained more customers, it made forays into different racing categories. In order to supply this market, in 1986 the firm built a new production plant just for competition and high-performance valves. In 2002, Basso purchased Manley, a renowned valve producer in the United States, and moved the plant entirely to Rafaela by ship. This purchase widened Basso's customer base in the United States and increased its international stature.

Insertion in the International Original Equipment Market

In the 1990s, a number of events set the future path of the firm. In 1990, Juan Basso passed away unexpectedly and his sons took over control of the firm. The transfer to the next generation went smoothly. José Luis was already Basso's vice president, and both he and his brother were familiar with all aspects of the firm's management. In that context, the firm had to adapt to important changes taking place in Argentina and its automotive industry. Argentina was opening its economy to foreign trade. Albeit with a special regime, so was its automotive industry. Several automakers, some of them Basso's clients, ceased to produce engines in Argentina. Also, due to increased access to imports, competition with imported auto parts intensified. Basso searched abroad for new customers for its products. The firm had its own know-how and local recognition. It was the supplier of several automotive assemblers, such as Ford, Fiat, and Peugeot, and had the necessary quality certificates to supply the major automotive assemblers.

In 1991, a new automotive regime regulating the sector's international trade came into force. To protect the local industry in the face of drastic trade liberalization, an administered exchange system was devised. This system allowed local carmakers to import vehicles and auto parts under preferential tariffs on the basis of their exports. For the purpose of this calculation, carmakers' "exports" could also include exports of independent auto part producers (export credits) if they were directed to their headquarters or other of their affiliates.⁵¹

In the early 1990s, Peugeot did not have a strong market presence (or a plant) in Brazil. Therefore, it could not import cars to Argentina under the preferential tariff since it could not

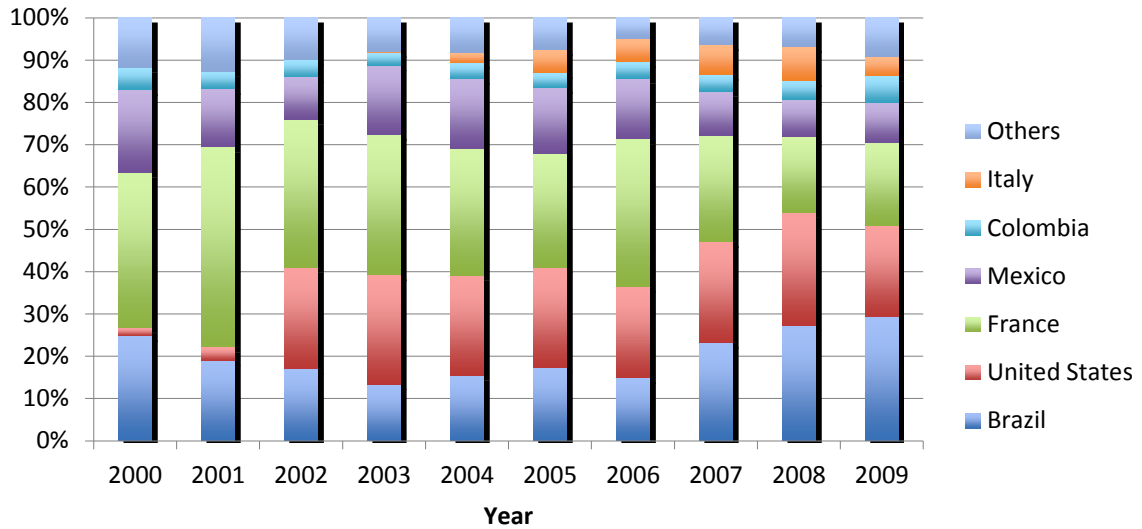
⁵¹ This mechanism of export-credit transfers lasted until 1999.

compensate those imports with exports to Brazil, as most other automakers did. In this context, Peugeot had strong incentives to find Argentine suppliers for its French plants to take advantage of the implicit subsidy. The assembler looked for suppliers that had the know-how to perform product development in co-design. Peugeot Argentina pointed its parent to Basso as a supplier that could perform that task. In 1991, Peugeot France sent a first auditory team to Rafaela. Then it asked Basso to send representatives to Paris for a meeting with its top managers at their headquarters. The objective of the meeting was to assess Basso's engineering and product development capabilities. After passing those tests, in 1994 Basso finally became a supplier of Peugeot in France, which became its first international original equipment customer.

