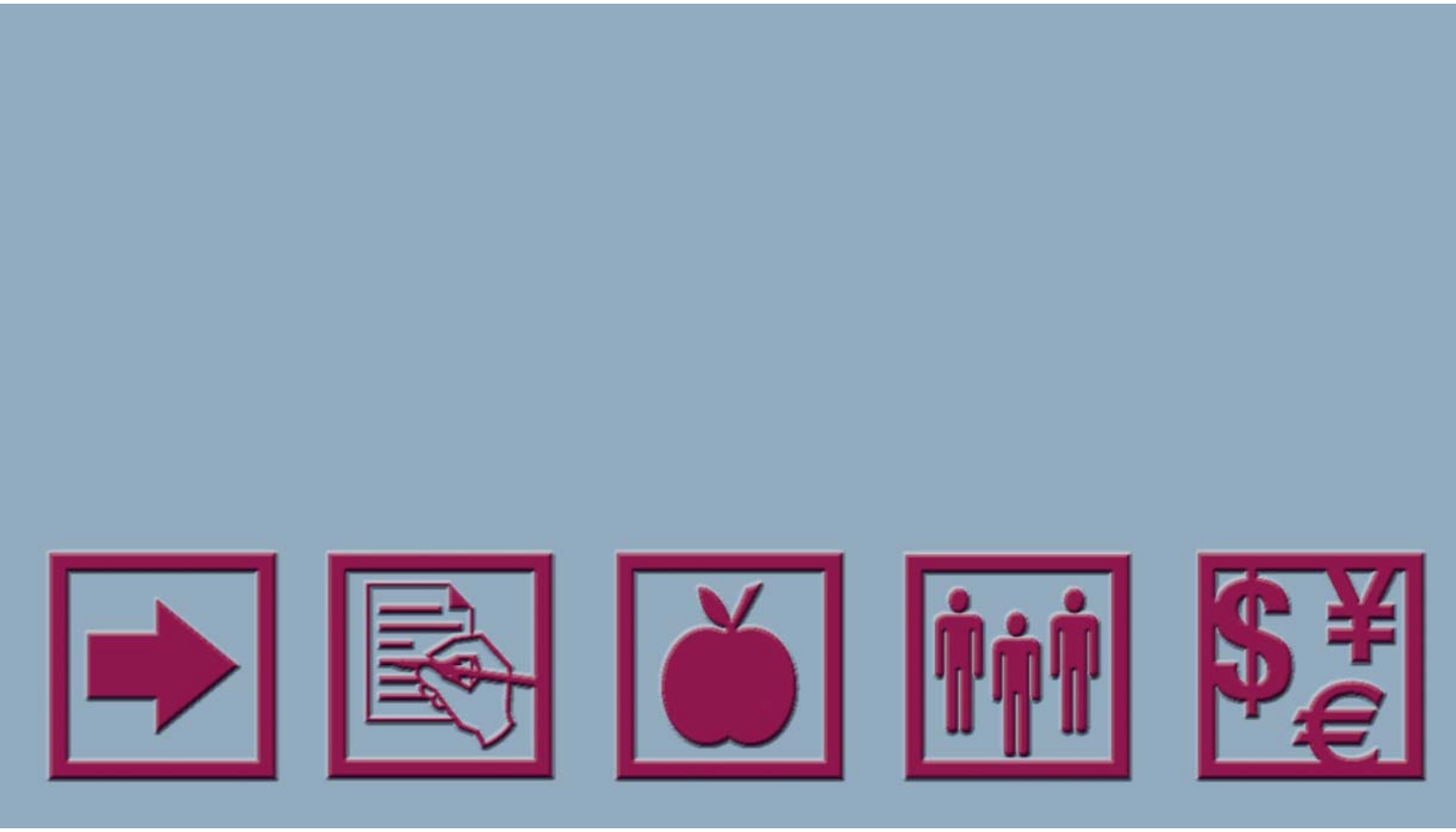
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ValueLinks Manual

The Methodology of Value Chain Promotion

First Edition

gtz

The *ValueLinks* Manual

- Introduction and Outline -

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About this manual

This manual is the reference book for the *ValueLinks* methodology. *ValueLinks* is the name given to a systematic compilation of action-oriented methods for promoting economic development with a value chain perspective. It provides essential know-how on ways to enhance employment and the business income of micro and small-sized enterprises and farmers by promoting the value chains they are operating in.

The *ValueLinks* manual is intended for use by development projects or by public agencies promoting specific agribusiness, handicraft or manufacturing sub-sectors of the economy. It has no specific sectoral focus. However, the emphasis is on those product markets that offer opportunities for the poor.

The *ValueLinks* manual is one of several knowledge products that use the *ValueLinks* methodology. The *ValueLinks* training seminars for professional staff of public agencies and development programmes comprise an important instrument for sharing know-how, and are given by recognised *ValueLinks* trainers.

The *ValueLinks* methodology

ValueLinks is entirely action-oriented. The know-how has been compiled by reviewing real-life experience. It builds on lessons learned with rural development programmes and private sector promotion supported by GTZ.

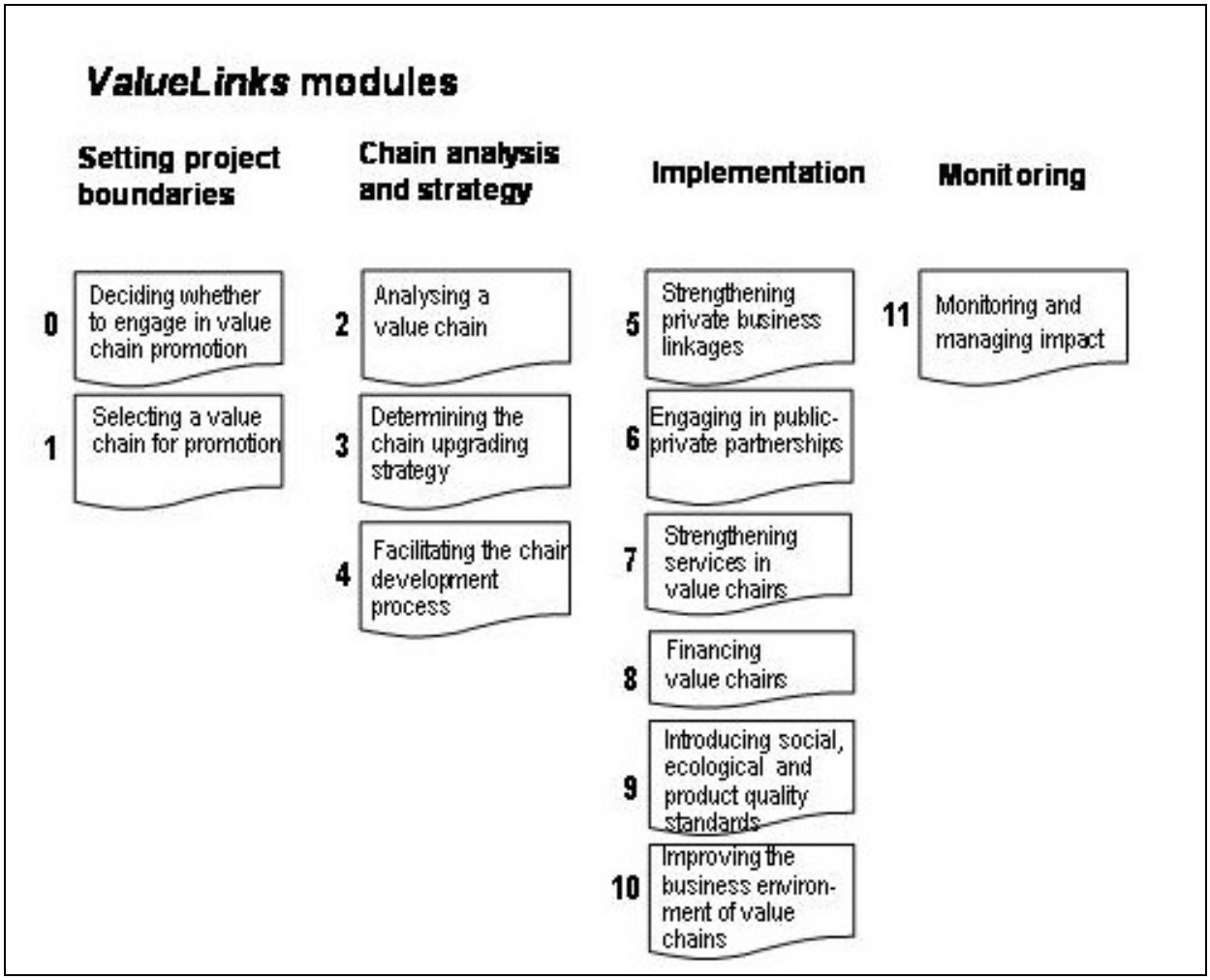
The *ValueLinks* manual structures the know-how of value chain promotion into 12 modules organised according to the project cycle.

It starts with the decision whether to engage in value chain promotion at all, and how to combine VC promotion with other development approaches (module 0). The first step in value chain promotion is the identification of a value chain to promote (module 1), followed by value chain analysis (module 2) and the formulation of a chain upgrading strategy (module 3). Module 4 presents know-how for facilitators of value chain promotion projects. The following modules (5-10) are all devoted to the implementation of projects. Three major fields of action are distinguished – business linkages (modules 5-6), services (modules 7-8)

and the business environment including standards (modules 9-10). Finally, module 11 closes the cycle with know-how on monitoring impacts and managing for development results.

The core of the *ValueLinks* methodology is contained in modules 1-4 and 11, which consist of know-how that is specific to the value chain concept. Modules 5-10, on the other hand, utilise and adapt knowledge from other related fields of development work.

The graph below shows how modules relate to a project cycle of value chain promotion:



ValueLinks does not prescribe any particular sequence in which the modules should be used. In fact, the methodology is iterative. Practitioners usually have to move between implementation and analysis. Monitoring is placed at the end in the above graph, but should certainly be conducted throughout the process.

Each module specifies recurring tasks that business organisations and facilitators of value chain promotion have to perform. Users can choose among a total of 37 tasks, e.g. “value chain mapping”, “agreeing on a vision” or “engaging private partners in development work”. Text boxes present tools and templates as well as concrete examples of value chain projects supported by GTZ around the world. This therefore provides users of the methodology with the building blocks with which they can construct their own VC promotion projects, selecting elements of *ValueLinks* according to their specific needs.

A complete overview of the tasks is presented in Table 2 (pp. 4-5).

Characteristics of *ValueLinks*

Value chain promotion is not a new concept. Nevertheless, there are a few defining features of *ValueLinks* that distinguish it from other guidelines. The features listed in Table 1 below are relevant for the major criteria that determine the quality and impact of development cooperation:

Table 1

The *ValueLinks* methodology…	**…and its relation to criteria of aid quality:**			
	Efficiency	**Outreach**	**Impact**	**Sustain-ability**
addresses value chains as economic, institutional and social systems	*	*	*	*
is entirely oriented towards action and implementation	*		*	
creates synergies by combining value chain promotion with other economic development approaches	*	*	*	
clearly distinguishes between the upgrading undertaken by value chain actors and the role of external facilitators	*	*		*
promotes close cooperation between the public sector and private companies (public-private partnerships)	*		*	*
uses a specific visual language that facilitates cooperation and exchange	*	*		

ValueLinks is an evolving concept. In its present state, it embraces the generic methodology of value chain promotion. Its application in different industries and in countries with varying degrees of economic development calls for additional situation-specific tools. Of particular interest is its application to business opportunities at the bottom of the pyramid. It is planned to produce sector-specific as well as country-specific versions of *ValueLinks* that address specific needs.

