Expanding Opportunities Worldwide

Value Chains & Poverty Reduction: Equitable Growth in Today's Global Economy

Globalization is changing the environment in which poverty reduction strategies are being implemented. In this new context, two things are clear: poverty alleviation cannot be sustained without economic growth, and economic growth cannot be sustained in noncompetitive industries. It becomes difficult to reduce poverty or to increase incomes for micro and small enterprises (MSEs) without considering their links to productive markets.

ACDI/VOCA is conducting training for USAID mission and project staff in the value chain approach and its applications. As a result of this training, participants are able to use the value chain approach as a tool for understanding trends in global markets and conditions under which MSEs can contribute to and benefit from the increased competitiveness that globalization brings.

Training Objectives

The training covers the following major topics:

- analyzing the value chain approach and the range of factors and relationships that affect the performance of an industry, including end markets, enabling environment and coordination/cooperation among firms
- sharing strategies and interventions effective in overcoming bottlenecks throughout the chain that foster value chain competitiveness
- exploring how to catalyze private-sector stakeholders within an industry to collaborate for improved industry performance

This three- to five-day event is based on the highly regarded training in value chain analysis offered by ACDI/VOCA at the Springfield Centre entitled "Making Markets Work for the Poor" and at the SEEP pre-AGM in 2005.

The training includes examples of how the framework can be integrated into program design and uses case studies to guide participants through the process of industry selection, analysis of the value chain, identification of potential interventions, the development of a competitiveness strategy and the drafting of an implementation plan. The training incorporates modules and case studies to prepare the participant to lead a value chain analysis team, develop through a participatory process a strategy for competitiveness, and facilitate a stakeholder workshop to articulate an action plan.

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VALUE CHAIN TRAINING

The Value Chain Methodology

Value chains encompass the full range of activities and services required to bring a product or service from its conception to its end use. Value chains include input suppliers, producers, processors and buyers; a range of technical, business and financial service providers; and the final markets into which a product or service is sold, whether local, national, regional or global. Understanding how industries in which MSEs participate can become more competitive requires both systematic and systemic analysis of the factors affecting the performance of the firms in the value chain and the relationships among these firms.

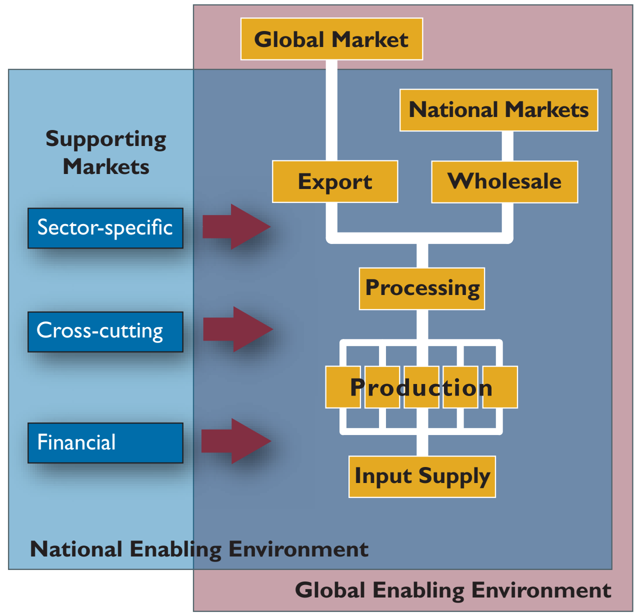
Factors include:

- Business enabling environment
- End markets
- Supporting markets, including finance and other sector- and non-sector-specific services and products
- Vertical linkages
- Horizontal linkages
- Firm-level upgrading (product and process upgrading)

Relationships include:

- Power dynamics among firms
- Access to learning and innovation
- Distribution of benefits

The Value Chain Approach



End Markets

End markets determine the characteristics of the final product or service generated. The demands of the end market drive quality and standards. End buyers are important sources of demand information, learning and benefits that flow down the chain. Analysis of end markets must demonstrate the potential for competitiveness through a combination of three strategies: producing and delivering goods and services more efficiently, differentiating products or services through quality standards and branding, and exploiting new market demand. The value chain approach assesses the opportunities in all possible markets into which products and services flow.

Enabling Environment (Local, National and Global)

International trade agreements and standards tremendously affect the constraints to and opportunities for industry growth. They present opportunities for market expansion but can be extremely expensive for firms, especially MSEs, and can easily preclude a developing country from being competitive.

The national policy and regulatory environment is critical to the functioning of markets and enterprises; it should create incentives for private sector growth and involvement in the policy process. Moreover, poor local government operations and poor enforcement of legal and regulatory regimes increase transactions costs and risks, limiting investments in relationships and upgrading. Conversely, conducive local and regional policies can provide opportunities for rapid improvement of the enabling environment.