Entering the international original equipment market gave Basso increased worldwide prestige and recognition. Later, the firm signed contracts to supply original equipment to producers of other types of vehicles, such as John Deere and Harley Davidson. One the major achievements of the firm would come in 1999 when the firm became a supplier of Ferrari. At the time, Basso supplied valves for various competition teams in European car-racing categories. Some of the cars that ran with their valves had won their championships, which was a signal of the quality of Basso's valves. These cars were equipped by the competition departments of the main automakers, who eventually recommended Basso to Ferrari as a supplier for their Formula 1 cars. While they did not reach an agreement to supply those cars—Basso could not afford the dedication Ferrari requested—Basso was hired to become Ferrari's exclusive global supplier for their street vehicles.

Currently, the company exports regularly to most leading countries in the automotive industry, including France, Italy, Germany, the United States, and Japan, and different Latin American countries such as Brazil and Mexico. In 2010, its main markets were Brazil, France, the United States, and Mexico. Exports to Brazil and Mexico accounted for 36% of total exports in that year, while France accounted for 22% and the United States for 17% (Figure 11).

**Figure 11: Basso's Exports by Destination Country and Year
(%, 2000–2009)**



Source: Argentine customs data.

Competition with Edival (now Mahle)

Basso and Edival (now Mahle) are two of the few cases in Argentina of successful insertion in automotive GVCs. These firms are currently the only valve producers in Argentina and are in the group of the ten largest Argentine auto part exporters. Both firms were born in Rafaela roughly during the same period. They grew in the same social, cultural, and geographical environment, and their owners even had personal ties. By the mid-1960s, the technology for producing valves was accessible, and fourteen valve producers existed in Argentina. Over the years, competition between Basso and Edival in customer service and product development drove all other competitors out of the market. By the early 1980s, Basso and Edival were the only two valve producers in Argentina. To understand Basso's history, it is necessary to also understand Edival's.

Edival was founded in 1953 by Edison Valsagna.⁵² The firm originally produced engine valves for the local aftermarket. Valsagna kept up to date about improvements in valve technology and production processes through several trips he took to Italy, starting in 1962, to visit valve factories. Edival focused solely on the aftermarket until 1967, when it entered the original equipment market as a supplier of General Motors Argentina. During the rest of the

⁵² This section draws heavily from Ascúa (2003).

decade and the 1970s, Edival became the valve supplier of all car assemblers in Argentina. As in the case of Basso, Edival's first export was to Uruguay's aftermarket (in 1975) followed by exports to the aftermarket of other neighboring countries. In 1978, using business links established as a result of the 300 Indy Car race in Rafaela, Edival made its first incursion in the U.S. competition market. This incursion consolidated in the late 1980s when the firm obtained its first important car-racing customer in the original equipment market.

Throughout the 1990s, Edival had to face a difficult generational change. In 2001, Valsagna's family decided to hire professional management to put an end to their disagreements. In this context, in 2002 Edival made the first foreign acquisition of an industrial plant in Braga, Portugal. In 2007, Edival was acquired by the German auto part multinational Mahle. Since then, the fierce competition that had always existed between Edival and Basso has gradually subsided as Mahle refocused the acquired firm toward valves for heavy equipment, while Basso is still primarily concentrated on car valves.

Currently, in addition to valves, Mahle produces other parts and components for engines. It supplies the most important car manufacturers such as General Motors, Audi, BMW, John Deere, Porsche, Toyota, Ford, Fiat, Renault, Peugeot, and other vehicle producers such as MWM, Cummins, Scania, Volvo, Internacional, Caterpillar, and Perkins. Mahle exports to leading countries in the automotive industry. In 2007, the main destinations were Germany (36%), the United States (22%), Brazil (14%), and Sweden (12%), among others.

The unrelenting cutthroat competition between Edival and Basso is one the most important features in the history of these two firms. To gain customers and markets, they competed in all fields. For example, they monitored each other's technological improvements and fought fiercely for every customer. Also, they reinvested most of their profits so as not to give the other firm any advantage. Rather than hurting them, the fierce competition between these two firms made each one stronger. They both achieved international recognition despite lack of international competitiveness in the Argentine automotive industry and their location in a small city far from the main industrial centers of the country.

