SMEs AND THE COMPETITIVENESS FROM INTERNATIONAL LINKAGES

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Dengan berbagai kendala yang dimiliki, usaha kecil dan menengah (UKM atau SME) terutama dari negara berkembang mengalami kesulitan bersaing ketika berada di pasar internasional. Namun, bertaut pada perusahaan global (global buyer) yaitu dengan menjadi salah satu mata rantai dari rantai perusahaan global (global value chain), merupakan strategi yang disarankan agar daya saing SME meningkat. Dengan cara ini, SME akan mengalami upgrading karena mereka dipaksa untuk menghasilkan produk yang memenuhi persyaratan internasional. Learning process yang terjadi melalui interaksi dengan global buyer merupakan proses yang penting karena bisa berdampak pada peningkatan kemampuan SME ini. Namun diingatkan, bahwa strategi ini bisa menyebabkan meningkatnya ketergantungan SME di negara berkembang kepada global buyer.

Keywords : SME, global buyer, usaha kecil dan menengah, negara berkembang

Introduction

Internationalization refers to the geographic spread of economic activities across national boundaries (Gereffi et al 2001:1; Buckley and Ghauri 1999). The other term that is recently much more employed is globalization, a functional integration between internationally dispersed activities (Dicken 1998:5 cited from Gereffi et. al. 2001). For small enterprises, the term internationalization is frequently used due to the limited activity of firms involved in the foreign market. There are three generic methods by which a firm can penetrate a particular foreign market; exporting, licensing, or direct investment. Many SMEs consider exporting as an important route to growth (Cooper and Kleinschmidt 1985). Moreover, it is important as a learning process (Clerides et al. 1998). However, several barriers caused small firms to not be competitive from a distance, especially for small firms from developing countries. Linking to global buyers is the critical way to be competitive, since they will be able to overcome the barriers that hinder small firms. This paper deals with how competitiveness can be reached by small firms through linking with foreign buyers.

This paper is organized in the following manner: section two will delve into the definition and type of global value chains, and global buyers; section three will deal with global buyers, small firms' competitiveness and innovative capabilities; section four about the governance in the global value chains; section five will show experiences from some developing countries, inserting to global value chains and the upgrading; section sixth will discuss governance and transaction costs; section seven is the conclusion.

Definitions and Types of Global Value Chains

A global value chain or global commodity chain[1] is an international economic network, referring to the whole range of activities involved in the design, production, and marketing that are spread worldwide (Gereffi 1999a:1; 1999b: 38). In this Global Value or Commodity Chain (GVC or GCC) Analysis, Gereffi introduced an analysis in which the chain is seen as a set of inter-organizational networks clustered around one commodity or product, linking firms in different regions and countries. Several terminologies usually used to describe global value chains are global commodity chains, a global value system, and a global production network or global value network (Gereffi et al. 2001: 2). Many scholars do not distinguish between the meaning of each term but Gereffi et al. stresses that each term is different and has its own emphasis. In this global value chain, a lead firm is an actor who is coordinating and managing between different activities along the chains.

According to the role played by the lead firm, Gereffi (1999a:1; 1999b:41) distinguishes these global commodity chains as producer driven and buyer driven commodity chains.

(1) Producer driven commodity chains are those industries in which large, usually transnational, manufacturers play the central role in the coordination production network. This is usually characterized by capital and technologically intensive industries such as automobile, aircraft, computer, semi conductors, and heavy machinery industries. Besides earning, product advancement and the ability to apply control over backward and forward linkages are the key economic agents. According to Kaplinksy (1998), the lead firm relies primarily on technological rents[2] and organizational rents. The lead firm in this commodity chain is a global oligopoly.

(2) Buyer driven commodity chains are those industries in which large retailers, branded marketers and branded manufacturers play pivotal roles in

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[1] Gereffi (1999: 3) stated that his framework of commodity chains is different from Porter's value chains approach in four aspects: scope of analysis that includes the international dimension; focuses on the power that is exercised by lead firms and the changes overtime; key source of competitive advantage in coordination of the entire chain that requires using networks as strategic assets; and the critical mechanism for firms to attain their position is through organizational learning.