Overview of the *ValueLinks* modules and tasks

The following table presents an overview of the *ValueLinks* tasks, structured into two parts. The first set shows the analytical and decision-making tasks for preparing a value chain promotion project, while the second covers the fields of implementation action and monitoring.

Table 2

Analytical and decision-making tasks preparing a value chain promotion project

***ValueLinks* Modules**	***ValueLinks* Tasks**
Module 0 Deciding whether to engage in chain promotion	• (0.1) Assessing potential and limits of value chain promotion • (0.2) Combining chain promotion with other development approaches
Module 1 Selecting a value chain for promotion	• (1.1) Determining the scope of value chains to be promoted • (1.2) Conducting and supporting market research • (1.3) Setting priorities across alternative value chains
Module 2 Analysing a value chain	• (2.1) Value chain mapping • (2.2) Quantifying and analysing value chains in detail • (2.3) Economic analysis of value chains
Module 3 Determining the chain upgrading strategy	• (3.1) Agreeing on a vision and strategy for value chain upgrading • (3.2) Analysing opportunities and constraints • (3.3) Setting operational upgrading objectives • (3.4) Identifying actors to implement the upgrading strategy • (3.5) Anticipating the impact of chain upgrading
Module 4 Facilitating the chain development process	• (4.1) Clarifying public, private and donor roles • (4.2) Designing a process and setting entry and exit points • (4.3) Organising the chain promotion project and scaling it up • (4.4) Institutionalising the collective action of chain actors

Table 2, continued

Fields of implementation action and monitoring

***ValueLinks* Modules**	***ValueLinks* Tasks**
Module 5 Strengthening private business linkages	• (5.1) Brokering vertical collaboration: Supplier – buyer contracting • (5.1) Fostering horizontal collaboration of value chain operators • (5.1) Business matchmaking
Module 6 Engaging in public-private partnership	• (6.1) Engaging private partners in development work • (6.2) Concluding private-public partnership agreements
Module 7 Strengthening services in value chains	• (7.1) Assessing service needs and service markets • (7.2) Strengthening private service markets and arrangements • (7.3) Improving the responsiveness of public service providers • (7.4) Strategic use of temporary support services
Module 8 Financing value chains	• (8.1) Brokering value chain financing arrangements • (8.2) Publicly funding chain development
Module 9 Introducing social, ecological and product quality standards	• (9.1) Facilitating the development of standards • (9.2) Accompanying the implementation of standards • (9.3) Developing the capacity for the verification of standards
Module 10 Improving the business environment of value chains	• (10.1) Supporting private initiatives addressing macro-level constraints • (10.2) Fostering a coherent value chain promotion policy
Module 11 Monitoring and Managing Impact	• (11.1) Formulating impact hypotheses of value chain promotion • (11.2) Verifying impact hypotheses • (11.3) Managing for development results

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ValueLinks Glossary
Terms used in value chain development

Added-value
See “value added”.

Approche filière
One approach to study commodity chains. The francophone filière tradition was developed by researchers at the Institut National de la Recherche Agricole (INRA) and the Centre de Coopération Internationale en Recherche Agronomique pour le Développement (CIRAD). (http://www.ids.ac.uk/ids/global/pdfs/GCCs%20and%20filieres.pdf)

Benchmarking
The process of comparing own performance parameters with the performance parameters of businesses or value chains considered the leaders in the field. Parameters can refer to various aspects. Important benchmark parameters are productivity, cost of production or product quality. Benchmarking is used to identify gaps in the performance of the value chain promoted.

Broker
A broker is a market intermediary who brings buyers and sellers together and is paid a commission by either party.

Business environment / investment climate
Business environment means the broad legal, regulatory and infrastructure conditions under which enterprises operate in a country. These are conditions at the *macro level*. They include macroeconomic and political stability, an effective governance and judicial system in general, as well as the regulations specifically relevant for doing business, such as well-defined property (e.g. land and water) rights, business registration and employment regulations, financial institutions, the transport system, and the efficiency of administrative procedures. There are general conditions of the business environment cutting across many sub sectors, as well as conditions specific for each value chain.

Business linkages
VC operators relate to each other both horizontally (among enterprises at the same stage of the value chain, pursuing the same type of activity) as well as vertically (between suppliers and buyers of produce). Vertical business linkages can range from accidental market exchanges to a full coordination of activities regulated by contracts (see *market relationships*). Horizontal business linkages range from informal networks to associations and business membership organizations (BMO).

Business matchmaking
Business matchmaking is the activity to create and promote business contacts and sales opportunities of specific business groups or of the entire value chain community. It is a support service for the value chain.

Cluster
A cluster is a geographic concentration of enterprises which are closely connected, along a value chain or as a network settling around an important buyer or industrial company (e.g. *value chain actors* in the cut flower export business all located close to an international airport). A simple definition says: A cluster is a value chain that is concentrated at the same location.

Certification
Certification is a procedure by which a third party (the certifier or certification body) gives written assurance that a product, process or service conforms to specified requirements – a standard. Being certified is an asset for producers.

Commodity
Commodities are bulky (natural-resource based) product, that are internationally traded either as a raw product or after basic industrial processing. The most important agricultural commodities include grains (rice, wheat), green coffee, palm oil, cotton or white sugar. The value chains of commodities mostly are loosely integrated, although trade may be concentrated. In terms of increasing the value-added an interesting strategy is "decommo-dification", that is the diversification of conventional commodities into high-value variants (e.g. specialty coffee, specialty rice, aromatic cocoa or organic cotton).

Competitiveness (determinants and indicators)
The performance of an economy results from a series of variables: At the *micro level*, competitiveness is determined by "hard" comparative advantages such as the location, the availability of primary resources and the cost of labour, as well as by "soft" conditions, e.g. the entrepreneurial competence.
Yet, competitiveness also is a function of *value chain* coordination and the existence of supporting agencies at the *meso level*. Finally, the *business enabling environment* determines the overall cost of business making. Taken together, competitiveness is expressed by measures indicating technical efficiency and profitability as well as innovation and investment rates.

Contract Farming
A form of production in which farmer and buyer enter into a contract in advance of the growing season for a specific quantity, quality and date of delivery of an agricultural output at a price or price formula fixed in advance. The contract provides the farmer an assured sale of the crop. Sometimes, the contract includes technical assistance, credit, services, or inputs from the purchaser (see *embedded service arrangement*).
(http://www.bancomundial.org.mx/pdf/SaladePrensa/EstudiosRecientes/Lanpolfor/7.pdf)

Embedded service arrangement
In an embedded service arrangement operational services are delivered in combination with a basic business transaction (sale of products or loans). The basic idea is to finance the service as part of the business transaction, e.g. linking technical advice to the sale of inputs. Embedded arrangement may include other business partners as the service providers, such as input dealers or processing companies, or professional service providers as third parties.

EurepGAP
EurepGAP is a private sector body that sets private voluntary standards for the certification of agricultural products. EurepGAP is a series of specific pre-farm-gate certification standards that have been developed by retailers from the European Union, in partnership of agricultural producers. (http://www.eurepgap.org/Languages/English).

Facilitator / facilitation
Facilitators are initiatives pursuing a public interest in economic development (such as the *pro-poor growth* goal). This includes government programmes for private sector development as well as development projects funded by international donors. Contrary to the *VC actors*, such programmes and projects are funded publicly (by tax money). They remain outsiders to the regular business process and restrict themselves to temporarily facilitating a chain *upgrading* strategy. Typical facilitation tasks include creating awareness, facilitating joint strategy building and action and the coordination of support activities.

Food safety / product safety
Safety means freedom from environmental and other contaminants and sources of toxicity (physical, chemical and/or biological) which are injurious to health.

Governance
See "value chain governance".

Impact Model / Results framework
This is the sequence proceeding from ´project outputs´ to ´outcome´ and on to direct and indirect ´impacts´. The sequence entails causal linkages (´if-then relationships´). Synonyms are “results framework”, “results chain”, “impact chain” or “impact pathway”. The impact model is the theory of action of a project, i.e. it brings together the hypotheses about the results expected from taking action.

Impact hypothesis
Impact hypotheses are the anticipated ´if-then relationships´ linking the stages in an impact model. The sequence of impact hypotheses tells the anticipated story of the project.

Interventions (to promote value chains)
Interventions are temporary actions of external *facilitators* aimed at mobilising and/or joining *value chain actors* and building their capacity thus promoting change in the value chain. The idea is that an external intervention triggers an internal change of the system, in this case the behaviour of VC actors.

Lead company
Lead companies are key traders or industrial companies assuming a coordination role within a *value chain.* Highly integrated value chains often depend on lead companies who are the main buyers of the produce (see *value chain governance*).

Leverage point
An element in a system, where a small intervention or change can yield large effects in the overall system.

Macro level
The macro level refers to the public agencies and institutions constituting the *business enabling environment*. Typically, the macro level of a *value chain* is made up of national, regional and local government, the judicial system and major providers of public utilities (especially roads and water supply). The macro level determines the general cost of doing business cutting across different value chains and *sectors* of the economy.

Markets / market relationships
A market is the interaction of demand and supply (buyers and sellers) of particular types of goods or services. The exchange rules differ depending on the character of the good traded (e.g. *commodities*, perishable products, investment goods or services). There are different forms of market relationships: The basic market transaction is a once-off purchase of a product displayed by a seller, e.g. in a traditional street market (so called arms-length market relationship in a “wet market”). Sophisticated forms of market relationships include order contracts or regular subcontracting.

Margin (profit margin or price mark-up):
The *gross (profit) margin* is the difference between “sales revenue” and “cost price”, expressed as percentage of the cost price or as discounted percentage of the sales price. The *net (profit) margin* is the same, excluding VAT (Value Added Tax).

Micro level
In a *value chain*, the micro level includes the *VC operators* and the *operational service providers* taken together.

Meso level
In a *value chain*, the meso level includes all chain-specific actors providing regular *support services* or representing the common interest of the *VC actors*. Functions at the meso level include, for example, public research and technology development, agreement on professional standards, promotional services, joint marketing or advocacy. They are taken by *support service providers*.

Operational services / operational service providers
Operational services are those services that either directly perform *value chain functions* on behalf of the *VC operators* or are directly related to them. Operational services therefore are business-to-business (B2B) services. They include value chain specific services as well as generic business services such as, for example, accounting services.

Product
This is a generic category comprising physical, tangible products as well as services sold to costumers. The value chain is defined by a product or group of products, e.g. a tomato value chain or a fresh vegetable value chain.