The Industrial Environment of Rafaela

The city of Rafaela is in Santa Fe Province, 234 kilometers away from the port of Rosario and 530 kilometers from the city of Buenos Aires. It is the third most populated city in the province—behind Rosario and Santa Fe (INDEC, 2010)—with nearly 100,000 inhabitants. Rafaela was founded by Italian and Swiss immigrants in 1881 and has a remarkable socio-cultural identity. Agriculture and manufacturing are both strong economic activities. Rafaela is the center of Argentina’s most important dairy basin. Within the manufacturing sector, food and beverages account for 50% of industrial added value, while the metalworking industry sector accounts for 35%.⁵³ These two activities employ 56% of the total employment in Rafaela’s industrial sector. The city has over four hundred manufacturing establishments. Approximately 90% of the industrial companies are family firms.

Rafaela has many of the characteristics of an industrial cluster. However, despite the geographic concentration of economic activity, unlike in standard industrial clusters, such activities are diversified into various economic sectors. Within the manufacturing industry, the metalworking sector comprises various activities such as the manufacture of machines and equipment—the latter related to the farming sector. It also includes activities such as manufacturing of metal products for automobiles, trailers, and semi-trailers.

Rafaela is characterized by a strong activity of business associations and public-private initiatives that facilitate the development of economic activities and the collaboration of different sectors. Initially, most of this collective action was carried out by private institutions, some of which were created when the city was founded. Public institutions started to play a more significant role later. Among the most relevant institutions in Rafaela are the Rural Society, the National Institute of Agricultural Technology (INTA), Rafaela’s Trade and Industrial Center, and the Chamber of Foreign Trade.⁵⁴ Rafaela also has various public-private organizations such as the Rafaela Technological Innovation Center and the Business Development Center. In 2001, Argentine customs built a dependency in Rafaela, which streamlined the administrative procedures to export. The city also has had an industrial park since 1970.

⁵³ Information from Ascúa (2007) based on Rafaela’s census for 2006.

⁵⁴ Juan Basso founded the Chamber of Metallurgical Industries in 1966.

Educational institutions play a key role in Rafaela's economic prosperity. They were created to meet requirements of skilled labor from the private sector, and their programs are designed to match those requirements. Among the most important educational institutions are the School of Technical Education, the National Technological University, and Rafaela's Technological Institute. The School of Technical Education was founded in 1915. It played a key role in the development of the city's metalworking sector. Most businessmen and industrial managers of the city graduated from that high school, including José Luis Basso, and many of his classmates are now workers and managers at his firm.

8. Determinants of Basso's International Success

Many factors appear to have played an important role in the successful international insertion of Basso in GVCs. One of the most important factors is that José Luis Basso was always convinced that it was possible to grow and gain international stature. He was convinced that his valves could achieve international quality standards and hence compete nationally and internationally. José Luis was convinced himself, and he also managed to instill this confidence in his workers and managers. To this aim, he sought to take advantage of any available opportunity to acquire knowledge and technology. Also, the firm actively and consistently sought to establish long-term relationships in the export market (particularly in the U.S.) and made every effort to maintain those already established. Product quality and customer service are sacred values within the firm.

At a deeper level, a critical question is what convinced José Luis Basso of his firm's potential to succeed internationally. Surely multiple factors play a role. One we would like to emphasize is his international experience. At a very young age, Basso acquired international exposure by working at a steelworks in France (Basso's steel supplier) and later at a Renault valve plant in the same country. This experience allowed him to become familiar with the best international practice. He learned about different types of valves, materials, production processes, and quality controls. This knowledge provided him with a benchmark to assess how far Basso was from best practice. He could identify areas for improvement and evaluate the possibility and the costs of reaching international standards. Most importantly, he could know

when his products had achieved the standards to compete in a given market segment.⁵⁵ This knowledge provided him with the incentives to spend time and resources building long-term business relationships abroad even when such attempts initially seemed condemned to failure. Soon after coming back from France, he worked for some years as a production manager at Renault Argentina. This experience was also important because it allowed him to become familiar with the operation and needs of an automaker and to view the relationship between assembler and input supplier from the automaker's point of view.