[2] Technological rents arise from asymmetrical access to key product and process technologies. Meanwhile, organizational rents are form of an intra-organizational process know-how involving new organizational techniques such as JIT, TQC, and continuous improvement.

setting up a decentralized production network in a variety of exporting countries, typically located in the third world. This is usually characterized by labor intensive, consumer goods industries such as garments, footwear, toys, house-ware, consumer electronics, and a variety of handicrafts. Production is generally carried out by tiered networks of third world contractors that make finished goods to the specification of foreign buyers. In this industry, firms are highly competitive and part of a globally decentralized factory system. Using Kaplinksy's term, this lead firm in a buyer driven commodity chains relies on relational rents[3], trade policy rents, and brand name rents.

The key differences between producer driven and buyer driven commodity chains are in the actors setting the key parameter, control of resources, and the scope of the key parameters that should be enforced by the suppliers. In producer driven chains, the global firms, the transnational corporations that control the key products and process technology, set the parameters. Meanwhile, in buyer driven chains, agents, retailers, and brand name owner's firms, who do not always own production facilities, set the key parameters which focus on design and marketing (Humphrey and Schmitz 2001:1; Gereffi 1999a:1). Among these two types of global activity networks, buyer driven commodity chains are currently widespread in developing countries and involve a lot of small firms. Some characteristics of buyer driven commodity chains are: (1) the company design and or market branded products they order (2) there is a separation in the production of goods from the design to the marketing stages (3) profit is derived from a unique combination of high value research, design, sales, marketing and financial services that allow them to function as strategic brokers.

The important role of buyers in increasing trade from developing countries is stressed by Egan and Moody. Traditionally, Egan and Moody (1992) distinguish three types of buyers, which are retailers, importers, and manufacturers: (a) Retailers may be large or small retailers. Since they have their own outlets, these firms can buy directly from foreign countries without conducting market research, doing product development, or design. Some retailers provide financial assistance, quality control, and a distribution system. (b) Importers or wholesalers buy to resell to retailers or other intermediaries. They specialize in importing, market identification, and development of new sources. (c) Manufactures or producers buy finished products or components from local producers and sell them in the international market.

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[3] Relational rents refer to techniques that are based on inter-firm relationships; trade policy rents refer to the scarcity value created by protectionist trade policies such as quotas; and brand name rents refer to returns from the product differentiation techniques used to establish brand name prominence in a major world market.

In his study on the apparel industry, Gereffi (1999) emphasizes that the global buyer plays a strategic role in coordinating activities in the global value chain. He classified global buyers into three groups: (a) Retailers are stores selling directly to final customers. (b) Marketers are companies selling all over the world without having their own factories. They deal with capable contractors globally to supply their products. (c) Branded manufacturers are large manufacturers producing their products in cooperation with domestic producers' firms by providing intermediary input. These firms organize and manage the assembly process of foreign firms. The evidence from the apparel industry (Gereffi 1999) shows that retailers and marketers are those who buy ready made products or rely on a full package sourcing network, whereas branded manufacturers are those focusing on assembly or do further processing of unfinished imported products. This firm is the primary source of inputs, technology transfer and knowledge.

From the explanation above, it can be concluded that globalization has created different types of global value chains and global buyers. Typology of global value chains or global buyers is important since this describes the different roles of lead firms in coordinating a range of activities. This also implies on different capabilities owned by each type, the relationship between buyers with their local producers, and the interest of the actors to assist local partners for upgrading.

Global Buyers, SMEs' Competitiveness, and Innovative Capabilities

Reaching Competitiveness From Global Buyers

Exporting has been the most common practice in the internationalization process of SMEs (Leonidou 2002). However, considerable evidence shows many small firms, especially from developing countries, are not able to compete because they do not have a competitive advantage. Small firms do not only have limited resources and knowledge about foreign markets, but they also lack the ability to perceive risk and uncertainty surrounding the market. These difficulties hinder small firms from entering the developed countries market. To overcome these problems, many SMEs do not do direct exporting (Peng and Ilinitch 1998). There are many barriers faced by SMEs, but scholars have different opinions in identifying which barriers are important. Egan and Moody (1992) stressed that entry barriers are part of product criteria, and almost all buyers have minimum product criteria needed to be met by their suppliers. They suggested three minimum product criteria for suppliers in terms of price, quality, and delivery. They argued that the price should be competitive without sacrificing quality and delivery, where as quality should meet the defined standards;

and delivery should be on time. These three criteria are usually referred to as an 'inseparable triad'. Other scholars state critical barriers in entering the export market are the sunk costs of gathering information about the foreign market, establishing a marketing channel, and defining a product that is suitable for the new market (Roberts and Tybout 1995).

