Value-Chains

What is behind this ‚new' key word? And what is the role of development agencies in value chain development in developing countries?

By Daniel Roduner, LBL

The value chain approach has been re-discovered recently by the international cooperation community. The theories about value chain interventions aren't very new, but practical guidelines, good practices or experiences from development cooperation are still rare, or under development and intensely discussed. This essay gives a short overview of existing value chain (VC) theories and then illustrates the first results of a broad international Community of Practice on Value Chains in Rural Development [1].

Why are value chains important for development cooperation?

A general understanding of these days is that broadly effective and thus poverty-alleviating growth in developing countries that is also environmentally sustainable is not possible without access to the large and differentiated markets. Therefore, the question is not if any producer should participate in local, regional, national and international trade, but how they participate. The value chain approach presents possibilities to appropriately analyze the nature and determinants of competitiveness (Box 1), the links between interconnected enterprises and the distribution of benefits along the whole chain of producers, transformers, service deliverers and buyers. These basic understandings outline a frame for formulating appropriate development programmes and policies.

Box 1:
Determinants of competitiveness
- Product and innovations
- Production and processing procedures
- Relationships
- Access to information
- Ability to change and/or innovate; react to demands
- Infrastructure
- Regulatory and administrative conditions
- International Markets, etc.

Value chain interventions are business related activities and not all development actors (donors, NGOs, consultants) are well equipped for intervening in dynamic market related processes. Ongoing debates focus on possibilities and risks of outsiders (donors) intervening in value chains, and on the relevance of value chain development for achieving cooperation and international development goals. The discussions reveal that a certain common understanding for necessary outside interventions exist, but effective and innovative ways of supporting new or growing value chains are still scarce.

Theory of value chains [2]

For at least twenty years now, there have been systematic attempts in English-, German-, and French-speaking schools of thought to describe and analyze the vertical integration and disintegration of production and distribution processes. Many terms were used to describe production, marketing, commodity and value chains, as well as economic networks and triangles, in part with identical and in part with varying meanings.

[1] *Find out more about Communities of Practice (CoP) on www.lbl.ch/internat and about the CoP on Value Chains in Rural Development (VCRD) on www.sdc-valuechains.ch.*

[2] *This chapter is based on a study undertaken by Daniel Roduner, LBL (2004) on behalf of the Income and Employment Division of SDC Switzerland. The specific references can be found in this paper.*

Generally a chain is defined as a sequence of organisations that are involved in consecutive production activities[3]. The main approaches and concepts relevant for development policies are:

- The French **"filière"** concept: a static model with non changing actors and national boundaries, describing the linear flow of physical inputs and services in the production of a final product.
- Porter's **value chain analysis**: an instrument for identifying the value created at each step of the production; a basic approach that is further developed by other authors.
- **Global Commodity Chains**: a concept that is mainly focusing on the power relations in the coordination of dispersed, but linked, production systems.
- **World Economic Triangle**: a concept pointing out that the combination of strong local linkages within global commodity chains might bring upgrading prospects for regions in developing countries; and thus is an approach for showing the importance of linking vertical (chains) and horizontal (clusters) integration.

The following definition from Kaplinsky and Morris (2001) reflects a widely consensus:

Box 2:
Value chain definition

The value chain describes the full range of activities which are required to bring a product or service from conception, through the different phases of production (involving a combination of physical transformation and the input of various producer services), delivery to final consumer, and final disposal after use.