Personal characteristics also matter. José Luis Basso is the owner and CEO of his company. His leading qualities have allowed him to build a long-lasting team of loyal and motivated managers who share his view about how business should be conducted and a common pride about what the firm has achieved. They all recognize Basso as a visionary and emphasize José Luis's rigor and devotion to the firm. They respect him as a person and especially respect his technical knowledge. In fact, José Luis was one of the best engineering students at the University of Córdoba. Even though the growth and professionalization of his company has led him to increasingly spend most of his time away from productive concerns, he is still on top of the main production developments and is actively consulted for technical problems and production decisions.

Another critical factor to explain Basso's international success was its competition with Edival. There is a unanimous consensus among Basso's top managers (including José Luis) and business people in Rafaela that the cutthroat competition these two firms maintained for decades mutually strengthened their performances. On the one hand, it gave each of these organizations a strong motivation to work hard and strive for product and marketing innovations. On the other hand, these firms closely monitored what the other was doing, poached each other's employees, and fought hard over each other's clients. Therefore, any innovation at one firm soon had the potential to be adopted by the other. While the possibility of diffusion from one competitor to the other might have induced some deterrence from innovation, it is apparent that on balance, competition helped rather than hampered innovation.

⁵⁵ Artopoulos et al (2011) similarly find foreign market exposure to be critical for explaining the emergence of export pioneers in differentiated-product industries.

The last potentially important factor for Basso's international success was the favorable environment provided by the city of Rafaela. We highlight a few specific channels through which Basso benefited from this environment. For example, Rafaela's Chamber of Foreign Trade, created in 1972, helped Basso make its initial incursions in the foreign market. The Chamber organized commercial missions in which the firm participated with various other firms for Rafaela. In 2001, the creation of a dependency of Argentine customs in Rafaela, the result of lobbying efforts of city officials and businessmen, was critical to improving Basso's logistics, ensuring the timely delivery of its valves to customers around the world. Finally, the industrial environment of the city attracted and maintained technical education at the secondary and tertiary levels that allowed the firm to find capable workers for their various production necessities.

PART III

9. Conclusions and Policy Implications

The cases presented here suggest that integration into GVCs not aimed at the mass market may provide export development opportunities for a country like Argentina. As participation in those GVCs requires understanding key aspects of foreign demand, this participation is rewarded with a higher portion of the value added generated along the chain and hence can support higher wages. Nevertheless, since the knowledge requirements of this type of insertion are more difficult to acquire, the scope for public policies is larger.

The sole instance of a public policy that has clearly influenced insertion in a GVC is the implicit export subsidy provided to Basso by the automotive regime in place during the 1990s. A provision in this regime allowed automobile affiliates in Argentina to waive most of their tariff duties on imported cars with compensating exports of auto parts to their parent firms or other affiliates. This subsidy motivated Peugeot France to become interested in Basso as a global supplier. Except for this instance, public policies did not seem to play a prominent role in the cases of GVC insertion we have studied. Below we discuss various areas that we think can potentially benefit from public policy efforts to promote insertion in GVCs. While our policy recommendations are sometimes too broad to be mapped into specific policies, we hope they can provide guidance to public efforts aimed at this objective.

One area in which public policies could play an important role is the promotion of a culture of quality production among the various actors in the different industries. Improvements in this area are crucial because lack of quality is one of the most important hurdles to integration in GVCs. There are a number of directions such a policy could take. First, although it is natural to expect the quality of goods sold in less developed countries to be lower than in richer countries, local consumers could be empowered to be less tolerant of quality defects. In addition to public campaigns and support of consumer-defense agencies and NGOs, the government could regulate or promote return policies for defective products. In this regard, it is interesting to note that even in Chile, a country with slightly lower income per capita than

Argentina's, consumers are substantially less tolerant to defective items.⁵⁶ We think a potential explanation for this behavior is related to the openness of their economy and the implied competition of imported varieties in the domestic supply of goods. Another explanation is the fact that retail is concentrated in large department stores that impose uniform and strict return policies across brands. Regarding the specific two sectors we study here—footwear and engine valves—these policies would have a larger impact on footwear than in engine valves, because in the latter case quality standards are imposed by automakers' product standardization protocols across countries, even for cars sold in developing countries.

