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RESEARCH ARTICLE

Foreign Investment and Upgrading in the Garment Sector in Africa and Asia

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Abstract

In many developing countries, the apparel industry is seen as a 'stepping stone' towards industrialisation. Countries rely on foreign investment to enter the garment sector by engaging in simple assembly production and aim to gradually upgrade along the value chain by building their networks and capabilities. By comparing case studies in Africa and Asia, this article shows that foreign investors contribute differently to upgrading and creating linkages. The study reviews the historical experiences of Bangladesh, Cambodia, Lesotho and Madagascar to understand the roles played by various types of foreign investors in contributing to upgrading. The model of production of these investors and their embeddedness in the host countries' markets shape their contribution towards upgrading. This has important policy implications, suggesting that government policies aiming to develop the garment sector beyond the assembly stage need to correctly identify and attract the investors that are most likely to be or become 'embedded'. The case studies also highlight the importance of creating a domestic class of entrepreneurs that can actively contribute to the development of the garment industry.

1 | INTRODUCTION

In many developing countries the garment sector is seen as a 'stepping stone' towards industrialisation. Garment manufacturing can be kickstarted with limited domestic capital and a skilled workforce. Leveraging foreign investment, developing countries can start producing garments quickly, achieving short-term benefits in terms of employment and exports, but also longer-term benefits such as skills development and creation of linkages. However, given the generally limited requirements in terms of capital intensity, investment and skills, international firms in this sector can also be footloose and volatile (Rotunno et al. 2013). Therefore, countries that want to unlock long-lasting benefits need to make sure to leverage foreign investment to upgrade their production structure.

In the context of global value chains (GVCs), along which most of the global garment industry is organised, upgrading involves organizational learning to improve the position of firms in international trade networks. Upgrading is not a given, and it depends on a variety of factors. This article assesses the role of foreign investment in promoting upgrading along the garment value chain by looking at case studies in Africa and Asia. The research question is whether foreign firms have differentiated spillovers in the export-oriented garment manufacturing sector in host countries. We argue that this is the case, and the main factor is the 'embeddedness' of foreign firms and investors (Morris & Staritz, 2014; Morris et al. 2011; Staritz & Morris, 2013) in the domestic garment industry.

We adopt a comparative sectoral case study approach. Considering the question from a comparative angle, looking at new entrants in the garment value chain in Africa and Asia, allows us to build on the existing development and business literature and to tease out differences in the ability of various types of foreign investment to support upgrading. Bangladesh, Cambodia, Madagascar and Lesotho are selected as case studies, as they are relatively successful latecomers to global garment production in the respective regions, and they offer diverse insights into the role of inward investors. To follow the evolution of the garment sector in each country, we rely on an analysis of the literature, and in particular on historical accounts of the development of the garment sector in the selected countries. The use of secondary data and historical accounts makes sense for two reasons. First, in some of our countries, the origin of the garment sector goes far back in time, making it difficult to collect primary data. Second, our case studies cover countries where the garment industry has developed quite successfully, and as such they have been widely studied, making it redundant to collect additional data, except for some specific questions. Our chosen method has limitations – in particular, the literature on some countries does not explicitly consider the role of foreign investors. In those cases, we used insights on the prevalence of foreign investors in the industry, and the sector's performance in terms of upgrading, to draw answers to our question.

The study is structured as follows: Section 2 reviews the literature on learning and upgrading along the value chain in the garment sector and beyond. Section 3 reviews the experiences of Bangladesh, Cambodia, Lesotho and Madagascar. Section 4 summarises the findings from a comparative perspective and section 5 concludes.

Policy Implications

- To contribute to the upgrading of the garment sector, it is important to promote locally-embedded Foreign Direct Investment and domestic investment.
- If policy makers are interested in upgrading the domestic garment, they should not encourage all foreign investment equally, but should try to prioritise those that may be more 'embedded' in their domestic production network.
- Alongside this, policy makers should incentivise domestic businesses, and create a class of domestic entrepreneurs that has a strong stake in the sector.

2 | A REVIEW OF THE LITERATURE

2.1 | Upgrading in the garment value chain

The modern garment sees many different firms operating along the global value chain, each type performing different functions. At the lower end of the chain, firms undertake simple assembly (or cut–make–trim, CMT) subcontracting according to the specification and with the inputs provided by buyers or by other firms. Often located in developing countries, these CMT firms supply little more than the space of production and the labour, often at low wages, and thus have low value-added and low margins. Firms undertaking original equipment manufacturing (OEM, also called full-package manufacturing or free-on-board, FOB) production are responsible for financing and sourcing the inputs, organising the production process, finishing and packaging the goods, and arranging for the final products to be shipped to a designated location. A step above are original design manufacturing (ODM) firms, which provide design functions; and original brand manufacturing (OBM) firms, which own the brand (Gereffi, 1999).