[3] *Dicken & THRIFT, 1992 in BATHELT/ GLÜCKLER, 2002*

Key factors in value chain approaches

Actual value chain debates concentrate on how to create and distribute gains from economic activities better and how to do so in developing countries. This includes questions of how enterprises or regions from developing countries gain access to dynamic markets and to a higher share of value. Development cooperation agencies seek to understand and develop the necessary conditions for facilitating the participation of small and medium enterprises from developing countries in wider markets. Key analytical issues identified by leading value chain researchers are:

- **Barriers to entry**: Sustainable income growth requires the capacity to protect oneself from competition that is to take advantage of, or construct barriers to entry. This includes taking advantage of existing scarce resources (for example: water, land, knowledge) or processes (for example: economies of scale, transformation of products) or constructing new barriers to entry (for example: labelling, certification, designation of origin).
- **Rents**: the ability of constructing such barriers to entry – or with other words, taking advantage of unequal ownership, access or control over an existing scarce resource leads to economic rent. But scarcity can also be constructed through an innovative action, and hence economic surplus (= rents) can increase for those who create this scarcity.
- **Governance**: the concept of governance involves the ability of one firm in the chain to influence or determine the activities of other firms in the chain. The governance perspective shows which organisation(s) define who produces what, how much and when. These parameters can be set by a lead firm, by a group of actors or by parties external to the chain (for example: production and quality standards; organic and fair trade schemes; child labour standards or corporate social responsibility).
- **Upgrading**: a key capability is to innovate and to ensure continuous improvement in product and process development. Innovation in itself may not be enough though, important is the rate innovation compared to competitors.
- **Knowledge**: An elementary factor regarding the upgrading of value chains is the production factor

"knowledge". Especially the capacities of chain actors for jointly develop skills, share knowledge, know-how and information. This is basic for nurturing a trust-based relationship that creates win-win situations for all involved actors. Trust and transparency are often seen as the key elements for successful value chains.

Practical issues in value chain interventions [4]

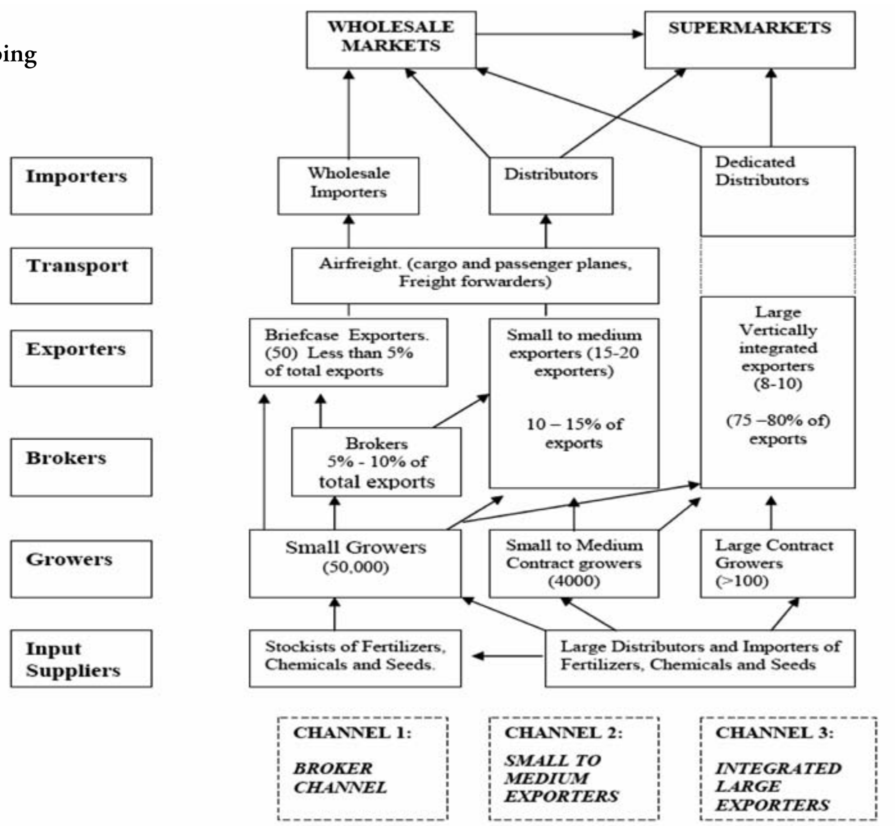
Over 80 practitioners and conceptual thinkers involved in strategic planning or direct value chain interventions in development countries debate regularly on an online platform. The so called 'community of practice of value chains in rural areas' (VCRD) follows a debate pattern of thematic steps initiating with 'value chain analyses', followed by 'identifying leverage points for donor interventions' and 'donor interventions in value chains'. At the time of publication the fourth discussion cycle that concentrated on 'value chains and poverty reduction' [5] is about to finalize. Some of the findings from this debate are presented in this article.