A second potential direction that the promotion of a culture of quality production could take is to implement public policies that foster the development of quality standards and certifications. The public sector could set those standards or confine itself to facilitating their development and implementation by the private sector. Compliance with those standards need not be mandatory. A group of firms interested in signaling a higher quality could develop "quality labels." The public sector could develop a specific expertise in creating and managing such labels that could be used to foster their implementation by the private sector.

A third potential direction to promote a culture of quality production is to use the communicating power of the bureaucratic apparatus to convince firms that quality matters in the export market. Even firms that are serious in their attempts to export often fail to fully commit to quality because they are not convinced of its crucial importance for maintaining a stable presence in developed markets. Those firms rarely succeed in their exporting attempts in the long run. One interesting avenue to implement this type of policy is to generate environments in which members of an industry or related industries gather to listen and share the experience of a successful exporter. Identification with peers can provide a framework under which information flows are internalized effectively.

Lastly, public policies could facilitate coordination efforts to upgrade quality. A common regularity we find is that supplier development is always a critical hurdle in experiences of integration in GVCs. The main problem arises from the fact that entrance into the export market is gradual. Hence, input orders are initially too small to provide suppliers the incentives

⁵⁶ This difference was emphasized by our interviewee at Prüne.

to introduce modifications or quality upgrades to their inputs, which can be small but are nevertheless crucial. While those hurdles can eventually be overcome, the costs may sometimes be prohibitive. Since many potential firms might benefit from the same type of input modifications or quality upgrades, policy efforts could promote information exchanges between players in the industry that could eventually lead to successful outcomes.

Lack of appropriate domestic inputs need not be a constraint when imported inputs are available. However, as discussed in the footwear case, it is sometimes excessively costly for small firms to identify and work with an input supplier abroad. Given the fact that obtaining the right input may be crucial to achieving the specific design that will be valued in the market, a natural policy recommendation is not to hamper firms' access to those imported materials and components. While import protection can sometimes be effective at fostering domestic production, it can also prevent other firms from achieving international competitiveness.

Another area in which public policies could play an important role is in the incorporation of design as a systematic activity in industrial processes. While there is a brewing emergence of design activity in Buenos Aires, design as a systematic stage in the production process is still confined to small start-ups by designers. Those designers usually possess a better understanding of central concepts of brand management than most established producers, but they lack more general management skills. Although the most important apparel brands are increasingly incorporating professional designers into their staff, the generalization of this trend to high-end products in many other industries could facilitate a wider integration of firms in GVCs that are not oriented to the mass market. Nevertheless, it is encouraging that a growing community of designers who were originally alienated from the consumer market is now increasingly integrated into it.

We think public policies could promote the professionalization of design in consumer goods. In fact, this is already recognized as an objective in the charters of agencies and units within the public sector (e.g., Fashion Observatory at INTI, CMD).⁵⁷ Specific policies include providing training courses to firms, assistance in design management and design-related

⁵⁷ INTI (Instituto Nacional de Tecnología Industrial) is the main national research and outreach industrial technology agency in Argentina. CMD (Centro Metropolitano de Diseño) is an agency of the city of Buenos Aires devoted to promoting design as an economic activity.

projects, sharing information about design trends in the world, facilitating the creation and diffusion of design-related knowledge, promoting and coordinating the interaction between designers, design managers, entrepreneurs, public officials, and academics, and supporting the formation of design networks. While the breadth of these efforts is notable, we cannot yet ascertain their effectiveness. Public agencies could also work closely with business associations to promote these goals. We are not aware of any effective joint work in this area. Developing design capabilities will not only foster the emergence of firms that create original designs in Argentina, but it will also enhance the capability of firms to interpret designs made overseas and hence be able to participate more prominently in product development activities.