Upgrading refers to the capacity of a firm to increase the value-added of its products and processes (Giuliani et al. 2005; Humphrey & Schmitz, 2002). By upgrading, firms increase their technological capabilities or organizational and managerial skills (Lall, 1996). Firms achieve this via a conscious process of accumulated learning through experience which requires time and capital investment. Some of these skills are developed through 'codified knowledge' that can be written down and transmitted from firm to firm and from person to person. In other instances, they are formed through 'tacit knowledge' that is neither written down nor articulated orally and can only be learned through practice or imitation. Tacit knowledge requires frequent interaction between firms and individuals to be passed on, for example, through social networks in which firms are embedded (Whitfield et al. 2020).

In the context of the GVC literature, there exist various types of upgrading: process or product, functional or intersectoral upgrading (Giuliani et al. 2005; Humphrey & Schmitz, 2002). This article is concerned with functional upgrading, which entails 'moving up' the value chain acquiring superior functions in the chain, such as moving from CMT to OEM production, or from OEM to OBM, performing tasks that offer higher value-added. This requires deepening existing capabilities and acquiring new ones through a process requiring conscious planning and investment (Whitfield et al. 2020).

The frequently cited success cases of garment firms in East Asia moved through functional upgrading. Starting from CMT production, garment firms in Taiwan, South Korea, Hong Kong and Singapore started implementing additional tasks such as sourcing material and financing their operations, thus transitioning to OEM. These firms then became full-range package suppliers for foreign buyers, and coordinated complex production, trade and financial networks on their behalf (Gereffi, 1995). For countries that are currently involved in CMT production, the main question is how to follow the path of their East Asian predecessors, upgrading from CMT to become OEM, ODM and ultimately OBM manufacturing. In comparison, and as will be shown in the remainder of this article, many African producers remained stuck to the low steps of the production ladder.

2.2 | Foreign investment and garment sector upgrading

Many actors play a role in the learning and upgrading process of local firms. Some studies focus on the role of global buyers, highlighting that the ability of local firms operating within a GVC to upgrade is conditioned by the power asymmetry between them and their lead firms. In some cases, global buyers transfer knowledge to local firms, and in other instances they withhold it, thus hindering upgrading (Gereffi et al. 2005; Humphrey & Schmitz, 2002; Schmitz & Knorringa, 2000). Other studies assess the role of local firms themselves to upgrade, focusing on their agency to develop their own capabilities, learn and achieve technological progress (Pietrobelli & Rabellotti, 2011; Staritz & Whitfield, 2019). Local firms play an active role in absorbing knowledge and upgrading through their efforts to develop human capital, build ties with suppliers and component manufacturers, and gather market intelligence (Kadarusman & Nadvi, 2013).

This article focuses on the role of foreign investors in supporting upgrading in the garment industry. This has been long debated in the literature. Willingly or unwillingly, foreign firms can transfer knowledge to their local counterparts or competitors (Harding & Javorcik, 2012; Javorcik, 2004; Javorcik et al. 2018). Historically, many late developers, particularly those in Asia, have benefited from technology transfers generated through foreign direct investment (FDI) (e.g. Lee & Tan, 2006).

Insights on the role of FDI in upgrading come from several disciplines, including development economics, economic geography and international business studies (Buzdugan & Tüselmann, 2018). These bodies of literature identify several factors that affect upgrading through FDI. Some of these are related to the host country, such as its endowments and (static and dynamic) comparative advantages; tangible and intangible assets, including next-to-market and cost factors; and its business environment. Others focus on local firms' characteristics, such as their absorptive capacity (Cohen & Levinthal, 1990; Peng & Yu, 2021) influenced by factors such as their access to capital, or the technology gap between foreign and domestic firms (Amighini & Sanfilippo, 2014; Auffray & Fu, 2015).

Foreign investment may differ in their upgrading potential, based on the type of investment (greenfield, joint venture or acquisitions) and drivers of investment decisions (market-, resource-, efficiency- or strategic asset-seeking) (Farole & Winkler, 2014; Zhan et al. 2015). FDI objectives – including strategies towards investment, interest in subsidiary development, and links with productivity, skills and so on – also affect upgrading (Cantwell & Mudambi, 2011; Kano et al. 2020). Another factor that matters for the role of FDI in upgrading is the embeddedness of the subsidiary in the wider multinational corporation (MNC) network, as well as in the host countries, to access locational advantages and assets (Meyer et al. 2011). Others focus on the embeddedness of foreign investors in the domestic garment sector, highlighting its importance in upgrading (Morris & Staritz, 2014; Morris et al. 2011; Staritz & Morris, 2013). Social networks influence how firms interact with the local, regional, and global relationships in which they participate (Hess, 2004). For instance, diaspora investors usually have wide social networks linking to their country of origin, that help them leverage finance and knowledge (So et al. 2001). Foreign firms whose country of origin is geographically close to the host country are often more embedded in the host country and can more easily tap into both global and local resources (Morris, Plank et al. 2016).