Productivity
The amount of output per unit of input, e.g. the quantity of a product produced per working hour or per hectare

Pro-poor growth (PPG)
Pro-poor growth is the most commonly quoted objective of *value chain promotion*. There is a relative and an absolute concept of pro-poor growth. The relative concept states that economic growth is pro-poor if poor people increase their incomes above the poverty line, even if their share in the national income does not improve (a positive growth rate for poor). The absolute concept states that growth is pro-poor, when the income of the poorest (e.g. of the lowest quintile in a population) increases at least equally or more than the average income. (such that inequality is reduced). PPG stresses the need to make the poor participate directly in the economic growth, and does not rely on social transfers.

Public-private partnership (PPP)
Whenever private companies share the public interest in economic development, public agencies may realize certain development activities jointly with a company. PPP denotes a joint project of government and a private enterprise to realize certain *upgrading* activities. An important criterion for a public agency engaging in a PPP is that an adequate proportion of the benefit accrues to the other *VC actors* or to the general public.

Sector / Sub-sector
The economy can be divided into sectors following different criteria. Here, the term “sector” is defined according to broad product *market* categories. These include, for example, the “agri-food sector”, “forestry”, the “apparel sector” or the “tourism sector”. Each sector comprises the companies operating in the respective market as well as the specific market rules. Sectors can be further broken down into sub-sectors by differentiating into specific product or service markets, e.g. “horticulture”, “non-timber forest products” or “ecotourism”. Further differentiating these markets leads to the definition of a *value chain.* However, there is no generally accepted classification of sectors, sub-sectors or value chains. In practice, terms often overlap. The term sector (or economic sector) is a higher-order term than sub-sector and aggregates several sub-sectors.

Services
Services are economic goods delivered by a service provider to a client. Services differ from physical products, because service delivery and consumption are closely interconnected. One important distinction is between private services delivered to private clients or to enterprises (business-to-business services), and public benefit services delivered to groups of people in their collective interest. In *value chains*, it is necessary to distinguish between *operational services* and *support services*. Another category is membership services provided to insiders of an organisation, e.g. a cooperative, association or board.

Standards
Standards are a means of defining and regulating product quality by specifying the characteristics which a product or the process of making it must have. This regards intrinsic as well as ethical attributes. Business linkages in value chains have to observe product safety standards, as well as product quality standards and ecological and social standards wherever applicable. Once standards have been formulated and agreed upon, they still have

to be implemented – and the compliance with standards verified. Operators fulfilling standards receive a certificate (see *certification*).

Support services / support service providers

Contrary to the *operational services*, support services do not directly support (or perform) the basic functions in a *value chain*. Instead, they refer to general investment and preparatory activities benefiting all or at least several *value chain operators* simultaneously. Support services therefore provide a collective good shared by the VC actors. Typical examples are the setting of professional standards, provision of sector-specific information, joint export marketing, the generation of generally applicable technical solutions, or political lobbying. Support services are often provided by business associations, chambers or specialized public institutes.

Supply chain / supply chain management

The basic concept of a supply chain is similar to the *value chain*. The difference is that the supply chain refers to sequence of (upstream) sourcing and (downstream) marketing functions of individual enterprises, mostly of *lead companies*. Therefore, supply chain management is a business management tool rather than a development concept. It is concerned with logistics rather than market development.

Transaction cost

Apart from the cost of production and marketing at each stage of the value chain, the market relationships between suppliers and buyers engender "transaction cost". They include the cost of search for business partners, for seeking information and screening the market, and for negotiating, monitoring and enforcing contracts. High transaction costs often are the result of market inefficiencies, such as low market transparency, lacking grades and standards or deficiencies in the business environment. They can be brought down by organizing markets and by improving value chain coordination.

Upgrading / chain upgrading

The term upgrading denotes the development path of a *value chain*. Gary Gereffi distinguishes "product upgrading", that is the innovation, diversification or improvement of the final product, and "process upgrading", which is the improvement of production and distribution technology and logistics. These forms of upgrading improve overall efficiency. "Functional upgrading" means the shifting of value chain functions from one *VC operator* to another (e.g. shifting primary processing to farmers). It leads to a different distribution of *value added* across the stages of the value chain.
In the *ValueLinks* terminology upgrading implies activities in different fields of action, that can be summarized as ´improving business linkages, associations, and partnerships´, ´strengthening service supply and demand´ and ´introducing standards and improving policies and the business environment of the chain´. Another aspect is the expansion of productive capacity which enhances the volume sold.

Upgrading strategy

An upgrading strategy is an agreement between chain actors on joint action to upgrade.

Value added

Value added is a measure for the value created in the economy. It is equivalent to the total value generated by the *operators* in the chain (chain revenue = final sales price * volume sold). The value added per unit of product is the difference between the price obtained by a *VC operator* and the price that the operator has paid for the inputs delivered by operators of the preceding stage of the value chain and the intermediate goods bought in from suppliers of inputs and services who are not regarded as part of the value chain. In short: "The worth that is added to a good or service at each stage of its production or distribution" (McCormick/ Schmitz). Part of the additional value created remains in the chain (= value captured), another part is captured by suppliers external to the chain

Value capturing / value captured
The additional value added as a consequence of value chain upgrading that remains with value chain operators.

Value chain (VC)
A value chain is
- a *sequence of related business activities (functions)* from the provision of specific inputs for a particular product to primary production, transformation, marketing, and up to the final sale of the particular product to consumers (the functional view on a value chain).
- the *set of enterprises (operators)* performing these functions i.e. producers, processors, traders and distributors of a particular product. Enterprises are linked by a series of business transactions in which the product is passed on from primary producers to end consumers.
According to the sequence of functions and operators, value chains consist of a series of chain links (or stages).

Value chain governance
Governance refers to the way business activities in a value chain are *vertically coordinated*. Following the terminology defined by Gary Gereffi, we can distinguish different forms of governance, of which the most important are *markets*, modular value chains, captive relationships and *vertical integration*. While in a modular value chain an independent supplier makes products according to buyer specifications, captive relations describe a form of governance, in which small suppliers depend on a much larger *lead company*.

Value chain map / value chain mapping
The value chain map is a visual representation (chart) of the *micro and meso levels* of the *value chain.* According to the definition of the value chain it consists of a functional map combined with a map of *VC actors*. Mapping can but does not necessarily include the *macro level* of a *value chain*.

Value chain operator
See VC operator*.*

Value chain promotion
Promoting a value chains means supporting its development by externally *facilitating* a *value chain upgrading* strategy*.*

Value creation / value created
The additional value added as a consequence of value chain upgrading.

VC actor
This term summarizes all individuals, enterprises and public agencies related to a *value chain*, in particular the *VC operators*, providers of *operational services* and the providers of *support services*. In a wider sense, certain government agencies at the *macro level* can also be seen as VC actors if they perform crucial functions in the *business environment* of the value chain in question.

VC operator
The enterprises performing the basic functions of a *value chain* are VC operators. Typical operators include farmers, small and medium enterprises, industrial companies, exporters, wholesalers and retailers. They have in common that they become owners of the (raw, semiprocessed or finished) product at one stage in the VC. Thus, there is a difference between operators and *"operational service providers"*, the latter being subcontracted by the VC operators.
However, in a *service* value chain the VC operators include both the enterprise providing the service product to the final consumer (be it an individual client or a company) as well as other specialized providers of inputs and (secondary) services upstream.

VC supporter / support service provider
Value chain supporters provide VC *support services* and represent the common interests of the *VC actors*. They belong to the *meso level* of the value chain.

Vertical coordination / vertical integration

As value chains upgrade the vertical coordination between the different stages of the value chain increases. This means that relationships are being regulated through agreements and written contracts. This coordination function is often taken by a *lead company*. At the extreme, the relationship between suppliers and buyers is "integrated" to the extent that the production and marketing functions of a supplier are entirely controlled by the buying company (also see *value chain governance*)

Vision / visioning (for value chain development)

Value chain promotion needs a strategic perspective. The vision describes the aspired change of the value chain answering the question: How should the value chain in question look five years from now? It is very important to make sure that the vision is formulated and shared by the VC operators and supporters, so as to derive operational objectives and facilitate the coordination of *upgrading* activities.

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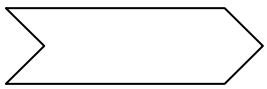
Chain Mapping Symbols in Workshops and Documents

Card shapes & colour code used in workshops and training seminars

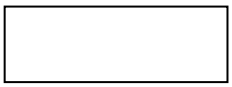
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Levels of the value chain (VC) at which the symbol is used

Micro level of the VC

VC stage



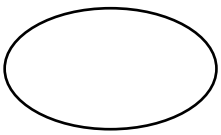
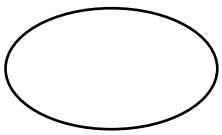

Specific business activity




Value chain operator

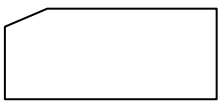



Links between operators

End market of value chain

Meso & Macro level

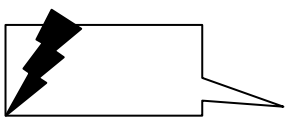



Value chain supporter




Value chain enabler

All levels of the VC

Constraint




Potential



Action

ValueLinks Module 0

Deciding whether to Engage in Value Chain Promotion

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ValueLinks Module 0

Deciding on whether to Engage in Value Chain Promotion

What this module is about

The point of departure for this manual, and indeed the fundamental goal to which it seeks to contribute, is that of "pro-poor growth" (PPG). The PPG concept builds on the basic premise that only economic growth and the market success of poor people are capable of providing a sustainable solution to the problem of poverty. Wherever poor people are able to participate in product markets, e.g. in the markets for food or labour-intensive manufacturing products, promoting the respective value chains can help lift people out of poverty. Box 0.1 presents two standard definitions of pro-poor growth, both of which relate to increasing the income of the poor.

Box 0.1 Two definitions of pro-poor growth

The relative concept of pro-poor growth

Economic growth is considered to be pro-poor if the incomes of the poor grow faster than those of the non-poor (so that the inequality between the poor and non-poor narrows).

The absolute concept of pro-poor growth

Economic growth is considered to be pro-poor if poor people increase their incomes above the poverty line, even if their share in the national income does not improve (i.e. a positive growth rate for the poor).

Source: taken from A. McKay, 2005

While income poverty is the focus of market-oriented development, other poverty aspects are also highly relevant. Property rights, access to education and social services or political participation are all factors that enable the poor to participate in business, thereby gaining a higher income in the future.

This first *ValueLinks* module introduces the *"value chain promotion"* development approach, locating it within the wider context of development strategies for poverty alleviation. It provides criteria for implementing value chain promotion as a development project strategy. Value chain promotion can either be a stand-alone project, or a component in a development programme that also pursues other approaches.

What is value chain promotion?

Value chain promotion fosters economic growth – as a necessary precondition for incomes to rise – by making sure that the additional income generated actually benefits poverty groups. This is to be achieved by strengthening the way that commercial product markets relevant for the poor function, by improving their access to these markets, and/or by influencing the distributive outcome of market processes. Value chain (VC) promotion thus harnesses market forces to achieve development goals. It is oriented towards business opportunities, and consciously builds on the existing or emerging economic potential of the poor. Therefore, value chain promotion is essentially a development approach – and clearly needs to be distinguished from supply chain management. While value chain promotion takes a public perspective, supply chain management aims at optimising the logistics of input sourcing and marketing – from the perspective of a particular lead company. The latter is a private management instrument and much more limited in scope.

