CHAPTER 1
INTRODUCTION

1.1 Background to the Study
This thesis attempts to explore the relationship between export orientation and industrial clustering in a traditional industry\(^1\) in a developing economy. The case that is examined is that of the leather and leather products industry in India. This industry is an interesting case study for an exploration of the dominant concerns of this thesis, which are to do with the factors contributing to change and development in traditional industries that are dominated by small firms and the possible development paths open to such traditional industries dominated by small firms that are export oriented and organised in the form of industrial clusters.

The question of the role and relative importance of small firms in economies in general and in developing economies in particular has been discussed extensively from the nineteen seventies onwards. It has been observed that while the inherent logic of capital causes firms to grow in size such that large firms tend to dominate in size and importance as economies advance, small firms also play an important role in differing ways due to their capacity to generate employment, their diverse production structures and flexibility of response. Even in several advanced economies, the share of output and employment contributed by small firms has been substantial and it has been suggested that there has been a shift in size distribution towards small firms in a large number of countries. The contrasting cases of the USA, where the share of small firms is relatively low and of counties like Japan and Italy, where the share of small firms has been high, suggest differing paths and institutional contexts of small firm growth.

\(^1\) Traditional industry here refers to one using technology and producing products that have a pre-colonial origin, where the use of hand-tools has been prevalent for a long period of time, where a large part of production has historically been in households and small enterprises and even today continues to be true for several segments in the industry. Apart from these aspects of production organization, the term traditional has been used also to indicate the intertwining between social relations such as caste and community and economic activity.
In developing economies, given the importance of small firms, the discussion around small firms and their contribution to the development process centred for a long time around specific constraints faced by them, their relevance and viability in the long term and to what extent and how they should be promoted. In the last couple of decades or so, a vast volume of literature has come up around the phenomenon of industrial clustering, with the focus shifting from the individual firm to a group of firms organised in the form of industrial clusters. It has been seen that industrial clusters offer a form of organisation for small firms that allow them, in specific production and institutional contexts, to overcome constraints associated with isolated existence and achieve growth and efficiency. The production context consists of the existence of decomposable production processes that permits the specialisation of operations/products between different firms that enter into relationships with each other that can be competitive and co-operative at the same time. The institutional context consists of common social linkages between agents in the production process that set implicit norms for behaviour and make co-operation possible, and intervention by the State or other institutions that address constraints faced by individual firms as well as create the conditions for co-operation. Given these conditions, industrial clusters are seen to have been able to overcome the difficulties of isolated, small-scale production, with the cluster as a whole exhibiting certain features of a giant firm. In addition, in specific kinds of industrial clusters labelled industrial districts (to be elaborated below) that have been seen in Italy and other European countries, this efficiency and performance has also resulted in high rewards to labour in terms of pay and working conditions.

These possibilities are especially relevant in traditional industries that are highly employment intensive, have artisanal roots and where social relations are intricately woven into the production structure, apart from the decomposability of production processes and the possibility of linkages emerging between firms. Apart from the possibilities for growth and efficiency of small firms in industrial clusters, it has also been seen in more recent years that many export oriented clusters have seen a great deal of dynamism, giving rise to a vast literature that argues that export orientation offers a viable development path for industrial clusters in different sectors.
The leather and leather products industry has been chosen for this study because it is a traditional export oriented industry on the one hand, as well as one that is organised primarily in the form of small-firm dominated industrial clusters on the other. It is also a sector where social factors have played a major role in shaping economic organisation. The nature and evolution of the organisational structure of both the industry and the firm have been shaped by three factors: insertion into global markets from the colonial period, historical and contemporary links with traditional leather working castes and communities and State intervention in terms of government policy that primarily shaped the nature and degree of export orientation. At present, about 46% of the production in the sector is exported and it ranks fourth in the list of India’s top export earning industries. A large number of people engaged in the industry (entrepreneurs as well as workers) are even today from traditional leatherworking castes (belonging to the lower castes in the caste hierarchy) and the Muslim community. State intervention has been crucial in this sector with government policies emphasising export orientation and value added production primarily geared towards exports. The sector is dominated by small-scale firms that have existed in the traditional artisanal segments, those that have come up as a result of a policy of small-scale reservation of important segments in the industry, as well as those that have come into existence due to the specific production conditions in the sector, which make small size viable on its own terms. There also exist a significant number of medium and large sized firms in all segments of the industry, a large number of these having come up primarily to cater to the export market. The industry is concentrated in several leather clusters in four or five distinct locations in the country, with each cluster containing a wide variety of enterprise forms and organisational structures. Each of these clusters, even though dominated by small-scale firms, have a wide spectrum of firms, varying from tiny firms at one end to large, integrated firms at the other, with a large variety of intermediate size firms in between.