However, foreign firms may also not be well suited to support local upgrading owing to their mobility and 'footloose' nature. Foreign investors may be attracted by government incentives, market access and attractive cost factors, but as soon as these conditions are no longer in place, 'footloose' investors will leave the country, with negative implications for upgrading. Therefore, attracting FDI does not, in itself, guarantee upgrading, and it can even relegate a country's domestic manufacturing to simple, routine and low-value-added CMT activities. In these cases, while learning may be rapid at first, over time there may be no incentive for the foreign investors to promote domestic upgrading over moving to new low-cost production sites (Gereffi, 2014). In reality, empirical evidence shows that the ability of FDI to promote upgrading varies widely. In some cases, foreign companies are found to invest little in building human capital (Nolintha & Jajri, 2016).

In summary, the existing literature points to a variety of outcomes in terms of FDI and upgrading, but it does not explain which investors are more conducive to upgrading, and which ones are likely to reinforce the position of local firms at the low-end of the value addition spectrum. Therefore, what should governments interested in upgrading their garment industries do? Should they open their doors to all foreign investors, or should they target specific firms which are more conducive to upgrading? Who are these investors, and what makes them different? What can historical experience teach us in this regard? The remainder of this study disentangles the impact of various types of FDI on upgrading and attempts to identify which kinds of foreign investment may be more conducive to upgrading, and why.

3 | COUNTRY CASE STUDIES: A HISTORICAL OVERVIEW

3.1 | Bangladesh

At the time of writing, Bangladesh is among the top ten largest textile and garment exporters in the world, mainly supplying Europe and the United States. The garment industry represents almost 10 per cent of the country's gross domestic product (GDP).

The beginning of the garment industry in Bangladesh dates back to the late 1970s. In 1977, a collaboration agreement (not a joint venture) between a Bangladeshi businessman and the South Korean conglomerate Daewoo led to the creation of Desh Garments Ltd (Rhee, 1990). This collaboration involved limited financial investment, with Daewoo instead focusing on providing guidance to Desh Garments, building capacity and transferring knowledge in the process.

The successful collaboration between Desh Garments and Daewoo was pivotal for the Bangladesh garment sector and had several effects:

- *Building capacity*. One hundred and thirty Bangladeshi workers and managers were trained in South Korea for six months. They returned to Bangladesh, to work in a factory built according to Daewoo's specifications (Yunus & Yamagata, 2012). The workers were exposed to the systems and operations of Daewoo and received comprehensive training in shop floor work; factory management; international procurement and marketing. The trainees went on to train other Desh employees to pass on the skills they acquired (Rhee, 1990).
- *Transferring skills*. Some of the 130 trainees went on to set up their own factories (Rhee, 1990), while those with little or no financial means became managers in, or traders for, newly established entrepreneurs (Mottaleb & Sonobe, 2011). This led to the rapid circulation of skills beyond those who took part in the original training.
- *Building trust as a supplier*. The role of Daewoo as an established firm was critical in transforming Bangladeshi firms into trusted suppliers. Daewoo initially mediated deals between Desh Garments and overseas buyers to establish Desh Garments's reputation as a credible producer, and gradually enabled other Bangladeshi firms to access the international market as trusted suppliers (Rhee, 1990).

The early stages of the modern garment industry in Bangladesh saw a prevalence of CMT-type firms, importing inputs from South Korea and exporting the final product to European and American markets. Though CMT remains the prevalent model for woven products, there now exist more vertically integrated operations, starting from cotton or yarn to produce the final products (mostly knitwear) (Fernandez-Stark et al. 2011). Bangladesh does not export textiles, but it imports cotton to produce textiles for the domestic industry, therefore showing some success at vertical integration and upgrading (Moazzem & Sehrin, 2016).

The Bangladeshi garment sector is dominated by domestic firms (Fernandez-Stark et al. 2011). This was made possible through former Desh Garments's employees who went on to set up their own businesses, or helped others do the same (Rhee, 1990). The extraordinary performance of the firm generated interest among domestic entrepreneurs who could provide finance and human capital but had little knowledge of the garment sector. They hired former Desh Garments's employees to manage their firms or worked with them as traders, which enabled the transfer of knowledge and skills (Mottaleb & Sonobe, 2011). Thus, the garment industry in Bangladesh grew through a ‘demonstration effect’ generated by the success of Desh Garments, and through ‘labour circulation’ of former Desh Garments's employees.