Value chain promotion can be combined with other development approaches. It is not a substitute for other PPG strategies.

Tasks in conceiving value chain promotion for development

The first and very fundamental point for planners intending to engage in value chain promotion is to verify the basic premise of pro-poor growth: To what extent will it be possible to achieve the double objectives of economic growth *and* poverty alleviation in the given development situation? This module provides criteria to judge the potential and limits of value chain promotion as a means to poverty alleviation.

Depending on the answer to the question, value chain promotion may be combined with other development approaches, so as to prepare and complement the development of product markets. This leads to a second set of considerations regarding the design of development programmes in which value chain promotion is just one component among others. Making sure that value chain promotion actually contributes to poverty alleviation, we distinguish two tasks:

- (Task 0.1) Assessing the potential and limits of VC promotion in the given development situation
- (Task 0.2) Combining value chain promotion with other development approaches

The first task includes verifying whether minimum conditions for the participation of the poor in commercial markets are fulfilled. If certain conditions are missing, a development programme design may include additional approaches preparing and supporting a value chain promotion component. Even where there is a promising potential, it will be necessary to set boundaries further on - determining the scope of interventions and selecting specific value chains. This aspect of programme design is treated in *ValueLinks* module 1.

(Task 0.1) Assessing potential and limits of value chain promotion

Before engaging in value chain promotion, development policy makers need to explore under which conditions a value chain perspective actually is appropriate for attacking the poverty problem. In fact, supporting poverty groups within the context of product markets may not be sufficient as the economic potential and competitiveness of the poor often is limited by generic problems cutting across many if not all value chains. Box 0.2 lists constraints affecting the participation of the poor in commercial markets.

Box 0.2 Concept: Factors affecting participation of the poor in commercial markets

Generic factors limiting the market participation of the poor

Business environment and policy

- The business environment implies higher risks and relatively higher costs of doing business for small enterprises as compared to large ones.

Access to cross-cutting service markets

- Small farmers and micro enterprises are negatively affected by the conditions of access to formal financial markets requiring securities and guarantees.
- Because of the size of their operations, small producers regularly face problems of access to input and business service markets.

Productive assets and property rights

- Low education and health problems put the poor at a disadvantage in labour markets.
- Lack of assets and missing property rights on land and water critically limit investment of farmers.

Conditions of the location

- Poverty is often concentrated at marginal locations, where market access is critically limited – raising marketing costs and preventing investment.

Source: own compilation

Designing a value chain promotion approach has to take these factors into account. As the relevance of the factors differs between markets, the possibility of translating growth into poverty reduction is a matter of carefully selecting the product markets to be developed. One option is to select those value chains presenting the least problems for the self-employed poor in the first place. Another possibility is to make the best of an adverse condition. For example, even if a particular location appears marginal, it may offer some typical local specialty or be attractive for tourists. The constraint could thus be turned into an opportunity. Some of the adverse conditions only apply to self-employed poor entrepreneurs or to micro-enterprises. It is possible to circumvent these conditions by focusing on labour-intensive industries generating employment opportunities for poor people. The pro-poor impact is not in terms of poor farmers and micro enterprises getting access to the market, but in the jobs created as a consequence of value chain promotion. The analysis of the particular conditions and opportunities is part of the process of selecting value chains for promotion. Module 1 of this manual is mainly devoted to this question.

However, wherever the generic factors mentioned in box 0.2 become so pervasive, that value chain promotion cannot accommodate them, development policy needs to reconsider the development approach at large: The question is whether a VC promotion may still be applicable if complemented with interventions targeting the cross-cutting problems separately. If not, the focus should be shifted away altogether, moving from value chain promotion to another approach towards poverty alleviation.

A general rule pondering these options is to consider the severity of the poverty problem and the interconnections between the constraints. The less developed the economy, the more important become the constraining factors mentioned in box 0.2. A helpful classification of rural poverty situations is provided by the OECD (“Promoting pro-poor growth agriculture”,

2006). OECD-DAC distinguishes five different “rural worlds” according to their degree of economic development and market orientation ranging from “large-scale commercial agriculture” (“rural world 1”) to “chronically poor rural households, many no longer economically active” (“rural world 5”). The least developed rural worlds present an intricate mix of poverty-related problems limiting the significance of market-oriented approaches - value chain promotion included. While it is difficult to determine a definite “cut-off point”, below which value chain promotion would no longer be feasible, it is clear that there are absolute limits. Certainly, chain promotion would not have much sense under conditions of severe poverty as in the “rural world 5”. Wherever major barriers to economic participation remain, poverty groups will continue to be excluded from the benefits of economic growth. In these cases interventions addressing land and water rights, basic education or health services, social organisation, or even transfer of social benefits have to precede any market-oriented development.

Fortunately, the line separating the potentially “competitive” from the “non-competitive” poor can be shifted. Even people with incomes of below 1 US$ per day can become interesting market partners. Recent studies show that there are important business opportunities at the economic “base of the pyramid”: An example is the village phone market in Bangladesh in which initially poor “phone ladies” sell mobile phone time to their fellow villagers boosting their own income and providing a service that pays off for their clients as well (S. Hart, 2005, p.119 pp).

Sounding out potential negative impacts of market-oriented development

Development practitioners need to be aware of potential negative implications of using a commercial market development approach. One issue concerns the consequences of structural change: The promotion of competitive markets tends to squeeze out traditional producers in small scale industry and agriculture benefiting bigger and more efficient producers. Building exclusively on low cost and low wages can lead to market integration, but may fail to produce a substantial poverty impact (the so-called “low road” of market integration). Any investment into productivity improvement in highly competitive, low value food markets translates into a fall in prices. In turn, small-scale cash crop production in monoculture may negatively affect food security. Great attention also needs to be given to the terms under which vulnerable groups of workers (migrant and casual labour) participate in the economy.

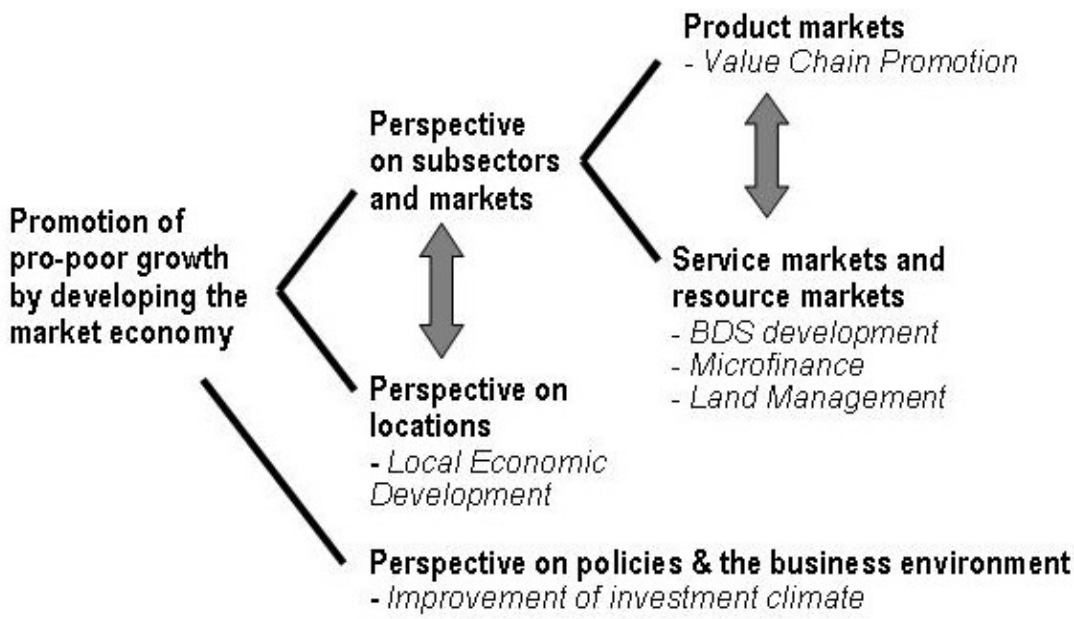
Depending on the importance of the constraints, the value chain perspective has to be complemented with other interventions targeting the general ability of the poor to engage in business activities. One option is introducing a territorial focus addressing the infrastructure conditions of marginal locations, others tackling administrative hurdles for the poor or generic problems of service access. Indeed, most development programmes combine different types of interventions. Typical combinations of value chain promotion with other development approaches are treated in point 0.2, below.

(Task 0.2)
Combining chain promotion with other development approaches

Promoting pro-poor growth can take different perspectives depending on the subsystem of the economy that is to be promoted. Box 0.3 shows how these perspectives interrelate: A fundamental distinction is between the sectoral and the spatial perspective on economic development. While local and regional economic development (LRED) focuses on enhancing the competitiveness of a location and the local or regional economy, the sectoral perspective aims at activating the growth potential of a particular market. The sectoral perspective can be further broken down into consumer product markets on one side, and service or resource markets on the other. In a product market (i.e. value chain) perspective poor people come into play as producers and suppliers of marketable products. In a business service (BDS) or microfinance development perspective they are seen as clients of a pro-poor service system that needs to be put in place. The focus on economic policy and the business environment takes an overarching perspective on PPG. Hence, value chain promotion is just one of several possibilities of conceptualizing economic development.

Box 0.3 Concept/template: A hierarchy of perspectives on economic development

Perspectives of economic development (bold) and development approaches (italics)



Source: own concept

The different perspectives are not mutually exclusive. In development practice, spatial and sectoral approaches are often combined and value chain promotion becomes a component within bigger programmes of economic and rural development.

Typical programme designs include combinations of:

- value chain promotion & spatial economic development (LRED or rural development)
- value chain promotion & business service market development (BDS)
- value chain promotion & economic policy advice

The perspective on particular markets taken by the value chain approach also combines well with development programmes in the fields of natural resource management, especially the sustainable management of tropical forest resources, marine ecosystems and biodiversity. A key principle in protecting these natural resources is their sustainable economic utilization.

Hence, developing the markets for natural products derived from protected areas can also be a component in natural resource management programmes.

The following sections provide criteria for exploring potential synergies and complementarities between value chain promotion and other development approaches – following the idea that combining development perspectives can boost the prospects of impact.

Combining value chain promotion with regional economic development

Local (and regional) economic development (LRED or LED) is a well documented development approach widely used by development agencies. A brief description of the concept is presented in box 0.4.

Sectoral and spatial perspectives on economic development complement each other. The focus on a particular region envisages different industries at that location. Analyzing their economic potential starts with a multisectoral perspective and leads to the identification of promising market and value chains. In turn, the focus on a particular industry or value chain allows envisaging all business linkages leading to up to final consumer markets. Analyzing the value chain often brings out relevant factors of location that need to be addressed to enhance its competitiveness.