In his study, Lall (1991) argued that the barriers for small firms are varied by industry, but he points out the importance of marketing barriers. He distinguishes the barriers in pre-shipment and post-shipment. Pre-shipment barrier consist of design, quality, production, packaging and presentation, shipping, and delivery. Post-shipment consists of wholesaling, retailing, after sales service, and brand name promotion. Meanwhile, Leonidou (2004) recognizes that barriers for SMEs are not only in marketing but also in many other aspects. He identifies 39 barriers that can be distinguished in two groups: internal and external. Internal barriers are barriers associated with organizational resources or capabilities and the company approach to exporting, consisting of informational, functional, and marketing; whereas external barriers that are connected with the home and host environment within which the firm operates, consist of procedural, governmental, task and environmental barriers. The impact of the barriers, which can be very low to very high, are situation specific depending on the condition of the managerial, organizational, and environmental background. These barriers caused small firms to need assistance from specialized agents to overcome them. A link to global intermediaries is necessary to allow them access to the foreign market. For SMEs, using intermediaries is an efficient way to locate and negotiate with international customers, since these intermediaries have contacts, experience, specialization, and scales of operation (Peng and Ilinitch 1998).

Basically, an export intermediary is a specialist acting as an export department from several manufacturers in non competitive lines. Due to the task of providing services for a group of entrepreneurs, sometimes it's also defined as a group of entrepreneurial service firms connecting domestic manufacturers and foreign buyers (Oviatt and McDougall 1994 cited from Peng and Ilinitch 1998). Global buyers as intermediaries perform important functions in export transactions, which are characterized by geography and separation between buyers and sellers. These intermediaries are also known as international traders or a lead firm in a global value chain (Gereffi 1999[4]). The role of foreign buyers in marketing SMEs' exports is very critical. It functions as the central agent for collecting and disseminating the information needed (Lall 1991). Therefore, in

[4] Global commodity / value chain refers to the whole range of activities involved, from the design, production, and marketing that are spread all over the world

the global value chain literature it is argued that a firm's development needs to be linked with lead firms in an industry, since these lead firms control access to major resources or markets (Gereffi 1999; Schmitz and Humphrey 2000).

While GVC literature emphasizes the important role of global buyers, previous literature described the role of buyers, merchants, traders, or intermediaries mostly in a negative sense (Schmitz and Knorringa 2000). Neo Marxist literature illustrated buyers as surplus extracting parasites or exploiters. Furthermore, the dependency theory regarded global buyers as the main agents of neo-colonialism that transferred a surplus from the periphery to the center (Cohen 2000). The position of buyers in neo-classical economics is explained as passive intermediaries that physically connect supply and demand. Although some researchers considered buyers to have more important roles, such as being a value added creation, industrial development facilitator, etc., the negative image in portraying buyers is still dominant. However, opportunities provided by global buyers to upgrade SMEs from developing countries (Gereffi 1999), gives a new hope for buyers to play a more positive role.

The idea of the GVC approach is that an external linkage with global buyers will have an impact in the upgrading process of local producers. The approach assumes that despite the lack of resources, the difficulty firm from developing countries have in gaining access to foreign markets is caused by small firms' incapability in production and marketing (to collect and read information about the market). Meanwhile, global buyers, who mostly come from developed countries usually have more resources, understand the market better, and are able to read the needs of foreign customers. To be competitive, small firms should upgrade or adopt continuous innovation as the key weapon to compete in the international market. Upgrading can be effectively reached when small firms link with global players. Linking to these chains offers a possibility for local producers to become competitive by being involved in progressive upgrading through learning processes and new knowledge acquired from external buyers. The theory emphasizes that access to lead firms is seen as a necessary step for industrial upgrading, because it puts firms and economies in potentially dynamic learning curve countries (Gereffi 1999).