Once Bangladeshi entrepreneurs got a stake in the garment sector, they expanded their operations to capture more of the value of production and increase their gains. They started lobbying actively with their government, through their association, the powerful Bangladesh Garment Exporters and Manufacturers Association. Over time, the government introduced policies aimed at improving vertical integration, such as the establishment of export processing zone (EPZ) regulations which required backward linkages, encouraging the establishment of knitwear factories; and upgraded labour regimes which improved workers' rights (Fernandez-Stark et al. 2011; Moazzem & Sehrin, 2016).

Government policies also played a role in supporting the development and upgrading of local capacity in Bangladesh's garment sector. While the Bangladeshi government gradually lifted controls and restrictions on foreign investment from the late 1970s onwards, which enabled firms like Daewoo to enter the market, the government mostly only allowed investments in areas where domestic firms lacked capacity. This paved the way for the second generation of Bangladeshi firms to enter the garment sector after the initial wave of foreign investment, building on the knowledge gained about production processes and the networks of suppliers and customers established initially through the presence of a foreign company. Specific policies were introduced to create backward linkages, including financial incentives to encourage imports of raw materials and machinery for domestic textile production and EPZ regulations mandating backward linkages to spinning, weaving/knitting, dyeing and finishing, which encouraged the development of knitwear factories (Fernandez-Stark et al. 2011). Further government support for upgrading included a back-to-back letter of credit facility to aid imports of raw materials, a duty-free import allowance for capital machinery, raw materials and intermediate products used in export-oriented industries, a cash subsidy of 5 per cent of the value of fabrics for manufacturers of indigenous fabrics supplying fully export-oriented industries, and financial support – including subsidised credit – through an export promotion fund (Moazzem & Sehrin, 2016). Many of these policies were introduced in response to needs voiced by the private sector.

3.2 | Cambodia

Cambodia started producing and exporting garments in the 1990s and, by 2019, garment and textile products made up almost 60 per cent of Cambodia's total exports, a ratio among the highest in the world. The country exported over US$8 billion worth of garments and textiles, of which 99 per cent were garments, mainly to the US, Europe, Canada and Japan. Cambodia benefits from duty-free and quota-free market access through several Generalised System of Preference (GSP) schemes, including the EBA scheme for least developed countries.

In the mid-1990s, the country opened up to FDI. Foreign investors could easily set up shop in the country and enjoy the same benefits as domestic producers. Moreover, the 1994 law on investment granted tax concessions and incentives, including tax holidays, low corporate tax rates, tax-free reinvestment of profits and tax-free repatriation of earnings, and import duty exemptions. Furthermore, the Cambodian government made it easy to obtain work permits for foreign experts (Bargawi, 2005; Hossain, 2010). Market access was the single most important reason for foreign investors to set up shop in Cambodia, while low wages were of secondary importance (Bargawi, 2005).

The garment industry began to grow rapidly after 1997 when Cambodia was granted most-favoured nation status by the US and signed a framework cooperation agreement that allowed access to EU markets under the GSP. The US expanded quotas on Cambodia's exports in 1999, enabling the rapid growth of the sector. In addition, in 2005, the EU and US limited quotas on exports from China, which prompted many Chinese producers to relocate part of their production to Cambodia. Though quotas on China were lifted in 2008, the increase in Chinese workers' wages allowed Cambodia to remain a competitive platform for garment production (Asuyama & Neou, 2012; Bargawi, 2005).

The combination of an initial lack of quotas, an open trade regime and an FDI-friendly investment environment, together with preferential access to the EU and other markets, made Cambodia a suitable destination for investment in garment manufacturing. These factors also shaped the salient features of the sector observed today. The first feature is the prevalence of CMT firms having very limited opportunities for domestic value addition. Around 60 per cent of producers work on a CMT basis, operating at low profit margins. Firms based in Cambodia import all materials and inputs from China, Hong Kong, Taiwan and South Korea, cut the fabrics and stitch them together, before exporting the final product (Asuyama & Neou, 2012; Natsuda et al. 2010).

The second, and related, feature of the Cambodian garment industry is its reliance on foreign capital. Around 90 per cent of the garment firms operating in Cambodia are foreign, with the majority coming from China, Taiwan, Hong Kong and South Korea (Hossain, 2010). Of the 615 member companies of the Garment Manufacturers Association in Cambodia, only 45 have Cambodian owners; 118 are Taiwanese-owned and 65 are Hong Kong-owned (Balchin & Calabrese, 2019). Foreign companies could thrive in Cambodia as they enjoyed access to capital and expertise that Cambodian companies, weakened by years of civil war and the presence of a limited financial system, did not have. Foreign companies also had access to networks of clients and sources of inputs and could rely on their expert managers and skilled labour (Asuyama & Neou, 2012).