Despite the leather and leather products industry being export oriented from colonial times and being a thrust sector for exports from India from the nineteen sixties onwards, it has progressively lost share in important segments in the international market. Its export growth in absolute terms has also declined since the nineteen nineties, reversing a trend of impressive export performance in absolute terms in the past. At present, its export performance both in terms of rates of growth and shares in
the international market is declining. In this context, an exploration of the relationship between export orientation, industrial clustering and performance is especially relevant in order to analyse the links between organisational structure, its determinants and performance. This study explores this relationship with a detailed study of two important leather clusters, Madras and Calcutta. The two clusters were chosen because they are both representative of the industry, in the sense that all stages of leather and leather product production are done in these two clusters. They have also existed as important centres ever since leatherwork became an important economic activity catering to colonial trade. In addition, landmark developments, both historically and in more recent times, have impacted significantly on production and organisational structure in both these clusters. While there are similarities between Madras and Calcutta in terms of their relative composition and pattern of growth, there are also interesting contrasts in terms of the social composition of the agents in the industry. Also, social relations affect economic activity crucially, as seen in clusters in many parts of the world. This is another reason why these two clusters were chosen, as they provide fairly distinct patterns of the interaction between social institutions and economic activity. Within the industry as well as in available research on the industry, comparing and contrasting these two clusters is routine and often questions are raised as to which cluster’s productive performance has been better and where organisational structures have been more efficient.

1.2 The Dominant View and The Main Questions.

Two sets of arguments constituted the starting points for this study and generated the main questions that were explored. The first set of arguments emanates directly from the vast literature on the phenomenon of industrial clustering that has come into existence since the late nineteen seventies or so. The second set of arguments emanates from the analysis of the leather industry in India that has been done by one of the very few studies available on the subject (Banerjee and Nihila 1999), as well is echoed in publications by the Central Leather Research Institute and several bodies of the industry. This has to do with the role played by institutions in developing

---

2 This thesis refers to the two clusters as Madras and Calcutta and not Chennai and Kolkata as they are known at present. This is because this is an industry that began its development in colonial times and it is routine in the industry to refer to the clusters by their old names, indicating a historicity in its development.
economies and specially, the role played by social institutions in the leather industry in India in relation to export performance.

The literature on industrial clustering is diverse in the questions raised as well as in the analysis of factors that determine organisational form and performance in them. However, in more recent years, some dominant arguments can be identified which have both steered the course of academic discussion as well have been crucial in influencing policy formulations for industrial clusters. Similarly, policy formulations for the leather industry in India reflect an understanding of the industry that is similar to that put forward by Banerjee and Nihila (1999). What has been examined as the dominant view in this study consists of both these sets of arguments.

As mentioned before, industrial clustering is a form of economic organisation that has been discussed widely in the context of Third World industrialisation. It has been observed that groups of small firms that are clustered together spatially and sectorally have in many industries and across several countries seen phenomenal success in national as well as international markets. This success, in terms of growth, export performance and the establishment of a significant presence in national as well as international markets is seen to have provided a possible route for small-firm based development in a scenario where small firms, especially in developing countries, faced a variety of growth constraints. It is argued that industrial clusters have come to constitute a typical form of industrial organisation that can generate a capacity to achieve high levels of efficiency and competitiveness under specific conditions that have been mentioned above. It is also argued that exposure to international markets or export orientation improves this capacity for clusters. Thus, export orientation is assumed to make lucrative markets available, induce modernisation, enhance quality and in turn impart a high degree of dynamism to industrial clusters and play a major role in promoting growth, competitiveness and improved export performance. It is argued\(^3\) that the experience of a large number of export-oriented small-scale clusters has resulted in a major shift in the small-scale industry literature and shaken off the belief that came across earlier that small-scale firms cannot perform well in exports.