A ***Firm's Competitive Capacity, an Innovative or Upgrading Capabilities***

Upgrading is defined as shifts in activities that sustain higher income (Humphrey and Schmitz 2001). Similar to Humphrey and Schmitz, Tam and Gereffi (1999) define industrial upgrading as a process of improving the ability of firms to move to a higher added value, become more profitable, and utilize more sophisticated technology. According to Gereffi (1999: 52), industrial upgrading operates at several different levels of analysis: (1) within factories, shifting to more higher value added activities, such as from cheap to expensive products, from simple to complex, and from small to large orders (2) within inter-firm enterprise networks, shifting from mass production of standardized products to flexible production of differentiated products (3) within local or national economies, shifting from simple assembly of imported inputs to more integrated OEM (Original Equipment Manufacturing) or OBM (Original Brand Manufacturing) production; and (4) within regions, shifting from bilateral, unbalanced, and inter-regional trade flow to more full intra -regional and integrated production.

In a firm, to upgrade means to make better products, make products more efficiently or switch to more skilled activities. Both definitions above put the meaning of upgrading as a static concept, in which any shift or change is considered as upgrading regardless of the position of the firms compared to each other. Humphrey and Schmitz, (2001: 3) distinguished upgrading into several categories: process upgrading, product upgrading, functional upgrading, and inter-sectoral upgrading.

> *Process upgrading: firms can upgrade processes-transforming inputs into outputs more efficiently by re-organizing the production system or introducing superior technology.*
>
> *Product upgrading: firms can upgrade by moving into more sophisticated product lines (which can be defined in terms of increased unit values).*
>
> *Functional upgrading: firms acquire new functions (or abandon existing functions) so that they increase the overall skill content of their activities. For example, they might complement production with design or marketing, or move out of low-value production activities altogether.*
>
> *Inter-sectoral upgrading: firms apply the competence acquired in a particular function of a chain to move into a new sector.*

The dynamic concept of upgrading means connecting upgrading with competitiveness and relating it to a relative position with its rivals (Kaplinsky and Morris 2000; Fleury and Fleury 2001). According to these scholars, change does not always mean upgrading unless it will affect their competitiveness. Kaplinsky and Readman (2000) defined industrial upgrading as being more than just the capacity to innovate, but also the ability to ensure continuous improvement in production and process development. In the dynamic concept, they put the concept of upgrading in a relative position from their competitors and define upgrading as an ability to innovate faster than their competitors. Furthermore, learning will not be valuable if it does not result in an enhanced competitive position for the firm. They emphasize the need for continuous and sustainable upgrading, while also offering indicators to improve the concept of upgrading as follows (Fleury and Fleury 2001):

There would be upgrading if:

1. *There was an improvement in the competitive position of the firm: (i) relative to its previous position (ii) vis a vis other firms, (iii) catching up to the best performers in the field.*
2. *The changes were a consequence of an improvement in the firm's competence.*
3. *They wanted to increase discretionary power regarding other firms.*

Therefore, upgrading is distinguished from innovation, a capacity to innovate relatively faster than competitors. Upgrading means continuous and sustainable innovation will take place as a consequence of purposeful action. Even though the indicators proposed by Fleury and Fleury are more dynamic and represent a firm's competitiveness, these indicators couldn't be easily applied.

From the explanation above, it can be concluded that innovative or upgrading capabilities are an important factor for SMEs to compete in the international market. These capabilities can be reached by SMEs through linking to global buyers.

Governance in the Global Value Chains

Traditionally the term 'governance' is defined very broadly as a *"mode of organizing transactions"* (Williamson and Ouchi 1981; Heide 1994).

Heide expresses a more specific definition of the activities covered by this concept.

> "A *multidimensional phenomenon encompassing the initiation, termination and ongoing relationship maintenance between a set of parties*" (Heide 1994).

While Williamson (1979) defines governance as any mode of coordination of activities including markets, firms, and networks Humphrey and Schmitz (2001:3) stress on the network define governance in being applied to developing countries as follows:

> *"Governance is a coordination of economic activities through a non-market relationship (network)."*

The significance of governance in the global value chains started from a skeptical view about the capabilities of developing countries' firms to meet the international standard requirements in terms of price, quality, and delivery reliability. This caused some experts to suggest the importance of firms from developing countries to be linked to global buyers (Gereffi 1999; Egan and Moody 1992). By linking with global buyers, these firms reduced barriers to enter a developed country's market through access to marketing information, production technology, and larger industrial networks.