How to analyze value chains?

Analysing existing or potential value chains is the first step for understanding product markets and market trends, relationships between value chain actors and the level of cooperation between these actors. Characteristics of VC analysis are:

- **Mapping** the whole range of activities: from production to consumption.
- **Geographic coverage** for markets and trends at all levels (local, regional, national, international).

Illustration 1:
Illustrative example of a value chain mapping



[4] *This chapter is mainly based on insights from the online Community of Practice 'Value Chains for Rural Development'. An initiative from the Employment and Income Division, SDC Berne.*

[5] *Syntheses of all discussion cycles can be found on www.sdc-valuechains.ch. Anyone interested in joining actively the debate, please send a note to daniel.roduner@lbl.ch.*

- **(Global) benchmarking** with competing countries, regions…local competitors.
- Visualizing **relationships** between participants: describes functions, participants and relationships between participants.
- **Governance** structures: describes who the decision maker is when it comes to qualities, quantities, prices and so on.

An illustration (mapping) of the value chain helps building a common understanding of real trade systems (Illustration 1, adapted from AFE).

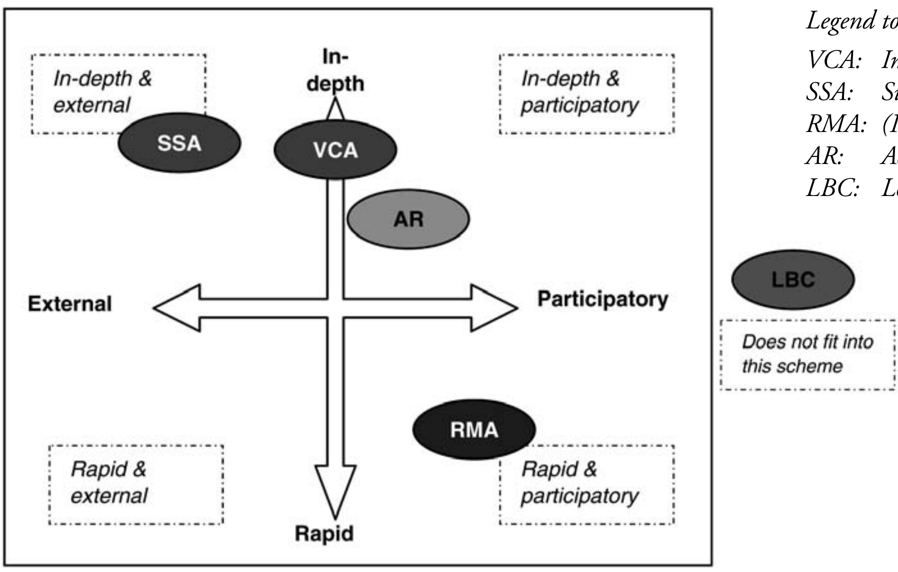
Methods for analyzing value chains

There exist different methods for different needs. Thorough sub-sector and (often international) value chain analysis are carried out by external experts: a time and money intensive approach. Other methods base on participatory principles. These approaches are usually led by an expert / facilitator who tries to bring the most important and interested actors into the analysing process. Participatory processes involve a lot of time and some money, and at the same time are important for creating or fostering trustful relationships. Entrepreneurial thinking people don't bother on extensive studies, but develop a business idea, talk about it with key informants (usually other businessmen) and then 'just-do-it'. This learning by doing approach involves a lot of hard-nosed decisions and some money, while it delivers real insights, information and experiences. A magic formula for the most adequate method does not exist. In any case, before starting an intervention some kind of study or analysis is needed; and the method has to consider all basic information (see the five points mentioned above). Illustration 2 illustrates in a pragmatic way some different analysing methods.