\(^3\) Schmitz (1999a) is one of the most representative views.
The discussion on industrial clustering arose in the context of the experience of Italy's "industrial districts", which are agglomerations of hundreds, sometimes thousands, of predominantly small and medium sized firms oriented to the same sector, concentrated in a common geographical location with many stages of production and producer services included within the district. The 'Italianate' experience was considered interesting for two reasons: first, the unusual economic success of firms from these districts in both the domestic and international markets; second, workers were paid well and had good working and social conditions, compared to other small firm settings. Thus the Italian industrial district model appeared as an alternative form of economic organisation and held out the promise of a combination of economic vitality, characterised by productive efficiency, as well as strong flexibility of response to changing market conditions, and equally importantly, very high labour standards. It was also held up as the prime example for the flexibility that a group of small firms could achieve through specialisation and co-operation between themselves, what came to be referred to as 'flexible specialisation'. The experience suggested that small-scale firms, even in traditional artisanal industries, could be successful in coping with volatile market situations without resort to low wages and poor labour standards. Perhaps equally importantly it was found that State intervention, which in primarily providing co-operative infrastructure and regulating and shaping the economy in various ways, played a critical catalysing role in the success of these districts, benefiting all agents in the districts, including both capital and labour.

Developing country industrial clusters, however, exhibited several differences as compared with a stylisation of this classic industrial district experience. The most obvious differences were in observed trajectories of growth and in returns accruing to labour. Differences in observed trajectories of development and growth were explained in terms of the nature and degree of size differentiation, relationships between firms of different sizes and the way in which markets are catered to. There were two clear patterns of development seen as far as labour standards were concerned, one combining competitiveness and efficiency with high rewards to labour, referred to in the literature as the 'high road to flexible specialisation'; the second, where competitiveness was the result of low labour standards and the casualisation of labour, referred to as the 'low road to flexible specialisation'. The majority of developing country clusters were examples of the
latter, although in several clusters, the low returns to labour were accompanied by high
growth and efficiency. Particular kinds of linkages between firms and joint action by firms
were seen to impart ‘collective efficiency’ to the cluster as a whole, with firms seeing
success while not upgrading labour standards in any particular way.

While the literature that analysed clustering in different contexts brought out these diverse
aspects, a dominant idea that came across from a large part of the literature was that
exposure to external markets offered a sure way of upgradation and sustained growth for
clusters as well as firms within them due to the high standards demanded by international
markets. The specific ability of firms in clusters to link up with each other and other
conditions that obtained in typical clusters were considered conditions that made it
possible to achieve these standards. The constraints to exploiting these possibilities were
seen in terms of clusters being unable to either reach out to international markets or create
the right conditions within the clusters.

The second set of arguments, as mentioned above, emanates from the analysis of the
leather industry in India that has been done by one of the very few studies available
on the subject and similar views expressed by some policymakers and organisations
involved with the leather industry. This has to do with the role played by institutions
in developing economies and specially, the role played by social institutions in the
argue that the leather industry in India is faced with vastly changed market conditions
since 1991 onwards which are extremely favourable. These changed market
conditions have been characterised by the increasing opportunities provided by the
Western European and American markets along with the collapse of the large markets
in the former Soviet Union and Eastern Europe. Given the right institutional
conditions, the leather industry in India can take advantage of vastly expanding
international markets for its products. The study compares the Madras and Calcutta
leather clusters and argues that the growth of each presents an interesting contrast of
the way in which each has dealt with institutional constraints hampering
modernisation and growth. These institutional constraints consist of certain
characteristics of the agents operating in the industry, the structure of the credit
market, the nature of labour relations and the nature of markets catered to. In Calcutta,
agent behaviour (ranging from entrepreneurs to workers) is influenced substantially
by historical factors and social embeddedness in terms of caste and community identities being paramount. This has been manifest in a resistance to change, reflected in an unwillingness to upgrade technology and to introduce a modern work culture that is essential to producing for highly discerning international markets. The Calcutta leather industry, it is argued, found it difficult to switch to the lucrative western markets with the collapse of the Soviet and East European markets because of the institutional set-up and preferred to switch to production for low value added domestic markets. In Madras (and Tamil Nadu in general), by contrast, the leather industry was able to respond immediately to the crisis imposed by the disappearance of the Soviet market by tapping more lucrative Western markets due to the more favourable institutional structure in Madras that allowed it to shake off the stranglehold of retrograde institutions such as caste and community. Agents are seen to be significantly more modern with attitudes suitable to quality upgradation and production for discerning international markets. It is argued, therefore, that in this traditional industry, internal institutional conditions tend to play a negative and constraining role and it is in locations where modernisation has been adopted by breaking free of the 'institutional straitjacket' that it has been possible to face challenges posed by the international market.