The CMT model and the high degree of foreign ownership led to the third feature, the lack of vertical integration. The presence of a large number of foreign firms that are not vertically integrated in Cambodia stifles their need to invest in backward linkages domestically and makes value chain upgrading in Cambodia a challenging process (Natsuda et al. 2010). Similarly, the lack of a domestic textile industry in Cambodia has prevented the development of more integrated production, while the production models of the dominant foreign firms operating in the country, which rely on extensive international sourcing networks, have created few incentives to invest in backward linkages domestically or upgrade local suppliers and domestic value chains (Natsuda et al. 2010).

Thus, while the FDI-friendly environment facilitated foreign investment in Cambodia, the lack of a pro-active government policy to promote domestic investment has not encouraged production in the country to move beyond basic CMT activities. Consequently, in contrast to Bangladesh and Madagascar (discussed below), there is a clear absence of local exporting firms in Cambodia which, as we examine below, is also a feature of the sector in Lesotho.

3.3 | Lesotho

Lesotho is widely regarded as an African success story in export-oriented manufacturing. Preferential trade and access to key markets, together with FDI, played a key role in kick-starting industrialisation centred on garment manufacturing.

Lesotho welcomed different waves of foreign investment, spurred by varying motivations and characterised by contrasting business models. In the early 1980s, motivated by a desire to capitalise on Lesotho's low-cost labour and duty-free access to Europe, as well as to avoid apartheid-related sanctions (Morris & Staritz, 2017), some Taiwanese-owned firms based in South Africa relocated plants to Lesotho. This was followed by further waves of investment from Taiwanese firms looking to capitalise on Lesotho's underutilised MFA quotas and the country's eligibility for Africa Growth and Opportunity Act (AGOA) preferences (with the added benefit of the third-country fabric derogation) after 2000, as well as to take advantage of the country's various FDI incentives (Morris, Barnes et al. 2016; Morris & Staritz, 2017). South African regional investors also relocated production to Lesotho in successive waves from the late 1980s, initially in the wake of apartheid-related sanctions on South Africa. In the 1990s, a second wave of South African investors relocated to Lesotho in response to lower tariffs on imports into the South Africa market, which made supplying that market less attractive. A third wave of South African investment was motivated by the promise of lower costs (both labour and overheads), greater labour market flexibility and duty-free access to SACU (Morris & Staritz, 2017). Foreign firms were also attracted to Lesotho by the early-stage FDI incentives offered by the government (Morris & Staritz, 2017), which also established industrial zones and provided serviced factory shells with subsidised rent (Shakya, 2011). These zones were located close to links with South Africa's road network to facilitate the transport of textiles and apparel to ports in Durban and East London and onward for exporting.

The contrasting strategies, business models and ownership and governance structures of the Asian and South African foreign investors attracted to Lesotho have had differential implications for upgrading and the broader industrialisation of the country's garment sector. Investment from Asian (mostly Taiwanese) transnationals in Lesotho since 2000 has been concentrated primarily in production units focusing on CMT activities to capitalise on AGOA trade rents and MFA quotas. In operating a disembedded, export-oriented production model based on preferential market access, these firms are generally not locally embedded in Lesotho, but instead use foreign networks for input suppliers and agents working with sourcing and buying offices (Morris, Barnes et al. 2016). While these firms brought knowledge and capabilities related to production set-up and processes through their initial investments, and helped link the sector in Lesotho to GVCs, they have not generated major process innovations or made significant investments to improve technology, capital or skills (Staritz & Morris, 2013). The focus on securing AGOA trade rents as part of an overriding strategy of global cost containment for exporting globally, rather than other strategic reasons for locating in Lesotho, stifles the need for investment in upgrading and skills development and disincentivises diversification (Edwards & Lawrence, 2010; Morris, Barnes et al. 2016; Staritz & Morris, 2013). Instead, with global production strategies focused on producing narrow ranges of basic products for export, local skills advancement through Taiwanese firms has mostly focused on basic production skills (e.g. on-the-job training for handling sewing machines). In addition, with market access the primary consideration, many Asian transnational producers left Lesotho after the phase-out of the MFA, leading to a notable decline in the country's exports (Whitfield & Staritz, 2021).