Box 0.4 Concept: Local and regional economic development (LRED)

Local and regional economic development

LRED is a strategy to promote local and regional economies. The main objectives of the LRED approach are to create conducive framework conditions for business at a particular location, removing administrative obstacles, enhancing the competitiveness of the location to attract new investors, and strengthening the local enterprises and business cycles. LRED enables the stakeholders of a region to undertake initiatives to jointly promote economic development of their region by establishing linkages between the private and public sectors and the interest groups of the civil society. Local development strategies are based on the region's economic potential, resources and institutional conditions. A related and even more localized concept is "communal economic promotion".

Source: own compilation

Hence, a combination of both perspectives may engender important synergies. This synergy can work both ways, as shown in box 0.5.

Box 0.5 Concept: Synergies between spatial and sectoral approaches

Contributions of a spatial development perspective to value chain promotion:

- adjustment of location factors to comply with the requirements of value chain development, especially local infrastructure, local administration and public service provision
- management of conflicts between competing demands of different chains on local resources (natural resources and scarce factors of production)
- working on interrelations and complementarities between different value chains

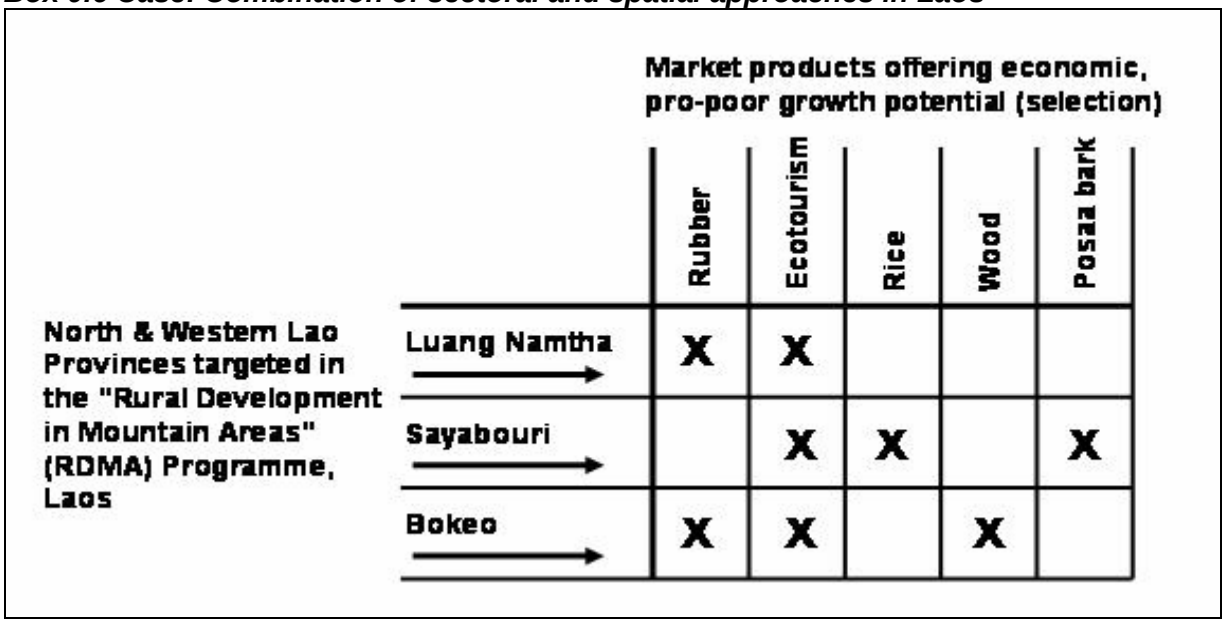
Contributions of a value chain perspective to local economic development:

- strengthening the local economy identifying those sectors of a region that offer the greatest market and development potential
- promoting exports from the location working on the competitiveness of producers integrated into national and global value chains
- analyzing the value added generated in the region and devising strategies to enhance the share of the region

Source: own compilation

In order to fully exploit the potential synergies, development programmes have to coordinate the selection of the regions and of the value chains to be supported. In fact, promoting a regional economy without using a value chain perspective to address the local economic potential may not be very effective. Obviously, the synergy is greatest wherever the final market of a value chain is in the region itself. In this case, VC promotion refers to local value chains or "local economic clusters" combining location-specific with market-specific development interventions. Hence, there is a close conceptual relationship and interface with the cluster development approach to economic development (see Pietrobelli and Rabellotti, 2004).

Box 0.6 Case: Combination of sectoral and spatial approaches in Laos



Source: based on information of RDMA programme, GTZ Laos

The example in box 0.6 shows how regional economic development can lead to a value chain perspective. The RDMA programme in Laos operates in selected districts of three Northern provinces in Laos. The analysis of the regional economic potential in each region delivers a list of promising products, e.g. latex (natural rubber) for export to China, Po Saa bark – a non-timber forest product providing the raw material input for high-value handmade paper, mainly for export to Thailand but also for local processing or rice for domestic urban consumption. Most of the products have their market beyond the provincial borders. This means that market development needs to include value chain actors at other locations. The case of ecotourism is particularly telling: The tourism sector includes international tourist operators in Europe or the US. In order to development tourist attractions in a particular region, development planners have to look for intermediaries outside the region to enhance sales.

The regional - sectoral link also comes to view when the starting point is a value chain. For example, fine Ecuadorian cocoa, an important export product, has its origin in several well-defined locations in the country. Promoting the industry makes it necessary to address technology and service problems regionally. The spatial dimension of value chains provides an interface with interventions supporting decentralisation and regional planning. E.g., investing in organic honey production presupposes organized land use banning intensive agriculture in specific places so as to prevent the contamination of honey.

Combining value chain promotion with service market development

The development of demand and supply of services to enterprises are key elements of value chain promotion. Although there are many specialized services for particular value chains,

the majority of business services support generic production and marketing tasks that cut across subsectors. This is particularly true for financial services.

The development of business services (the "BDS" approach) and the promotion of microfinance systems constitute independent approaches to pro-poor economic development. Both focus on the problems of service availability for small enterprises (see the brief descriptions presented in box 0.7. As in the case of LRED, there is an intense international debate and well-documented methodology. Basic principles of these approaches apply to value chain promotion as well and are included in modified form in *ValueLinks* modules 7 and 8. Nevertheless, it can be very useful to combine chain promotion with approaches to generic service development. In fact, many BDS development projects switch to a value chain perspective in the course of implementation.

Box 0.7 Concept: Development of service markets for the poor

Development of business (BDS) service markets

The objective of interventions in Business Development Services (BDS) is to create a functioning market with a diverse array of high-quality services that meet the needs and are affordable to small and medium enterprises (SME). Business Development Services are non-financial services critical to the market entry, survival, productivity and growth of SME. Typical generic BDS include business training and advice, marketing assistance and information.

Development of microfinance systems

The microfinance approach aims at setting up and developing financial systems for micro and small enterprises as well as improving the access of the poor to financial services. This includes support of microfinance institutions, of institutions that provide business services for the microfinance sector as well as support to the public sector in developing and implementing policies in the area of microfinance.

Source: own compilation

The main synergies between service development and value chain promotion are listed in box 0.8. It is important making sure that the service categories fit the requirements of the value chains selected for promotion. The value chain perspective should take precedence, so that service promotion builds on the real demand derived from business opportunities.

Box 0.8 Concept: Synergies between service development and value chain promotion

Contributions of BDS and microfinance approaches to value chain promotion:

- developing microfinance institutions serving different value chains at the same time
- supporting microfinance services in a systems perspective including policy
- developing generic business services needed by and accessible to SME, such as specialized business training and advice

Contributions of a value chain perspective to BDS and microfinance approaches:

- referring service demand to the potential of end markets for SME and the respective requirements of value chain development
- providing the analytical framework for designing embedded service arrangements.

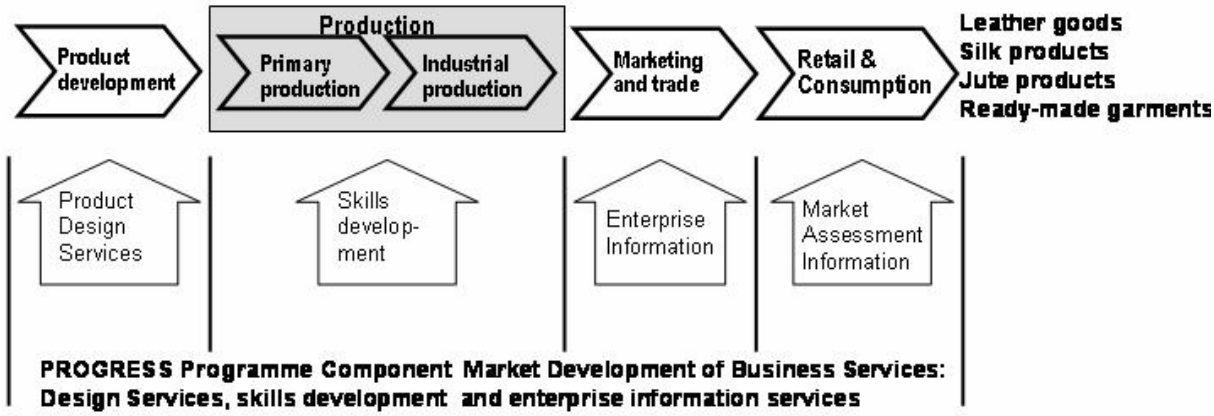
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An example of a combined programme design is presented in box 0.9. The PROGRESS programme in Bangladesh demonstrates how a service market development approach may be combined with a value chain perspective. This programme operates in four economic sectors - leather, silk, jute and garments. In each sector, sector and value chain studies have been conducted in which major service needs have been identified.

At the same time, the programme focuses on three categories of generic business services of great relevance for the economy – design services, skills development and enterprise

information services. The programme concept allows addressing upgrading needs derived from value chain analyses – and can focus on the professional competence in the respective service at the same time. Operating across sector limits, service providers have access to a broader market than would be the case in a single value chain. Similarly, this programme addresses constraints in the business environment and in the compliance with international social standards.

Box 0.9 Case: Combining BDS and the value chain approach in Bangladesh



Source: adapted from presentation on programme website: http://www.gtz-progress.org/

Creating an enabling business environment and investment climate is another private sector development approach (see *ValueLinks* module 10). Activities include the development of instruments for improving the regulatory and institutional framework creating better development opportunities for the private sector. The application of these ideas in a value chain promotion context is dealt with *ValueLinks* module 10 in along with examples.