What may be said to constitute the 'dominant view' that is explored in this thesis has been summarised above. It thus consists of the general conclusions reached by the vast research on industrial clusters in developing countries and those represented by the study mentioned above specific to the Indian case. Taken together, they imply the following: that exposure to export markets unequivocally upgrades production facilities in developing countries through competition and a greater emphasis on quality, that very often internal institutional factors prevent this upgradation through a resistance to change, and that changing internal conditions as well as institutions is what is essential to being able to take advantage of international markets. The dominant view on industrial clustering therefore addresses the issue in terms of being able to 'create' the right conditions for better performance by addressing 'internal' problems faced by clusters, which can generate the possibility of taking advantage of favourable 'external' conditions. These 'internal' conditions, especially in a traditional industry in a developing economy, largely consist of outmoded social institutions and attitudes that act as hurdles in production for the international market.
The questions that arise in the context of the above arguments are as follows and constitute the major enquiries in this thesis: What are the factors that account for particular kinds of structure and organisation in a traditional, export oriented industry such as the one being examined here? What is the nature of the link between observed economic organisation in the form of clusters and the nature of markets on the one hand, and between organisation and internal institutional conditions on the other? To be precise, does export orientation and the availability of external markets contribute to the unequivocal upgradation of production conditions in a labour-intensive traditional industry organised in the form of clusters and if this has not happened, is this due to the deadweight of internal conditions? How has the structure and organisation of the industry affected performance? What are the essential tenets of a strategy of viable development for an industry such as the leather and leather products industry in India?

In addition to these specific questions, some broad issues that arise from experiences of small firm clusters and industrial districts also need to be addressed, such as the role of the State in creating the context for co-operation between agents at different levels in the clusters, the possibilities of achieving high labour standards in developing country industrial clusters and the sustainability of small-firm dominated industrial clusters in changing contexts.

This study has explored the above questions and issues by looking at the Madras and Calcutta leather industry clusters in detail through fieldwork and the analysis of the overall industry from secondary information and published data. The organisation of the study is outlined below.

1.3 The Chapters.
The thesis has been divided into chapters in the following manner:
Chapter 2 that follows this introduction surveys the literature on industrial clustering and industrial districts in order to bring forth the important analytical as well as empirical questions in today's context. This survey, apart from examining the literature, also seeks to contextualise this literature in terms of locating it within the context in which theorising on small industry has taken place.
Examining economic organisational issues in the leather and leather products industry has to begin from the sites of raw material collection because firms and agents in the industry are also linked with the system for raw material collection and procurement thus covering the entire sector. Chapter 3 presents background information on the entire sector, ranging from remote rural areas where raw material collection takes place to the ultimate markets for the industry’s products. It covers the main production processes in the different segments of the industry, the structure that has been built up to cater to demand for the different segments, the various categories of demand for the sector’s products, and the policy framework within which the industry operates. The details presented in this chapter are based on information collected from various published sources as well as on information collected during preliminary visits to the two leather clusters that have been covered in the fieldwork for this study and other sites of leather and leather product production.