In contrast, South African firms investing in Lesotho operate a different production model. They are generally more locally embedded within a regional production network and have direct relationships with South African retailers. Motivated by a regional displacement strategy that hinges on relocating more functions to Lesotho (Morris & Staritz, 2017; Morris et al. 2011), these firms focused on establishing a regional value chain involving Lesotho to capitalise on lower labour costs and duty-free access to SACU markets (Kao, 2016). The South African-owned firms have recently been driving some upgrading to focus on producing shorter runs of more complicated products with higher fashion content to supply South African retailers. This contrasts with the long runs of basic or semi-basic items produced by Taiwanese firms for the US market in simple assembly facilities in Lesotho (Morris & Staritz, 2017).

In contrast to Bangladesh and Madagascar (discussed below), Lesotho has virtually no locally owned garment factories. Capacity and competitiveness limitations deter foreign-owned firms from sourcing locally from indigenous enterprises (Morris and Staritz, 2016). Further upstream, the domestic textile industry in Lesotho is non-existent and the country produces almost no fabric due to a lack of local fabric mills (apart from the Formosa Textile Mill, which produces denim textiles). This owes, at least in part, to the presence of the AGOA third-country fabric provision, which allowed firms based in Lesotho to import fabrics and engage only in the final stages of production for export, further reducing incentives to source locally. In line with this, the focus is on the downstream assembly of textile and garment products, using imported raw materials, with very limited integration upstream and little value addition. Production is highly routine and mostly concentrated in a narrow range of low unit value products in large volumes (Edwards & Lawrence, 2010).

3.4 | Madagascar

Since the early 2000s, Madagascar's economy has relied heavily on the export-oriented textiles and garment sector for jobs and revenue. The government's industrial policy was based on the adoption of a single factory EPZ model which allowed firms to benefit from a range of incentives, including duty exemption on capital transfers, tax holidays and concessions (Landry & Chen, 2021; Morris & Staritz, 2014). Alongside the EPZ incentives, preferential access to key markets (the EU, US and the Southern African Development Community, SADC) also served as an important motivation for locating production in Madagascar. Garment exports to the US were boosted heavily by the introduction of the AGOA, which stimulated growth in garment production from 2000 onwards (Morris & Sedowski, 2006). However, Madagascar's loss of AGOA benefits between 2010 and 2014, following a political crisis, prompted most of the Asian-owned firms focused on supplying the US market to relocate their operations away from Madagascar (Landry & Chen, 2021).

FDI from Asian, European diaspora and Mauritian regional investors has been a key driver of growth in Madagascar's highly export-oriented garment industry. However, in a similar manner to the sector's development in Lesotho, different types of inward investors have made varied contributions to upgrading, based on the differentiated nature of their GVC relationships, their level of local embeddedness and the varying end markets they have targeted (Staritz & Morris, 2013). Asian-owned firms investing in Madagascar operated a ‘both-ends overseas’ model mostly focused on CMT activities (Landry & Chen, 2021). These firms, many of whom were focused on supplying the US market and exited after the MFA phase-out at the end of 2004 or when Madagascar lost AGOA eligibility in 2010, tended to source fabric and other inputs from their own mills in Asia, which was made possible by the AGOA’s single transformation provision. While the involvement of these firms helped link Madagascar-based production into GVCs, it resulted in limited upgrading. In contrast, the export-oriented European diaspora investors (primarily French) were, and continue to be, more locally embedded in Madagascar. On the back of their historical roots in the country, they have set up head offices and decision-making functions within Madagascar. Their access to European networks and buyers provides powerful linkages to end markets (Morris, Plank et al. 2016). Similarly, the Mauritian firms with established regional production networks (and operating regional sourcing strategies) relocated basic production to Madagascar in the 1990s to access cheaper labour and capitalise on underutilised quotas. This enabled their production in Mauritius to shift to higher-value products and value chain segments (Morris, Plank et al. 2016). These firms have followed a process of upgrading that is regional in scope, and have demonstrated a higher propensity to upgrade in Madagascar compared to other foreign-owned firms (Morris & Staritz, 2014; Staritz & Morris, 2013).

Variation in the end markets targeted by different types of inward investors in Madagascar has also influenced upgrading. Whereas the Asian-owned firms operating in Madagascar export mainly to the US, the European and Mauritian investors, as well as some local Malagasy firms, export predominantly to the EU and, more recently, to South Africa. Buyers in the EU typically place greater emphasis on versatility and flexibility and often expect producers to make contributions to the design and product development, whereas US-based buyers usually provide strict specifications for producers to follow. The Asian-owned firms have taken on simple CMT activities in Madagascar as part of a strategy to undertake relatively basic long-run production for the US market. They emphasise efficiency in high-volume production to meet the specifications dictated by US buyers and thus prioritise improvements to processes rather than product or functional upgrading (Staritz & Morris, 2013).