Coordination in the specialty coffee industry allows smallholders to differentiate their products through high quality control standards, yielding greater profits.

Inter-firm Cooperation: Vertical Linkages

Cooperation among firms through vertical or horizontal relationships is critical for transferring skills and reducing transaction costs. Vertical linkages are the relationships among firms at different levels of the value chain between input supply and distribution to the final market. Vertical linkages are critical for moving a product from inception to the market and for transferring benefits, learning and embedded technical, financial and business services from firms up the chain to firms down the chain or vice versa. Mutually beneficial relationships among vertically related firms can improve MSEs' access to new markets, new skills and a wide range of services. They can also reduce market risk by securing future sales and create incentives for the adoption of more value-added functions or activities.

Inter-firm Cooperation: Horizontal Linkages

Horizontal linkages among producers are needed to reduce the transaction costs for exporters or local buyers of working with many small suppliers. By allowing for buying in bulk or meeting large orders, horizontal linkages can help small firms generate economies of scale, which can contribute to their competitiveness and bargaining power.

Horizontal linkages among MSEs can take the form of formal or informal groups, as well as networks that are managed through a third party (e.g., lead firm, broker, trader). Similarly, cooperation among larger firms can be important for creating industry standards, developing marketing campaigns or lobbying.

Supporting Markets

Supporting markets are key to firm-level upgrading and include sector-specific markets (e.g., input and equipment providers), financial services, business management services (e.g., auditors, lawyers), and information technology (particularly as it pertains to market information access and dissemination).

Where these services are needed over the long run, they must generally be provided commercially, either by stand-alone service providers or by firms in the value chain. In this latter case, services tend to be embedded as part of an existing market transaction, with the cost of the service included in the mark-up on the transaction. New technologies or technical services can have a substantial effect on the competitiveness of the industry and can even change the competitive dynamic.

Firms can increase competitiveness through product development and improvements in production techniques, marketing and distribution.

Firm-level Upgrading

Firm-level upgrading refers to changes made by firms to improve their competitiveness through product development and improvements in production and marketing techniques or processes. Firm-level upgrading requires access to information, technology and finance. Product development and improvements in production and marketing processes are integral to sustained competitiveness by enabling firms to meet the market's constant demand for innovation.

Power

The wielding of power in relationships between firms in the value chain shapes the incentives that drive behavior and determines which and how much firms benefit from participation in an industry.

Relationships can range from highly dependent, where one party dominates, to balanced, where all parties involved have some power that they can wield. In any given industry, relationships can cover the full range, and these relationships can change depending on shifting market demand.

Learning and innovation are key factors in increasing a firm's competitiveness.

Learning & Innovation

Learning and innovation are key to creating and sustaining an industry's competitive advantage since upgrading is dependent on knowledge of what the market requires and the potential returns on investments in upgrading. It is essential that learning and innovation flow through the value chain in order to optimize these returns.

The process of acquiring new knowledge or skills is not necessarily straightforward. Learning and innovating in a systemic sense are closely tied to the incentives that encourage or discourage the delivery and absorption of new knowledge or skills, and the types of mechanisms that are in place to affect their transfer.

For improvement to be long-term, the benefits must outweigh the costs associated with making significant operational and behavioral changes.

Benefits

If industries are to maintain their competitiveness, benefits must be sufficient to provide incentives for changes in behavior patterns that entail taking on new risks and adopting innovations.

Benefits are closely related to power relationships and learning. In the context of MSE development, benefits are much broader than just increases in income, although that is an important part of the equation. Benefits can also mean reduced market risk (more stable income) and increased value of assets. Power in value chains typically translates into benefits. The firms able to wield power through branding or access to worldwide suppliers, and those traders in a chain able to control information, can often exact a larger share of benefits from producers and suppliers.

Published Value Chain & Poverty Reduction Studies

**_Nature-Oriented Tourism in Ecuador: An Assessment Applying the Value Chain and Nature, Wealth and Power Frameworks_ by Robert Fries, ACDI/VOCA, Marcela Correa, CARANA, Douglas Pool, IRG, and Arnaldo Rodriquez, Green-Consulting, 2006.
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**_Haiti Handicrafts Value Chain Analysis_ by Eric Derks, Action for Enterprise, Elizabeth Dalziel, Ted Barber, Olaf Kula, ACDI/VOCA, 2006.
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Mozambique Rural Financial Services Study by Olaf Kula and Elisabeth Farmer, ACDI/VOCA, October 2004.
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Value Chains and Their Significance for Addressing the Rural Finance Challenge by Robert Fries and Banu Akin, ACDI/VOCA, 2004.
http://www.microlinks.org/ev_en.php?ID=7098_201&ID2=DO_TOPIC

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