Combining value chain promotion with natural resource protection

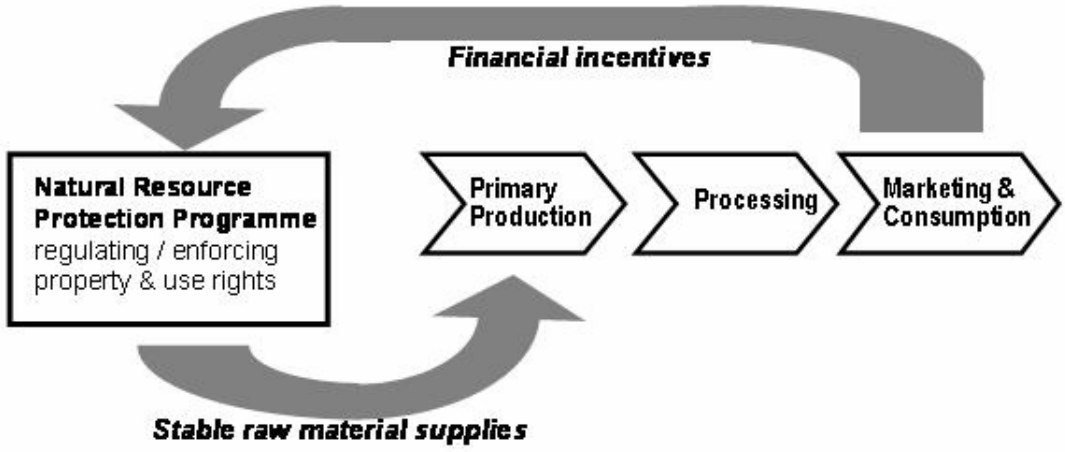
Contrary to the development approaches treated in preceding sections, programmes aiming at the protection of natural resources (natural ecosystems, wildlife, biodiversity or genetic resources) do not follow a uniform development methodology. Nevertheless, many natural resource management (NRM) programmes build on the same principle – protecting natural resources by using them economically. Endangered ecosystems and biodiversity can best be protected by opening up a market for their products.

Increasingly, NRM programmes complement their activities by a component fostering the sustainable, economic use of biological resources (e.g. to make pharmaceutical or cosmetic products), of environmental services (e.g. selling carbondioxide certificates) and of the landscape beauty (for ecotourism). The market development for these products raises the consciousness about their value, provides incentives for their preservation and generates income for the people living in protected areas. In return, value chain promotion programmes also benefit from environmental programmes as protected areas are a source of specific raw materials. Tropical forests and other habitats offer rare natural products, and therefore can be a source of product innovation. Local specialties and traditional plant varities are found in marginal regions with a poor rural population. Thus collaborating with the management of protected areas may strengthen the pro-poor aspect of VC promotion. Box 0.10 provides the concept of combining both development approaches.

An example is the protection and economic use of the wild Argania spinosa tree in South Morocco. This tree stands on around 800.000 hectares (“arganeraie” ecosystem) in the

Agadir region. The fruits are traditionally harvested to obtain the potentially high-value Argania oil, a local specialty providing the livelihood for the rural population. As Argania is extremely slow growing and hard to propagate, this ecosystem at the fringe of the desert is in danger. Unsustainable utilization and felling of trees lower the water table and accelerate desertification. The population migrates and availability of labour for Argania oil production is reduced. As result of a resource protection programme some years ago, a framework for use of the arganeraie was developed and the area declared a UNESCO biosphere reserve. In order to halt the degradation process, the tree has to be revalued also for its economic benefit. Improving the Argania oil value chain can be an important contribution to ahieving this.

Box 0.10 Concept: Combining natural resource protection with a chain perspective



source: own concept

When designing the combination of natural resource management with value chain promotion a number of critical considerations have to be taken into account. The most important has to do with a typical difference in perspectives: NRM programmes tend to think supply-driven, while chain development starts from the market demand. Whether the natural products on offer run a chance in commercial markets cannot be determined by the NRM side but follows from the demand of traders already buying similar products. In order to increase the chances of success, value chain promotion for biological and environmental products should not be limited to only a few products and origins, but collaborate with many NRM programmes at the same time. A related critical point are volumes and turnover. The natural products in question constitute, almost by default, niche products. This means that the effort to be invested in market development has to be limited, too. Therefore, value chain promotion has to take on entire categories of products and be extremely innovation-oriented.

Summing up, the combinations of different development approaches appear to be promising and can enhance potential pro-poor growth impact. Nevertheless, program design also has to apply pragmatic criteria to avoid overly complex concepts. Some of the related strategic questions are taken up in *ValueLinks* modules 3 and 4.

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The South-African Local Economic Development network: http://www.led.co.za/

Business development services: http://www.bdsknowledge.org/

ValueLinks Module 1

Selecting a Value Chain for Promotion

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ValueLinks Module 1

Selecting a Value Chain for Promotion

What this module is about

Value chain promotion represents a systemic approach to economic development. A value chain is an economic system composed of chain operators, operational service providers and their business linkages at the micro level, and support service providers at the meso level. All operators adding value to a particular marketable product on its way from raw material to the final consumer are considered part of the value chain. The system boundary of a value chain is defined by the final product, and the value chain itself comprises those producers and enterprises which perform functions necessary to bring the product to market.

Box 1.1 Definition of the term "value chain"

A value chain is an economic system that can be described as

- a *sequence of related business activities (functions)* from the provision of specific inputs for a particular product to primary production, transformation and marketing, up to the final sale of the particular product to the consumer;

- the *set of enterprises (operators)* that performs these functions, i.e. the producers, processors, traders and distributors of a particular product. Enterprises are linked by a series of business transactions in which the product is passed on from primary producers to end consumers.

- a *business model* for a particular commercial product. This business model allows defined customers to be reached using a particular technology and a particular way of coordinating production and marketing between several enterprises.

All the above terms are defined in the *ValueLinks* glossary.

Source: own definition, used throughout the *ValueLinks* Manual.

Value chain actors share an interest in the end product because changes in the end market affect them both collectively and simultaneously. The value chain community and its internal rules thus constitute a natural area of development action. (For a detailed description and analysis of value chains as economic systems, see *ValueLinks* Module 2.)

This module addresses the issue of selecting one or more value chains for promotion. Setting the boundaries of development action is the responsibility of all development or government agencies engaging in value chain promotion. The identification of a particular value chain is the first and certainly one of the most important decisions in every value chain promotion project. The choice of subsectors and value chains determines to a large extent the prospects for the impact of value chain promotion.

This module presents tools for disaggregating larger subsectors into individual value chains, and for setting priorities across promising products and chains. In order to reach a decision, the selection criteria have to be assessed. Hence, the methodology also includes how to collect information on the markets of the products in question.

Tasks in selecting a value chain for promotion

Defining a value chain promotion project starts by delineating a field of action determining the "systems boundaries" of the value chain that shall be promoted. As value chains are made up of producers and enterprises, selecting a product or category of products implicitly determines the enterprises to be promoted later on. The selection process has two iterative

stages: The first stage is to determine the level of aggregation - that is whether to take one product, a category of products or an entire sub sector. The first stage is to establish the structure of sub sectors, e.g. horticulture, handicrafts or leather goods, breaking them down into product categories and individual products. This provides a list of options and includes a preliminary decision on the size of markets and hence the size of the business community the value chain project is going to work with (task 1.1)

Based on the definition of these alternatives, the second stage is to choose between the options by comparing their relative advantages. The potential of market expansion is a “killer criterion”: A condition sine qua non and the key criterion for selecting a value chain is the existence of a demand potential for the product in question. Unless buyers absorb an additional quantity of the product or are willing to pay higher prices, any effort to promote the respective value chain will be in vain. In order to measure the criterion of demand, market information has to be collected from the very beginning of a value chain project. Therefore, market research is included in this module as a second task preparing and informing value chain selection. The end point is a priority decision on the value chains to be promoted

The module treats three tasks in total. The tasks are closely interrelated. They should be considered as iterative meaning that decision makers most likely have to perform the tasks in parallel jumping forward and backward

- (Task 1.1) Deciding on the scope of markets to be promoted
- (Task 1.2) Conducting and supporting market research
- (Task 1.3) Setting priorities across products and value chains

Market research continues to be necessary at any stage of value chain promotion. At the point of selecting a value chain market research cannot go very deeply. In order to verify the initial decision in favour of a particular value chain and to guide the formulation of an upgrading strategy further market research will be necessary.

(Task 1.1) Determining the scope of value chains to be promoted

Value chain promotion deals with the enterprises and the supporting organizations that constitute the value chain. The question is which economic actors a chain promotion project is actually going to deal with. The answer to this question is implicit in the selection of a product or group of products. The boundary of a value chain is derived by determining the functions and operators necessary to produce and market a particular final product. Hence, determining the type of product implies who needs to be regarded as part of the value chain. Therefore, understanding the structure of markets is the point of departure for setting project boundaries as well.

There is no definite method of subdividing the world of marketable products into categories as the criteria of classification depend on the purpose for which it is done. Two internationally recognized systems of product classification are the "Central Product Classification" (CPC) and the "Standard International Trade Classification"(SITC) of the UN Statistics Division. Both have been developed for the purpose of unifying national statistics across borders (see http://unstats.un.org/unsd/class/prodserve.htm). The CPC uses 10 broad categories, the first being "0 - Agriculture, forestry and fishery products", which are broken down into a maximum of nine subcategories at four levels. For example, ""0 - Agriculture, forestry and fishery products" is broken down into "01 - Products of agriculture, horticulture and market gardening" and other products. This category is for differentiated into, for example, "012 – Vegetables" and "0121 – Potatoes".

The product classification may be used as the starting point for establishing the structure of sub sectors. However, the breakdown does not always go down to individual products and raw and intermediate products are included as well. Therefore, the CPC and SITC do not fully correspond to a classification of value chains. What they make clear, however, is the hierarchical structure of a market classification.

Box 1.2 shows levels of aggregation in their relation to the value chain concept: At the highest level are economic sectors containing many product categories. These categories correspond to sub sectors on level below. Every sub sector is differentiated into several value chains, which in their turn can be broken down into "sub chains" or market channels. Box 1.2 shows how products and product categories are related to the definition of sub sectors, value chains and channels. The box is purely illustrative.

Box 1.2 Concept: Levels of aggregation in consumer markets

Sector	**Agriculture & Food**	**Tourism**	**Textiles & Clothing**
⇩ *Sub sectors*	- Horticulture - Dairy products - Meat … and others	- Ecotourism - Beach tourism - Conferences … and others	- Clothing - Textiles - Carpets … and others
⇩ *Value Chains*	e.g. Horticulture: - French Beans - Tomatoes … and others	e.g. Ecotourism: - hiking in national park - animal watching … and others	e.g. Clothing: - Apparel - Knitwear … and others
⇩ *Sub chains/ Channels*	according to end product: *- e.g. table tomatoes sold in supermarkets*	according to individual services & attractions *- e.g. cabin accommodation for hikers / facilities for nature observation*	according to end product *- e.g. brand name apparel sold in specialty stores*

Source: own concept

Starting from a whole sector, e.g. the textile and clothing industry, it is possible to select a sub sector for promotion, e.g. clothing, specify a value chain, e.g. cotton apparel, or even limit the promotion to one product only, such as a specific production line of men's shirts with the label "Egyptian cotton".

Breaking down the market into specific segments is important for two reasons:

- Before selecting a particular value chain, the alternatives should be clear. Some markets or market segments are more relevant than others from a pro-poor growth perspective. It makes sense to consider the full choice of options.
- The available resources must be in line with the number of operators involved. Establishing a hierarchy of market categories allows a choice between different areas of outreach and effort.
- There are limits below which a further disaggregation loses sense, either because the business community become too small and value chain promotion inefficient, or because product variants are made by the same operators.