Mauritian and European investors in Madagascar have played an influential role in regionalising exports towards South Africa and/or boosting production for the European market. Exports to the latter were not significantly affected by the elimination of MFA quotas at the end of 2004, meaning the growth of European diaspora, Mauritian and local firms supplying the European market helped the industry in Madagascar to rebound after the MFA phase-out. In addition, the diversification of exports has supported process and product upgrading in Madagascar. The loss of Madagascar's AGOA eligibility in 2010 forced them to shift to shorter-run, smaller-batch, higher-quality and more complex products to supply regional markets (especially the South African market) as well as Europe. This shift was possible because the Mauritian investors had a regionally embedded production network and were able to utilise management capabilities in a flexible manner (Morris & Staritz, 2014). The EU and South African markets, which demand smaller batches of differentiated products with higher unit values, are more stringent in processes and production capabilities. The shift to producing these types of products in Madagascar, in some cases through sub-contracting arrangements with local firms, has had positive impacts on upgrading, product quality and local skills (Kaplinsky & Wamae, 2010; Morris, Plank et al. 2016; Morris & Staritz, 2014).

Local firms in Madagascar benefited from proximity to regional assets operated by Mauritian-owned firms and their regional supply chain upgrading processes; and enjoyed access to an experienced pool of production managers as well as textiles and other inputs (Whitfield & Staritz, 2021). Through transnational social relations and networks, some local firms were able to leverage the presence of foreign-owned firms to learn and upgrade their capacities (Whitfield & Staritz, 2021). This was facilitated in different ways depending on the type and source of investment, varying from joint ventures with Mauritian investors, to buyouts of existing French firms and partnerships with French stakeholders or investors from Hong Kong (Whitfield & Staritz, 2021).

As a result, and in contrast to the absence of local firms in Cambodia and Lesotho, the split between local and foreign-owned firms operating in Madagascar's export-oriented apparel industry is fairly even – with 31 local versus 38 foreign-owned firms as of 2019 (Whitfield & Staritz, 2021). The local firms generally produce small volumes of niche and high-value garments for European markets (Whitfield & Staritz, 2021).

4 | THE ROLE OF FOREIGN INVESTMENT IN UPGRADING: A COMPARATIVE DISCUSSION

The four case studies reviewed here offer insights into the drivers of upgrading in the garment sector, highlighting the roles foreign investors play in contributing to upgrading. The literature shows how foreign investors can support or hinder upgrading, depending on both their own characteristics and those of the country and industry they operate in. But are 'foreign investors' a uniform category, generating uniform outcomes? Or does their impact on upgrading differ, even within the same country? While the literature seems to veer towards the latter, it does little to explain how various investors differ, and what is the contribution in terms of upgrading. By comparing four case studies, our article shows that what matters for foreign investors' contribution to upgrading is their level of 'embeddedness' (Morris & Staritz, 2014; Morris et al. 2011; Staritz & Morris, 2013).

In Bangladesh, a foreign firm kick-started the emergence of a competitive garment sector. Daewoo was instrumental in transferring knowledge and technical skills to Bangladeshi workers beyond the traditional shop floor, while also providing links to input suppliers and buyers in end markets, and this helped facilitate the emergence of domestic firms and enabled upgrading of local capacity. The Daewoo–Desh Garments partnership did have a positive impact on firms in the garment sector, which in the longer term contributed to developing supplying industries as well. This case illustrates the 'embeddedness' of local firms at play. As the Bangladeshi entrepreneurial class entered the garment sector, they had reasons to ensure that more of the value is captured domestically, rather than by foreign firms, and supported upgrading of the industry. This also solved the issue of mobility of capital, as (at least part of) domestic capital is bound to remain in Bangladesh, ensuring sustained upgrading.

In stark contrast, garment factories in Cambodia undertake CMT activities, and there is little evidence of diversification or vertical integration in the sector. The garment sector is dominated by Asian transnational investors operating disembedded production models, who use Cambodia as a base for exporting. All production and sourcing decisions remain in the headquarters of the foreign firms. Foreign investors have no interest in lobbying the government to promote domestic value addition, and therefore the Cambodian government has shown limited interest in incentivising value addition. In Cambodia we have a prevalence of disembedded foreign firms, which have limited stakes in the industry and therefore can leave the country whenever better opportunities arise. This type of foreign investment is not conducive to upgrading.

Lesotho offers a comparison between two different types of FDI. In a similar manner to the Cambodian case, investment from Asian transnationals has been defined by a global strategy targeting long-run production of a narrow range of basic products for export to capitalise on trade rents accruing through market access preferences, and thus focused only on CMT production while retaining the main sourcing and marketing decisions in their headquarters and drawing from a worldwide sourcing network. The benefits of this type of FDI in Lesotho have largely been limited to employment and exports. In contrast, by operating a regional production network, investment from South African firms in Lesotho's garment sector has been notably more locally embedded. By harnessing geographical proximity to the destination market of the garments, and catering to the relatively higher level of product sophistication required by South African brands, FDI from South Africa has helped to upgrade the capacity of producers in Lesotho.