An obvious area for public policy relates to current efforts in export promotion. First, public agencies could make a more effective effort at gathering information on the structure of distribution in foreign countries. Our interviewees in this study have consistently indicated that they did not receive relevant information from public agencies. It is important that those agencies can distinguish the different modes of insertion in GVCs so that they can advise potential exporters on the type of distributors to look for according to each mode and on the requirements entailed by the type of business relationship they would establish in each case. Currently, public agencies do not possess this knowledge. For example, a commercial office of the Spanish Embassy in New York has produced a set of online documents under the request of the main Spanish export promotion agency that describes the structure of U.S. footwear distribution in large detail.⁵⁸ These documents help Spanish designers and manufacturers to understand the pros and cons of the different available entry options to the U.S. market, from selling to a wholesaler to opening their own stores. Argentina's public agencies have not produced a similar document. It is interesting to note, however, that CMD has been working closely with the Japanese firm H.P. France in identifying potential designers to participate in the Tokyo Rooms fair and in helping them develop a marketable product, in particular defining the identity of the product (e.g., elaborating the designer philosophy and the story behind the

⁵⁸ Those documents are available at the following website: <http://www.icex.es/>

collections). Although incipient, we hope that the acquisition of this kind of knowledge by government agencies would help promote insertion in GVCs not oriented to the mass market.⁵⁹

The insufficient depth of public agencies' understanding of the structure of distribution in foreign markets and of what it takes to be part of them affects, through various channels, the effectiveness of their efforts to help firms become part of GVCs. First, they do not properly prepare firms before traveling to trade fairs. Sometimes the agencies' efforts are just limited to subsidizing traveling costs for firms that have no chance of achieving an established relationship with a foreign distributor. Second, they sometimes make efforts in generating business rounds but fail to properly match the capabilities of domestic firms with the requirements of foreign distributors. Interviewees consistently reported that business rounds arranged and financed by public agencies failed to generate relevant business relationships. More generally, in the footwear sector, public efforts to help firms participate in international trade fairs could benefit from a clearer strategic definition of the objectives to be pursued at each event.

The public export promotion apparatus does not seem well prepared to respond to clients' spontaneous requests. One U.S. footwear designer of Argentine origin actively sought to outsource manufacturing of her shoes in Argentina. She reported having visited the Argentine Consulate in New York requesting information about potential manufacturers, only to find that the Consulate personnel was not only unable to help her but also appeared unconcerned with her request. She received more positive feedback at the Brazilian and Portuguese Consulates. Also, an Argentine designer reported having failed to receive helpful information from the public sector regarding regulations involved in setting up a store in the United States. Similarly, a branded firm reported having failed to receive helpful information about regulations related to setting up a store in Chile and about franchising regulations in Mexico. These anecdotes suggest that public agencies involved in export promotion should attempt to build a broader know-how to foster insertion in GVCs in the various forms it can potentially take.

⁵⁹ We obtained detailed references about the work of Fundación Exportar (the main Argentine export promotion agency) from many of our interviewees, but unfortunately we have been unable to arrange an interview with public officials at this agency.

Finally, consistency over time and coordination among public agencies seems crucial. One critical aspect of insertion in GVCs for goods not targeted to the mass market is that the different links that Argentine and foreign agents establish in the different modes are relational (Gereffi et al, 2005). These relationships take more time to build but are more stable afterwards. Therefore, public efforts need to be consistent over time and sometimes require the coordinated effort of more than one agency. Current efforts often lack the required regularity and coordination. In the last Tokyo Rooms fair, mistrust between Fundación Exportar and the CMD led each agency to build a different stand at the fair. The stands were opposite each other, each with a different aesthetic and with a different overarching theme. As a result, Argentina failed to build a convincing country image to support the products displayed by its designers.

One final area for potentially helpful public policies is technical training. For example, Basso benefited from the wide availability of workers trained in metal mechanics by the technical high school in Rafaela—which counts José Luis Basso as one of its graduates. In Rafaela, there is also a branch of the National Technological University (UTN). In the case of footwear, INTI (the main industrial research and outreach public agency) created a technical school for footwear manufacturing in the 1990s (CEFOTECA). In addition, the emergence of new programs in apparel design is one of the main reasons for the current emergence of design activity in the country. Despite these efforts, except in the case of design, we think there is undersupply of technical training and lack of advertising of existing programs, which contribute to current complaints by firm owners and managers about shortages of workforce with technical skills.