The first point will be taken up below, in section 1.3. The second and third points have to do with the size of the market. The issue is to keep value chain promotion manageable and efficient. At the same time, the differentiation of markets cannot be taken too far: Often, the same operators produce, transform and trade a series of similar products, e.g. different kinds of fresh vegetables. The interests of the business communities often overlap, as in the case of different leather good manufacturers, who all rely on the same sources of raw material. Planners have to make sure to address the right level of aggregation, so that enough resources and know-how are available and the effort is in line with operators´ perspective. Box 1.3 shows the example of the textile and garment sector in Ethiopia.

Box 1.3 Case: Textile and garment sector structure in Ethiopia

Product category 1	***Product category 2***	***Individual Products***	***Options-***	***Arguments***
Technical textiles		not specified		
Home textiles		table cloth		growing market technology available, uses local resources (cotton) does not require high skills
		bedding (bed sheets)	**X**	
		curtains	**(X)**	see above, represents 50% of home textile export value
		decorative materials		established export links
Clothing	Knitwear	basic t-shirt / polo shirt	**X**	value-adding in Ethiopia, labour-intensive product for domestic and export market
	Uniforms and work wear	students, hospital & office uniforms	**X**	good domestic market, technology is available, uses Ethiopian cotton
		Factory work wear		
		military and police uniforms	**(X)**	good export opportunities, made to order - cannot easily be rationalized
	Dresses	Traditional (national) dress	**X**	rising demand for fashionable products, is produced by small enterprises, labour-intensive, technology is available, unique product
		Suits		narrow market

Source: *ValueLinks* Textile and Garment Seminar organized by ECBP programme, Addis Ababa, 2006

The sector structure was developed jointly by sector experts within two hours and used to identify products/value chains that might receive public support. The box not only shows the options, it also helps to decide where and whether it would be useful taking on a whole category rather than individual products. This is the case in the category ´uniforms and work wear´. Students, hospital & office uniforms do not need to be treated separately as all are made by a small group of firms with similar technology and sold on the domestic market. Although the markets differ, upgrading the respective value chains most probably includes the same activities. Here it makes sense to move up gathering different products in one category.

The aggregation or disaggregation of products generates alternatives that can be compared in terms of their attractiveness for private and public investment. The section on task 1.3, below, provides criteria for comparison.

(Task 1.2) Conducting and supporting market research

The possibility of achieving *any* development impact with value chain promotion depends on the growth potential, the prospects for market expansion. Market demand and the interest of buyers are ´killer criteria´ in selecting a value chain. Unless the final product can be sold and value-added increases, there is no additional income for poor people either. Besides the significance of market studies for value chain selection, identifying the market potential and specific market opportunities are basic tasks in every market-oriented development approach.

Market intelligence plays an important part at different stages of chain upgrading and promotion. It is needed for three main purposes, i.e.

- to assess the growth potential when selecting a value chain for promotion
- to identify market opportunities and formulate an upgrading vision and objectives
- to design support action in line with demand conditions

The first point means analyzing the market demand to verify that the minimum (´killer´) criteria for selecting a value chain are fulfilled. This does not require a complete market study but data on the annual growth of sales and the factors driving likely demand trends such as urbanization and changing consumption habits. The second use of market research is the identification of market opportunities to be developed. Solid market analysis is a crucial input into developing a vision of chain upgrading. Finally, market research plays a role for the fine-tuning of an upgrading strategy. In each field of upgrading the solutions have to be in line with market requirements (see *ValueLinks* module 3 for the formulation of an upgrading strategy and the subsequent modules on business linkages, services, and quality standards).

Elements of market research

Whichever the specific purpose of market research, it typically has to answer the questions in box 1.4. The box summarizes the main elements of any type of market research.

Box 1.4 Tool: Key elements of market research in value chains

Lead questions and criteria:

(a) Is there a market and how can it be characterized?:
- types of products in demand (e.g. varieties and seasonality as well as product quality and packaging as preferred by the processing industry and/ or final consumers);
- market size and trends (e.g. volumes traded, consumption of different consumer groups);
- seasonality of market supplies (e.g. periods of over- and undersupply), demand peaks;
- product prices (e.g. maximum & minimum prices, price trends, fluctuations, price range)
- Requirements of buyers in terms of quality, price, volume and reliability

(b) Who are the competitors and how do they perform?
- competing producers/ value chains (e.g. imports, supplies from other regions);
- performance of competing market participants (e.g. price, quality, market shares);
- competitive advantages of competitors (e.g. market distance);
- competing products (e.g. products used as substitutes);

(c) What are the conditions of market access?
- existing distribution channels (e.g. industry, export or end consumer markets)
- power of market participants (e.g. monopolies);
- infrastructure of roads and market places (e.g. rural/ urban markets, storage facilities);
- product standards (e.g. laws/ regulations on product safety, labelling or packaging);
- tax and tariff regimes (e.g. customs tariffs on inputs, levies on road transport);
- service offers facilitating market access (e.g. financial and information services).

Source: own compilation

Market research is a private responsibility in the first place. Every enterprise has its own buyers and needs to understand the particular market segment it is serving. While export promotion agencies and development programmes can be helpful in collecting and processing relevant data, eventually the enterprises concerned have to grasp and pursue the opportunities on their own. Enterprises are not only better placed to recognize a business opportunity; the venture to upgrade a value chain also involves creativity and entrepreneurial risk.

Nevertheless, the value chain as a whole depends on the same end consumers - and a profound understanding of end markets is in the interest of all chain actors involved. Therefore, *basic* information on end markets has the character of a common good that is shared among chain operators. To the extent that the business community and their organisations fail to generate this information, external development agencies and facilitators may take it over to conduct, facilitate or commission market research as an essential contribution to chain upgrading.

Methods of market research

Market opportunities are derived from combining information on
- the market demand,
- the conditions of market entry and the competition situation with
- the own competitive advantages of the value chain operators in that market.

Market research has to deliver data on each aspect. The method of market intelligence differs according to the respective purpose. Not all of the points in box 1.4 need to be analyzed in full detail. The principle is to generate just as much information as is necessary to fulfil the purposes mentioned above. Hence, selecting an appropriate procedure among the many approaches to market intelligence follows pragmatic considerations in the first place. Box 1.5 suggests sources of market information useful for preparing the selection of a value chain for promotion.

Box 1.5 Tool: Collecting market information to support the selection of a value chain

Type of market information	*Source of information*
Comparative information on demand and supply trends in different value chains	• Compilation of secondary data from internet sources (e.g. through ITC or CBI, see box 1.6) • Review of existing market studies for the products and value chains in question

Source: own compilation

Once a business opportunity has been identified and value chain promotion is taken on, further market analyses are required to build an upgrading vision and strategy. The information on market demand has to be specified in terms of real market opportunities, analyses of market structure and trade barriers to the European and US markets. This includes collecting quantitative data on sales volumes and prices, and on the corresponding parameters and benchmarks in competing value chains and similar products. Market analyses also include mapping the distribution channels, which is part of a chain analysis (see *ValueLinks* module 2).

Among the internet sources, the International Trade Centre (ITC) stands out with a series of valuable databases and tools to conduct market studies. ITC runs a web-based databank that is organized by trade flows (trade map), regions (country map), products (product map) and markets (market access map). Users of the databank have to pay a fee (see www.intracen.org).

Box 1.6 Tool: Elements of market studies and sources of information

Type of market information	*Source of information*
Detailed information on demand and supply figures	• General market databases available in the internet: ITC - http://www.intracen.org/mas/welcome.htm CBI - http://www.cbi.nl/marketinfo/cbi/? • Agricultural markets: http://www.amad.org (Agricultural Market Access Database) http://www.ers.usda.gov/Browse/TradeInternationalMarkets/ • West African agricultural markets: http://www.resimao.org/html
Analysis of market structure and distribution channels	see the chain mapping method in *ValueLinks* module 2
Identification of relevant quality standards	see the *ValueLinks* module 9
Identification of conditions of trade and trade barriers	• Conditions and barriers in international trade: http://www.tradeknowledgenetwork.net
Demand characteristics (quality, seasonal and quantitative requirements)	• Field visits and interviews with buyers and lead firms of the value chain
Major competitors, business contacts	• Open interviews with sector specialists • electronic business platforms (see *ValueLinks* module 5)
Competitive benchmarking	to be found on sector-specific internet resources such as, e.g. http://www.teaandcoffee.net/ (for coffee and tea in general), www.scae.com (for specialty coffee), http://www.astaspice.org/ (for spices) A guide to industry-related websites is http://ec.europa.eu/enterprise/sectors_en.htm
Analysis of local (rural) markets for producer groups at micro level	"Rapid market assessment" (RMA) or "rapid market survey" techniques generating first hand empirical information, e.g. www.**ciat**.cgiar.org/agroempresas/pdf/manual2_marketopportunity.pdf

Source: own compilation

Accuracy and reliability of these information sources and methodological options differ – as do the costs of market research. In many cases, it is most cost-efficient to gather the relevant information by conducting interviews with sector specialists, processors and buyers. In any case, it makes sense to collect market information as the chain upgrading project unfolds. Not all elements have to be analyzed at once. This allows to organize data collection according to the demand and specific know-how of staff and consultants.

The alternative option to a piecemeal approach is to commission a comprehensive market study at the outset of an upgrading project. This has the advantage that a reference document becomes available presenting the relevant information in systematic form. However, markets are permanently changing and new markets can emerge, so that the information may soon be outdated. Obviously, comprehensive studies are expensive as well. Box 1.7 presents the outline of the contents of a detailed survey of the mango market in Kenya. The box can be used to draw up terms of reference for similar studies. While compiling terms of reference for a marketing consultant, it has to be made sure, that the actual study effort corresponds to the decision and planning tasks ahead.

Box 1.7 Case: Commissioned comprehensive mango market study in Kenya

Methodology of a the market study

1. *Desk research – main tasks:*
- Collection of relevant documents (market/technology studies, statistics etc.);
- Analysis of documents/secondary data;
- Outline of the field research;
- Draft of interview guidelines/questionnaires for the field research.

2. *Field research – main tasks:*
- Shop checks;
- Poll among final consumers (limited number; probably product testing);
- Interviews of processors, exporters, retailers (probably round table discussion) and other key experts.

Analysis and presentation of results

1. *Demand analysis of the mango market in Kenya:*
- demand of final consumers
- demand of industrial customers and exporters

2. *Demand trend analysis*
describing recent demand trends over time (in terms of value, volume, variety and market growth)

3. *Quantified marketing channel diagram*

4. *Description of market access requirements (legal, industry and trade standards)*

5. *Description of product profiles of value-added products*
- available in the market (domestic and/or imported);
- processed by the Kenyan industry for the domestic and/or export markets;
- possible new products having a market potential in Kenya;

6. SWOT analysis (Strengths/Weaknesses/Opportunities/Threats) of the mango market regime in Kenya, covering, among other things,
- processing capacities and technology;
- physical infrastructure;
- logistics/transport/cooling facilities in processing and wholesale/retail trade;
- technical barriers to export trade;
- marketing services;
- Policy and regulatory impediments, administrative requirements, etc.

7. *Conclusions*
Strategic options and recommendations with regard to further steps of the PSDA Programme.