Governance is needed by buyers for two purposes (Humphrey and Schmitz, 2001): (1) Product definition. To win the market, many times buyers set up their own standards for products that should be met by suppliers. (2) To protect losses from a failure in the supply chain. Buyers should cover themselves from a failure of suppliers to meet their requirements or commitments. If the criteria are not met, buyers will consequently lose revenue in the particular transaction, resulting in damage to the buyer's reputation. Through governance, global buyers want to ensure that the requirements are fulfilled by their suppliers. So, governance is a system in exercising control throughout the chain. Enforcing control is formulated in parameters set by buyers that outline what suppliers should do.

Generally, the form of governance can be distinguished into market and non-market. Market governance is when an exchange occurs based on the invisible hand of the market, whereas in non-market governance, an exchange in terms of relationships appears based on a deliberate working relationship between parties. In the governance, the relationship and position of lead firms with other participants in the range of activities can be distinguished as follows (Humphrey and Schmitz 2001):

(1) Arm's length market relationship

Buyers and suppliers are not in a close relationship. In other words, buyers give no special commitment to their partners.

(2) Networks

Global buyers cooperate in an interdependent relationship, since they share competence and interdependence. Their relationship is close, and they have more or less equal power.

(3) Quasi hierarchy

The global buyer controls the operation of the chains by specifying the characteristics of the products to be produced and sometimes the industries or processes to be followed and controlled. In this relationship, the other parties become subordinate to the other, such as through a sub-contracting relationship.

(4) Hierarchy

The global buyer controls the operation of the chain by controlling the ownership.

From the types above, Gereffi et all (2001) identifies the characteristics of governance: (1) coordination within value chains that can take various forms; (2) where there is powerful lead firms in the range of value chains; (3) governance structure: a relationship and institutional mechanism through which non market coordination of the chain is achieved; (4) involves the ability of one firm in the chain to influence or determine the activities of other firms in the chain.

Each type of governance describes different roles of lead firms in the range of activities. However, Gereffi (1994) stresses the importance of a quasi hierarchy or buyer driven commodity chains, in which powerful lead firms steer the entire chain. Four factors that promote the development of a quasi hierarchy are:

(1) An increasing use of product differentiation and innovation as the source of competitive advantage.
(2) An increase in requiring of products to meet safety, labor, and environmental market standards.
(3) A degree of task complexity and /or time pressure that requires a coordination of tasks across firms.
(4) an increase in the effort of global buyers in the labor intensive sector to look at low cost inputs for a new source of supply.

In order to control supply value chains, global buyers set key parameters that should be followed by local producers. These parameters are (Humphrey and Schmitz 2001):

(1) What to be produced; concerning the design of a product, whether in a broad conception or a detailed specification. This product parameter is needed when a product is an integral architecture product, which requires high customized components or when the buyer is more knowledgeable about the market than the supplier.
(2) How it is produced; regarding defining the production process, including elements such as technology to be used, quality system, and labor and environmental standards. The process parameter is needed when the chain contains risks, in which a buyer has potential losses arising from a failure to meet commitments (failure to meet quality, process standards and delivery time).
(3) How are physical products flows; about how much is to be produced, when and how the flow of the product along the chain is to be handled. This logistic parameter is needed when there is a degree of task complexity and

time pressure that requires a coordination of tasks across firms.

It should be noted that parameters set and enforced for certain products changed overtime due to changes not only in business but also in the social environment. Besides global buyers, some parameters are set by international organizations and enforced worldwide. In terms of quality, for instance, the issue is stressed through the theme of assurance and food safety standards. However, a change in the environmental factor caused consumers to change their standards in assurance and food safety standards not only in a narrow view, but also social and environmental standards in a broad sense (Nadvi and Waltring 2003). These standards have currently become global standard rules. Furthermore, international organizations have set up more complex standards and compliance with products and processes are required when products are sold, especially to developed countries. These standards are ISO 9000 for quality systems, ISO 14000 for environmental standards, and SA 8000 for social standards.