In the broader auto parts sector, there might be room for policies to specifically foster GVC insertion. As discussed in the case of Basso, compression engine valves are characterized by a rhythm of product and process innovation that is slow but nevertheless substantial enough to pose a challenge for an Argentine firm to keep up to date with. In addition, there is a large market for customized valves, which require *relational* links between producers and buyers. There might be many other auto parts with similar characteristics to engine valves. In that case, it would be possible to identify constraints to GVC insertion by comparing Basso's case with the

case of other auto part manufacturers who fail to participate in GVCs—as we did in the footwear case. This endeavor would require a detailed understanding of how GVCs for these other auto parts are organized. While we do not undertake this task in this study, we hope our analysis here sets the stage for future work on this subject.

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APPENDIX: Methodology

We use study firms in two sectors – footwear and auto parts – to analyze the insertion of Argentine firms in GVCs. Several techniques of qualitative research were used to collect data, namely semi-structured interviews, participation in conferences and in national and international trade fairs, and revision of secondary sources. A total of 46 interviews were conducted between March and December of 2011. We describe below the activities carried out for each of the cases. Interviews with producers were usually followed by a tour of the production facilities, allowing for a direct observation of the activities, operations, and productive processes performed in each location.

For the study of the footwear sector, we conducted thirty interviews. Twenty two of these interviews were carried out in Argentina while the remaining eight were carried out in the United States and Peru. Among the first ones, seven were done to subjects directly involved with the firms Tosone, Mishka and Prüne. Specifically, we interviewed four owners and two managers of these firms – one brand manager and one product and planning manager – an external consultant of one of the firms, and the owner and manager of a Swedish firm that acts as an intermediary between Argentine producers and foreign brands.⁶⁰ The other fifteen interviews conducted in Argentina include nine with owners and managers of eight Argentine firms, three with officials of a Brazilian public entity and two Argentine public entities – one at the national level and another at the municipal level, one with the executive manager of the Argentine footwear business association, and one with an international consultant in the footwear industry. The production facilities we visited are located in the Buenos Aires area. Out of the eight interviews conducted outside of Argentina, seven were done in the United States and one was done in Peru. In the United States, we conducted six interviews with five executives of four international buyers of footwear and one with a professor of footwear design at the Parsons School of Design – one of the leading design schools in the United States. The executives we interviewed represent some of the potential alternatives distribution channels in the United States. Two of them are vice presidents of global sourcing and of product development and continuous improvement, respectively, of one of the largest U.S. footwear

⁶⁰ Two interviews were done with two owners of the firm jointly. One of them participated in both interviews.

companies. Another executive is the managing director of one of the main footwear distributors in the United States, and the other two are owners of specialized footwear stores in New York City. In Peru, we interviewed the merchandise manager of the footwear division of one of the largest department stores in Latin America.

In addition, we attended national and international industry events. In the United States, we attended the international fair "World Shoes + Accesories" held in Las Vegas on July 27-29, 2011. In Peru, we attended the fourth edition of "Calzatex", a showroom of suppliers of the leather and footwear industry organized in the Peru "Expotextil" fair held in Lima on October 20-23, 2011. In Argentina, we attended the Sixth International Forum of Latin American Chambers of Footwear in Buenos Aires on August 25-26, 2011. In Buenos Aires, we also attended the exhibition of the association of suppliers of the footwear industry (EFICA) held on July 23-25, 2011, and the seminar "International Markets, Trends and Technologies" given by the international footwear consultant Peter Kern at the Chamber of the Footwear Industry (CIC). During these events, we had informal conversations with several actors regarding the international dynamics of the sector and the perception of Argentina as a producer of footwear. We also listened to presentations on the competitiveness of the sector and relevant public policies in Latin America and Spain. Attending the fairs in Peru and Argentina also allowed us to learn how Argentine products are exhibited in stands funded by the CIC and the national government.

In the case of Basso we conducted sixteen interviews. Eight of these interviews were done with six senior staff of the Basso group, three with executives of the engines plant of one of the automakers operating in Argentina – one of the main customers of Basso – and five with members of several entities linked to the auto part sector. At Basso, we interviewed the President of Basso group, one director and four area managers. Most interviews were carried out at the production facilities of the company located in Rafaela (province of Santa Fe). At the automaker plant located in Jeppener – province of Buenos Aires – we interviewed managers of different areas (purchasing, production, and supplier quality control). In addition, we interviewed two officials of a private entity that groups entrepreneurs and industrialists from

the city of Rafaela, a public official of that municipality, a member of the Argentine Auto Parts Business Association, and a researcher of a private research center.