In this study, economic organisation is also looked at in terms of the historical evolution of the sector because economic organisation is shaped fundamentally by specific histories, particularly in traditional industries. Thus two industries/firms similar with respect to resources, markets or technology may end up with different institutional or organisational structures owing to different patterns of historical experience and in this sense, contemporary developments are in a very fundamental sense ‘path dependent’. This is all the more so in an industry where the impetus for the setting up of modern industry as well as its essential structure got situated in the colonial period and was guided by the imperatives of colonial trade and industrial policy. Tracing the historical evolution of the industry and through it, the roots of economic organisation in the sector as a whole and the clusters in particular, therefore, constitutes an important aspect of this study and forms the substance of Chapter 4. Chapter 4 also addresses the issues of why the leather industry was so amenable to the clustering form and how the process of cluster formation took place, especially in the context of international clustering experiences.

Two chapters of the study, Chapter 5 and 6, are devoted to analyses of production and export performance in the leather and leather products industry from the late seventies
onwards in the context of the policy frame that was put in place for the leather industry in the post-independence period, specifically from 1973 onwards.

Chapter 5 looks at the structure of the industry in terms of the relative presence and composition of the factory and non-factory sector, changes in scale of operations, mechanisation and productivity over time. Experiences of clustering in different parts of the world show a wide variety in terms of size composition, kinds of employment, degree of differentiation, degree of technological sophistication and productivity. It was also seen that clusters that have linked up effectively to international markets show greater degrees of success. It is thus necessary in any study on clustering to examine aggregate data on factory as well as non-factory enterprises to see which kind of enterprise exhibited dynamism, if at all, and their relative performance over time. Another major objective of this study is to gauge the relative importance of the formal and the informal sectors in this traditional industry because the debate on the role and nature of the informal sector has influenced discussions on the industrialisation process in developing countries, particularly with respect to small firm dominated traditional industries. In this respect too, the distinction between the factory and the non-factory sector are important.

The aggregate data sources that have been used in Chapter 5 are the Annual Survey of Industries over the period 1979-80 to 1999-2000 for information on the factory sector and Surveys on Unorganised Manufacturing conducted by the NSSO every five years between 1984-85 and 2000-2001 for information on the non-factory sector.

Chapter 6 looks at the export performance of the leather and leather products industry between 1977-78 and 2000-2001 in the context of the structure and nature of the international market for leather and leather products, as well as the policies for export promotion. Specifically, it analyses the nature of the international market and India’s place in it, and examines the salient features of export performance of the leather industry in the 1977-78 to 2000-2001 period in terms of commodity and country composition. The data sources used for Chapter 6 are the UN International Trade Statistics Yearbook, the RBI's trade database published in the Handbook of Statistics on the Indian Economy and the Monthly Statistics of Foreign Trade of India.
Chapter 7 analyses the economic organisation of two important clusters for leather and leather product production in India, Calcutta and Madras. In this chapter, the main focus is on unravelling the statics and dynamics of existing organisational forms in the industry in the two clusters. It attempts to examine the main questions that arise from the literature surveyed in Chapter 2 and the aggregate findings of Chapters 6 and 7 from field-level information and also seeks to contextualise them by linking them to the phenomenon of clustering. In this chapter, the structure of production, as embodied in different types of enterprise structures, the agents involved in production and trade and their motivations and actions, the degree and nature of interlinkages between firms, the nature and determinants of the labour process, the institutional setting including social relations within which enterprises and agents operate and the broader legal and political environment in which the industry functions are studied at the firm level. These have been examined on the basis of fieldwork done in the two clusters over different periods. Fieldwork consisted of detailed interviews with entrepreneurs, workers, representatives of trade unions, employers’ associations, trade associations, scientists and economists involved in research for the leather industry, government representatives and representatives of international organisations working with the leather industry. In addition, secondary information was collected from various secondary sources of information available from research institutes and industry level associations.

Chapter 8 sums up the analytical findings that can be arrived at on the basis of the information presented from the fieldwork in Chapter 7. The major findings are assessed in terms of the questions arising from the survey of the literature on industrial clustering and that on the leather industry.

Finally, the conclusion to the thesis is presented in Chapter 9, which analytically brings together the various aspects covered in the study. It answers the questions raised in the Introduction on the link between export orientation, industrial clustering and internal institutional factors in the leather and leather products industry in India. It also briefly outlines what future possibilities exist for the industry.