The increasing complexity of parameters that should be met by SMEs is getting more difficult overtime. This requires a fast change in upgrading capabilities and necessitates working closer with global buyers. Linking to global buyers is the fast track to acquisition of those capabilities. This link also enables firm buyers to transmit the best practices and provide hands on advice (and pressure). Moreover, the role of governance will be getting more important in the future as it determines the upgrading opportunity of firms. Meanwhile, lead firms are very demanding with regard to reducing cost, raising quality, and increasing speed. Thus, the prospect of upgrading depends very much on the type of relationships producers have with their buyers. This is the new challenge for SMEs from developing countries.

Inserting to GVC and the Upgrading

Experiences from firms in developing countries that are involved in the global value chain are varied. The fresh vegetable producers from Africa increased their production and exporting, since they were linked to supermarkets in the UK. As lead firms, UK supermarkets played a decisive role in structuring the production and processing of fresh vegetables exported from Africa. They structured the relationship with Zimbabwe and Kenya producers and processors in the quasi hierarchy form by setting up parameters that should be followed by firms in cost, quality, delivery, product variety, innovation, food safety, and quality systems. The governance has had an impact on upgrading since it indirectly increased the ability of producers and processors to meet international standard requirements. Dolan and Humphrey (2000) did not reveal whether the supermarkets provided assistance to the producers and processors in Africa. However, this relationship increased the dependence of small firms from those places.

Meanwhile, in the Sialkot cluster (Nadvi 1998), the role of foreign buyers is important in the success of firms to enter global markets. Long term relationships are established between local producers and reliable external buyers. Foreign buyers, importers, and manufacturers purchase not only high quality products but also cheaper and low quality ones. Foreign importers supply to wholesalers, retailers on medical end users, in Europe, America, and Asian countries, while manufacturers, especially German buyers, sub contract parts of the production to local producers. Inserting to global buyers provides access to technical know-how and emphasis on quality. The role of buyers not only enforces quality but also provides assistance and training in quality control and production to local manufacturers. Buyers are the primary source for ideas about new products, product development, and technical and marketing information. Ties with buyers provide access to new technology, know-how, and markets. Buyers visit regularly while most manufacturers go abroad at least once a year to consult with clients and seek new buyers. Buyers also give feed back on the design and product specifications that are sent to them. Most of the firms that have dealings with buyers for more than 5 years have frequent contacts. However, not all of the firms have an opportunity to be involved in value added ties with foreign buyers. For example, SMEs are more likely to trade with buyers who only concern about the low price and rarely have changed to get technical feedback or assistance in raising quality standards.

Foreign buyers changed the Torreon cluster (Bair and Gereffi 2001) to become more dynamic, in which Mexican domestic firms switched to become exporters involved in the assembly production of the blue jeans network for the US market. The lead firms were manufacturers who came first, and later the big buyers-retailers and brand marketers- modified the network of assembly works to full package. Due to requirements in quality and quantity standards that could not be met, they linked to the export network through assembly work in which undifferentiated US manufacturers or brokers were the decision makers. In the full package model, a local manufacturer received detailed specifications from the buyer responsible for acquiring the input and all parts of the production process. Upgrading occurs at the industry and firm level, as a result of switching to full package networks established. At the industry level, more backward linkages and values are being added in the region beyond the assembly activities, but design, product development, marketing and retailing have remained predominantly in the USA. A significant portion of full package orders is being handled by a small number of first tier manufacturers with the capabilities and capital needed to coordinate a full package network. Mexican firms later developed a direct link to export markets that eliminated the middlemen, like brokers or trading companies, which allowed them to enjoy higher profit. However, increasing competition led to pressure on local firms to reduce the production cost to a minimum in order to maintain competitive prices. The first tier manufacturers then exerted pressure on their sub contractors for the lowest possible prices and later this affected the wages for workers.

Liberalization in trade in Tamil Nadu (Dolan and Tewari 2001) forced the labor intensive textile or apparel sector to restructure themselves to maintain their competitiveness. Furthermore, their link with the global network caused the sector to become internationally competitive players and successful in securing a place in the overseas market and forging relationships with key customers. The power to govern the chain is not only derived from buyer competence in marketing, design or product development, and branding, but more specifically from their ability to coordinate the entire network. The upgrading took place due to the wide gap between market requirements and producer capabilities, in terms of knowledge required for production in the domestic market and export market. Upgrading occurred in terms of process, product, and functional upgrading by expanding backward and forward chains. The customers are small in number to define product standards and quality requirements, while they control brands, designs, and distribution. It acknowledges that linking into global buyers not only provides opportunities for upgrading but also carries risks, since suppliers are tied to a small number of buyers.