The case of Madagascar similarly highlights the varied impacts of different types of FDI and their motivations on upgrading and capacity building in the domestic sector. Asian firms operating a 'both-ends overseas' production model and attracted to Madagascar by the market access opportunities helped link Madagascar-based production into GVCs but contributed little to upgrading in the sector. In contrast, Mauritian firms with established regional production networks and sourcing strategies, and French firms with historically embedded roots in the country and links to European networks, buyers and end markets, were considerably more embedded in local and regional markets, and demonstrated a greater propensity for upgrading, to meet the more demanding processes and production capabilities necessary to supply the European and South African markets. This has helped develop a local cadre of export-focused Malagasy garment firms producing smaller batches of differentiated products. It has also helped the sector in Madagascar to recover from external shocks, including the phase-out of the MFA and the loss of AGOA eligibility.

The four case studies demonstrate that foreign investment can be crucial for upgrading. FDI has played a central role in kickstarting the garment industry in all four countries, but moving up the value chain has not been straightforward. In most settings, the investment of Asian transnational firms with disembedded production units has been motivated primarily by a desire to benefit from preferential market access. This investment has generally brought little backward integration or upgrading. This is evident from the experiences of Cambodia and Lesotho, where the dominance of foreign investors has been a deterrent to value chain integration and stifled the development of indigenous capacity and the emergence of locally owned firms. In contrast, domestic or regional investors with regional production networks and diaspora investors have been more locally embedded, and have helped to drive upgrading. It is not the nationality of investors that matters here; rather it is the role they play in the value chain and the stakes they have in the host country's garment industry.

The case of Bangladesh highlights the importance of domestic producers, the recipients of the knowledge transfers of foreign firms. Our analysis builds on the 'agency' argument (see, for example, Kadarusman & Nadvi, 2013; Staritz & Whitfield, 2019) to emphasise that domestic firms are not only responsible for their own upgrading, but also contribute to creating an environment that encourages upgrading for other firms as well. In Bangladesh, domestic firms have been instrumental in lobbying their government to introduce incentives for upgrading, making Bangladesh the most vertically integrated among the four case studies. In that sense, domestic firms have shaped the domestic industry environment.

5 | CONCLUSIONS AND POLICY IMPLICATIONS

In the garment sector and beyond, foreign investment is deemed an important tool to bring in technology and transfer knowledge to local firms, thus facilitating the development of the sector. This article demonstrates that not all foreign investment is equal in this respect. It shows that it is not the nationality of the investors that matters, but rather their modes of production, business strategies and levels of embeddedness in the domestic sector. These factors shape and influence their incentives for investing in upgrading and developing local capabilities. This article builds on the finding of earlier case-study based literature (Morris & Staritz, 2014; Morris et al. 2011; Staritz & Morris, 2013) to identify embeddedness as the most crucial factor in determining whether foreign firms will support upgrading. Foreign firms that are more embedded in the domestic industrial environment relocate (part of) their more complex operations, including the decision-making process, in the host country. By doing so, they contribute to transferring knowledge and therefore to upgrading. On the contrary, more disembedded and 'footloose' firms do not have an interest in, and most likely will not have an effect on, upgrading.

This article contributes to the literature and builds on studies such as Morris, Plank et al. (2016) by showcasing different examples from Asia. The study also poses new practical considerations for countries looking to attract investment into the garment sector and other light manufacturing industries, including: how to encourage investors to become more embedded? How to design policies that will incentivise them to invest in the upgrading of firms in the countries where they work? How to maximise their spillovers to local economies? These questions have very practical policy implications. The findings of this article suggest that governments that aim to develop their garment industry should try to attract mostly 'embedded' type of foreign investors.

Our findings have important policy implications, suggesting that any host government aiming to develop their garment sector beyond the assembly stage needs to provide the right set of incentives for investors to upgrade. Beyond the initial stages of development in a sector, it is important to incentivise investors to contribute to upgrading and be willing to relocate some of the investment decisions in the country. This can be done through specific policies that support the development of the necessary skills and networks to upgrade the sector.

Beyond the role of foreign investors, this article recognises the importance of the agency of domestic firms, as highlighted by Whitfield et al. (2020). This is critical and needs to be considered in conjunction with foreign investment.

CONFLICT OF INTEREST

The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

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DATA AVAILABILITY STATEMENT

Data sharing is not applicable to this article as no datasets were generated or analysed during the current study.

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