The **main challenges** for analysing value chains, especially in developing countries, remain the same for all methods and approaches:

- Availability of information,
- Reliability of information, and
- Cost / benefit / time balance.

Illustration 2:
Chart of different VC analysis methods



Legend to illustration 2:
VCA: In depth value chain study
SSA: Sub-sector analysis
RMA: (Participatory) rapid market appraisal
AR: Action research / R&D
LBC: Local business support centers

Donor interventions in VCs

Should donors intervene in dynamic market processes? How should competence-neutral interventions look alike? Let's have a look at some VCRD-findings:

The starting point for value chain outsiders are existing or potential local change agents. These change agents (local actors, entrepreneurs or organizations) usually are or will be VC leaders. Further, VC outsiders should only intervene where they can add real value to existing capacities of VC players, supporters and influencers (see Illustration 3). VC outsiders tend to ignore that value chain development activities and services can be fully commercial ventures. For example a market information system can be offered by a local enterprise on commercial terms for its users, and donors or public funded agencies acting like enterprises by offering these services for free are sabotaging the emergence of truly sustainable and viable enterprises. Value chain outsiders should therefore adapt a commercial and entrepreneurial thinking, for understanding complex and dynamic market issues, but not behave like a solely commercial oriented business.

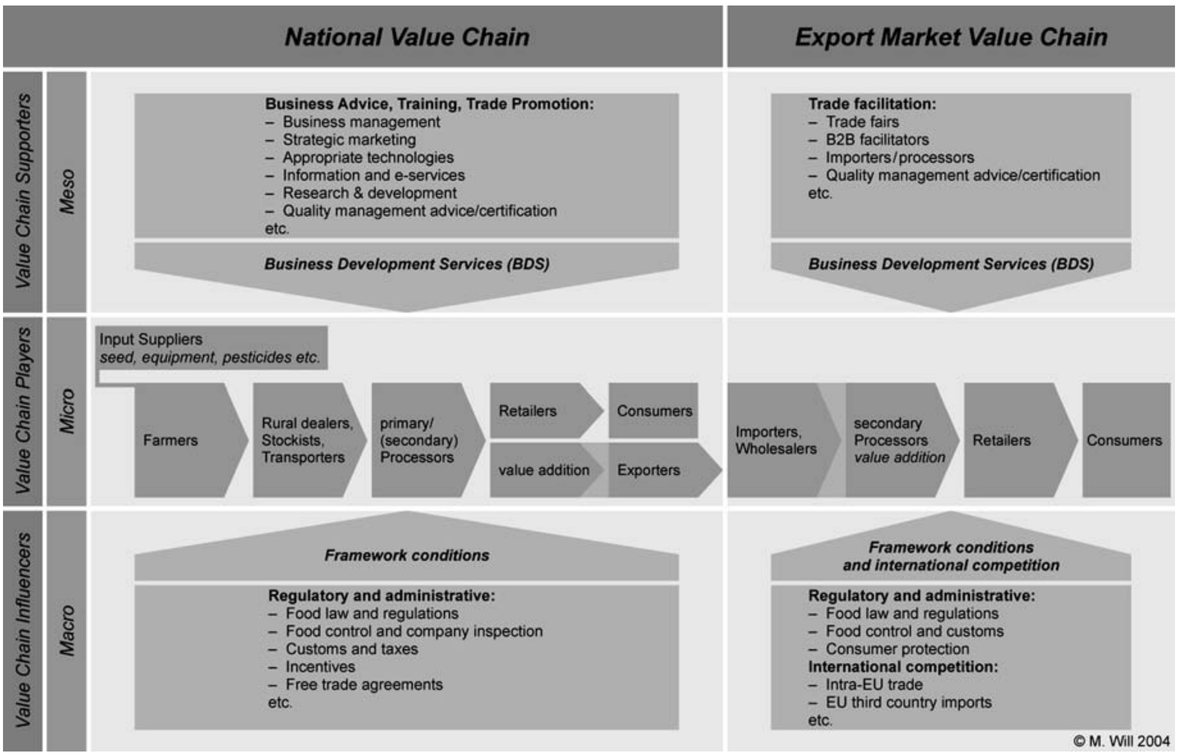
Donors, NGOs and consultants have several important roles they can play in value chain development. Their engagement can be directly with the value chain players and / or with value chain supporters and / or with value chain influencers, as illustrated in Illustration 3. Intervention points depend very much on specific contexts and no recipe for always adequate intervention levels can be described. The VCRD debate produced a list of important roles a development agency can play in value chain development:

Facilitator: VC actors have to identify intervention points, decide on action plans and concrete activities. A neutral outsider is often necessary for organising stakeholder meetings and trust building activities. An external facilitator seems inevitable in VCs where mistrust is common and for facilitating learning processes.

Trainer/Coach: To train and coach rural producers to be capable to take informed decisions.

Information: An outside understanding of the functioning of the whole chain can be an important contribution for all VC actors.

Illustration 3:
Value chain players, supporters and influencers



Support & Empowerment: Strengthening of the whole chain and support the weakest link that would have the biggest impact (financial, technical and moral support).

Initiator: Initiator or instigator of change, value chains and markets.

Trust-broker: for public-private and private-private partnership.

Value chains as an approach for poverty reduction

Are value chain approaches also benefiting the poorest people? What about resource poor people (landless for example)?

VC development is usually done through entrepreneurs, business companies or associations and if you want to have a certain impact or leverage effect you need to concentrate on most promising (non-poor) change agents for VC development. Even though the poorest or most marginalized people are not the engine of VC development, donors should care about inclusion of these people. With other words, donors should diversify their portfolio of clients and not only interact with innovative change agents, but also support the poorest towards inclusion in a VC.

Spill-over effects, for example from a good functioning chain to another product-chain, or economic gains from a strong industry to producers, should not be underestimated. Many development projects concentrate on the most promising value chains (in terms of gains and gainers) for an economic kick-off of a region or a cluster. The concentration on the 'winning horse' is also seen as a motivation for others.

Some resource poor farmers or workers tend to be excluded from market-oriented approaches, and need supportive interventions that improve their access to production factors (access to land, water, knowledge, food etc.) which further are essential to foster their access to dynamic markets. Besides working directly with entrepreneurs or poor farmers, donors can intervene at other levels and advocate for a fair and healthy business. For example with public-private-partnership projects fostering fair-trade schemes, labour standards or corporate social responsibility, etc.

The value chain perspective fosters definitely the understanding of existing market schemes. As agri-food systems are constantly changing in development countries, for example through the fast growing importance of trans-national supermarkets in many countries, many producers face new opportunities and threats in their own markets. If producers want to participate successfully in new markets, they have to cope with growing competition and need to develop new practices. The value chain approach provides a tool for analysing whole systems and defining adequate activities for rural people, as well as potential programmes and policies for development agencies.

Are donors fit enough for intervening in dynamic and complex markets?

On the VCRD platform we are still discussing the abilities of the development sector (especially donors and NGOs) for intervening and fostering value chains. Business decisions need to be made quickly and lack sometimes thorough studies; this means that many donors need to learn how to react fast on business necessities. Or donors need to find ways of outsourcing value chain intervention programmes to local business service providers. Several interesting and innovative ideas are presented on the platform. For example rural business incubation companies working with special venture capital funds, or fostering access to information through sponsored radio and TV programmes.

The ongoing VCRD debate is creating new ideas and insights within every cycle, if you want to join actively or just see what is going on, visit the debate-platform through www.sdc-valuechains.ch or contact daniel.roduner@lbl.ch.