The governance exercised by buyers, in terms of setting parameters, has consequently not only affected the inclusion and exclusion of firms in the chain but also the opportunities they have for upgrading, moving into more sophisticated roles within the supply chain, or into the production of more sophisticated commodities. The various dimensions of parameters set up by customers provide different levels of upgrading capabilities. From the experiences above, upgrading occurs as a result of learning by exporting, buyers promoting the capabilities of producers from developing countries, or entering the value chain with more demanding customers. By linking to global buyers, knowledge required for upgrading flows down through the chain, and customers are the most important source of knowledge about processes and the market.

The learning process is an important aspect in the relationship between small producers and global buyers. Gereffi argues a model for learning mechanisms for firms in developing countries that are inserted in GVC. In his study on the apparel industry, Gereffi explains the process of upgrading that takes place in small firms through the following stages: (a) starting from the assembly of imported inputs, (b) continue to handle the full production process, (c) move to design products under other firms' brand, and (d) go with selling their own brands.

From the stages above, Gereffi illustrates how capabilities have improved. The first improvement is when producers take full package production or OEM. By this mechanism, local producers make the product from start to finish according to the design specified by buyers. Besides the production process, these firms learn the logistical knowledge about how to find all of the parts needed to finish the product. Moreover, in this process local entrepreneurs learn foreign buyers' preferences, including international price, quality, and delivery standards. Firms are also pressured to develop reliable supply sources for many inputs, force local producers to generate substantial backward linkages in the domestic economy. Through this relationship, knowledge and capabilities are transferred from buyers to producers. Expertise increases overtime and spreads across different types of activities. As suppliers, the small firms learn much about the down-stream and upstream segments from buyers. Later, local producers learn tacit knowledge that becomes powerful and competitive weapons. The second improvement is through patterns of organizational succession. Local producers are involved in this mechanism when buyers are willing to pay significantly more money for higher quality versions. As a result, the discounters and mass merchandisers were pushed out of their factories. In this stage, manufacturers upgrade their facilities as they meet buyer demands for more sophisticated products.

However, these stages of upgrading are refuted by other researchers that doubt whether stages c and d can be reached by small firms linking to global buyers (Humphrey and Schmitz 2001). A similar pessimism is also stressed by Schmitz and Knorringa (2000), who argue that global buyers will discourage upgrading to the design and marketing stage, since these capabilities are the core competencies of global buyers.

From the explanation above, it can be concluded that upgrading capabilities are important for SMEs as a competitive weapon in the international market. According to the GVC theory, these capabilities can be obtained when local firms are inserted into a GVC. The form of governance, which is formulated in the product, process, and logistic parameters are the prescription to be followed.

Conclusion

From the explanation above, it can be concluded that upgrading capabilities are an important factor for SMEs to compete in the international market. These capabilities can be reached through linking to the global network and the quasi hierarchy provides the highest opportunity for SMEs to get these capabilities. Although Gereffi argues for the pattern of learning mechanism, in which knowledge or capabilities are transferred from global buyers to local producers, scholars doubt the pattern is also found in other commodities. It is assumed that global buyers apply a high road strategy by relying on upgrading capabilities as a competitive weapon. In fact, not all global buyers are concerned with the high road strategy, as there are many who are more concerned about the low price and neglect the way of local producers pressing the cost and work condition.

The global value chain (GVC) framework places greater emphasis on global links than on the internal development of a particular country. It uses the definition of a network that is too inclusive, because it does not encompass any kind of organizational linkage but focuses more on a cross border network and less on an inter-organizational network within a country. This approach tends to neglect the role of institutional frameworks and other forms of local governance that might influence the cluster's upgrading strategies. Furthermore, the GVC approach does not focus on micro level factors contributing to growth.

Working with global buyers helps local producers in developing countries to upgrade in the sphere of production but not beyond that such as in designing and marketing. The GVC approach helps to understand the role of key actors in driving the chain and to explain the global dynamics of the links between local producers and global buyer within the chain. Although it opens access to the international market, the GVC creates a dependence of local producers on global buyers.

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