If the study comes to the conclusion that there is demand potential for domestically produced and processed mango products, the study should as well:

- give first recommendations for improving the value chain from the perspective of the demand side (processing industry, export and retail trade, consumers)
- draft Terms of Reference for potential subsequent analyses.

Source: Private Sector Development in Agriculture (PSDA) Programme, Kenya 2005

Apart from the general knowledge about the demand of end markets that is relevant to all chain operators, each individual enterprise in the chain needs to understand its own sales market. Positioning a particular enterprise in the market is a private entrepreneurial task. Contrary to the supply of public-good type market information, it is not the role of development agencies to undertake micro level market studies for individual enterprises. There may be an exception to this rule in the case of cooperatives of small producers in the start-up phase.

External agencies can support the market intelligence capacity of enterprises indirectly, either by strengthening providers of marketing information and support services or by fostering vertical business linkages.

(Task 1.3) Setting priorities across alternative value chains

With limited public resources, only a few sub sectors or value chains can be promoted. Economic development policy has to focus on those markets that offer the greatest potential for achieving a development impact. Based upon a list of alternatives such as the one in box 1.3, development planners have to make a choice that should be based on criteria describing the pro-poor growth objective in the first place.

Three groups of criteria can be distinguished:

- Criteria describing the growth potential
- Criteria describing the poverty alleviation ("pro-poor") potential
- Pragmatic criteria

The sequence is not haphazard: The growth potential is the most important criterion. Unless the value chain has the potential to generate greater revenue (greater volume sold and/or higher value products), there is no additional income to be distributed. Economic growth therefore is a necessary precondition for sustainable poverty reduction. The third group of criteria refers to the likely success of external interventions: There are a large number of pragmatic criteria that should be used as well (see box 1.11).

Assessing the growth potential

The growth potential is determined both by the demand and the supply side. Hence, the lead questions turn around the unmet domestic and export market demand, and the competitive position of the value chain in question. This information is generated through market research (see previous section – task 1.2).

Box 1.8 Tool: Lead question to assess the growth potential

Lead Questions
What are the prospects for future demand growth?
Are traders willing to buy more of the product?
At what cost can the product be supplied to the consumer?
What are the competitive advantages of producers (cost, product characteristics)?
Is there a potential for product improvement and innovation?

Source: own compilation

Assessing the poverty alleviation potential

Economic growth only contributes to poverty reduction if an increasing part of the poor actively participate in economic processes. The concept of pro-poor growth has been treated in *ValueLinks* module 0 (see box 0.1 for a definition).

Assuring that value chain promotion actually is pro-poor is a question of selecting the right product market in the first place. The point is to find those product markets and value chains offering the greatest chances for the inclusion of poor people. Unless the characteristics of the value chain offer this potential, there are little chances for *any* promotion strategy to generate pro-poor impact. A value chain has poverty alleviation potential if it is a major source of livelihoods for the poor, generates employment, offers business opportunities for poor entrepreneurs or, at least, delivers products consumed by poor people.

Box 1.9 Tool: Lead question to assess the poverty alleviation potential

Lead questions:

Which barriers to market entry exist for poor producers?

Will growth generate additional employment?

Does the value chain offer the possibility of improving (at least maintaining) the current distribution of benefits along the value chain and across income groups?

Is market-oriented production compatible with food security objectives?

Is there a risk of replacing unskilled workers or women?

Source: own compilation

Compiling decision criteria for the selection of value chains for promotion

The following box 1.10 summarizes the different considerations into a comprehensive list of criteria that can be used for decision-making. While some of them are always relevant and can be applied across the board, others are of local significance only. Every project will have to compile an own list of selection criteria depending on the goals agreed beforehand. Not all criteria have to be judged positively. However, certain criteria need to be fulfilled at all cost, e.g. the first three criteria describing the growth potential. Unless there is scope for market expansion, any promotion effort will be in vain. The killer criteria, i.e. those minimum criteria that have to be absolutely fulfilled, are marked with an asterisk (*).

Box 1.10 Tool: Most important criteria for chain selection

Criteria describing the growth potential

- positive growth trend of the value chain, unmet market demand (*)
- available sales outlet, high interest of buyers in the product (*)
- scope for expanding production (*) and/or
- scope for value addition through processing or product improvement
- competitive advantage of the value chain vis-à-vis competitors (unique product / local specialty, low cost of production)
- Value chain complements rather than conflicts with investment into other chains
- sufficient technological and managerial level of enterprises in the sector
- access to infrastructure, qualified labour force, services, raw material, inputs

Criteria describing the poverty reduction potential

- share of poor people employed in the value chain as compared to the economy at large
- number of poor entrepreneurs and number of SMEs in the value chain
- low entry barriers for small-scale and poor entrepreneurs (small scale of production, low start-up costs, not requiring major capital investment, using low-tech skills)
- production using services, raw material and skills that are available locally
- labour-intensive technology
- covering locations where poor people live
- in line with livelihood conditions (year-round income, using family labour, rapid returns, contributing to food security, keeping the environment intact, not reducing availability of clean water)
- offering chances for women
- significance for the rural economy – linkages with other growth sectors, e.g. tourism

Source: own compilation

Apart from the two broad goal criteria, pragmatic considerations play an important role as well. The main questions concern the actual prospects of success and the outreach of the programme (box 1.11). Even if the value chain offers a good pro-poor growth potential, it may in fact include only few poor people. The amount of public investment has to correspond to the number of actors in the value chain. It is possible to select a small value chain, as long

as the investment is equally small. Otherwise, the efficiency of public promotion would be too low. Similarly, the value chain should offer success potential and not carry too many risks. Another set of criteria regards programme-related aspects, as the selection has to comply with political instructions and donor policies.

Box 1.11 Most important criteria for chain selection - continued

Criteria describing pragmatic aspects

Outreach

- Important size of the sub sector / value chain in relation with project resources
- Significant number of people employed and new job opportunities
- Significant number of small farmers, enterprises and companies
- Significant area covered

Prospects of success:

- Own initiatives and commitment of chain actors, their readiness for change (*)
- Sufficient resources (time, funds, and know-how) of the agency selecting the chain (*)
- Existence of partners to collaborate with, demand of investors and partners
- Conducive framework conditions and business environment

Programme-related aspects:

- Relevance to priorities of government economic policy (“thrust sectors”)
- corresponding to project objectives, mandate and resources
- Relevance to mandated area
- Synergies and scope for cooperation with other support programmes

Source: own compilation

The criteria in boxes 1.10 and 1.11 summarize important considerations in selecting value chains. In a practical decision-making procedure they have to be consolidated into a simple set that makes the decision transparent.

Organizing the decision-making process

Choosing value chains for promotion is a process in time. As the uncertainty about the development of markets remains, the choice is only valid under the current conditions and planners have to stay flexible. The decision may be revised later on. Hence, the time and amount of resources invested to collect information has to be limited. It makes sense to organize the list of potential value chains in order of priority distinguishing those chains where action can start immediately from secondary options which may be taken up later. Experience shows that the initial shortlist of products is often cut down once implementation starts.

There are two ways of approaching the selection, viz.

- a formal procedure using decision matrices or similar tools: A decision is made by assessing each alternative according to a fixed set of criteria.
- an opportunity-driven approach: The selection of a value chain relies on the investment proposals pf private enterprises and own initiatives of chain supporters, public agencies and donors.

The first possibility involves collecting data to judge the criteria. Generally, decision makers should generate just as much information as is needed to justify the start of promotional activities. Important sources of informed judgement are sector associations, representatives of ministries and the internet. It is advisable to start the selection process by compiling the arguments and criteria relevant for the location in question. Conducting detailed studies before taking a decision is a rather inefficient method: As new information emerges the choice of value chains may have to be revised later on anyway (see *ValueLinks* module 4 for the design of a promotion process).

Box 1.12 presents the example of a decision matrix used in the SME promotion project in Thailand. This tool is a "weighted criteria decision matrix". The decision matrix contains six criteria with differing weights. All criteria are assessed for each value chain alternative. The points allotted to each alternative are multiplied with the respective weight. The sum of weighted points delivers a total score that allows ranking the value chains.

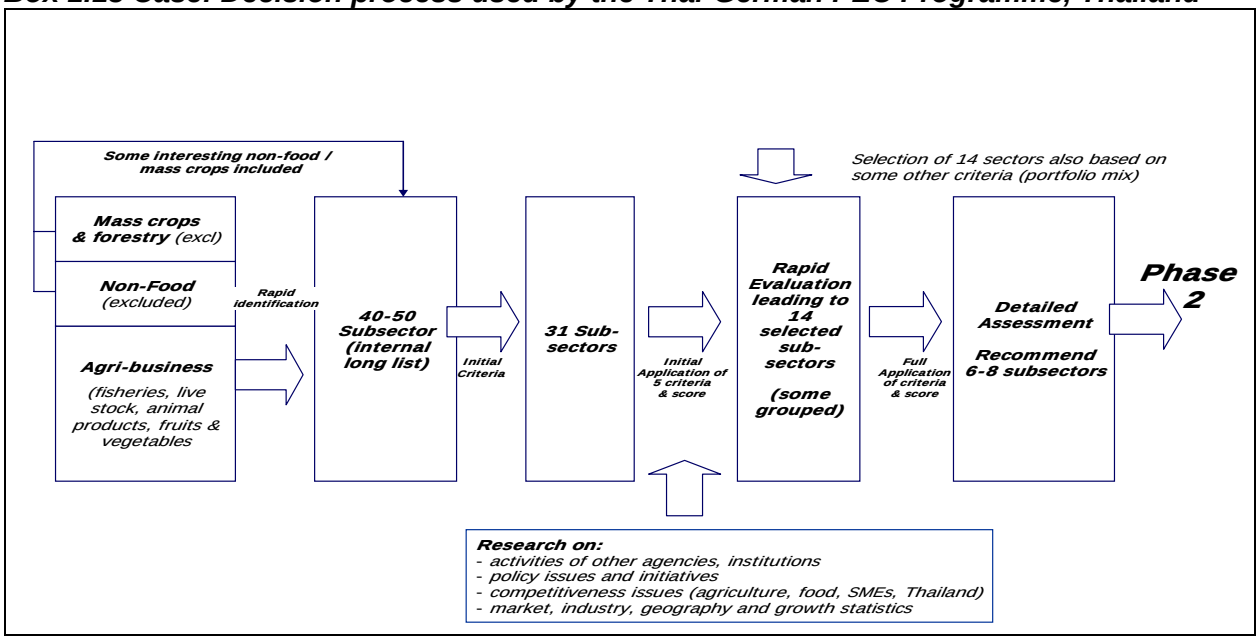
Box 1.12 Case/Tool: Decision matrix used to select value chains in Thailand

Selecting alternative value chains in the Thai-German Private Enterprise Competitiveness (PEC) Programme in Thailand			
Criteria and their weights	*Points for each alternative value chain*		
	VC 1	VC 2	VC 3 etc
Market Demand and PPG Potential (weighting 15%) • Contribution of the sub-sector to GDP/export earnings • Evidence of high market potential or strong effective demand for products being produced in the sub sector • Positive growth prospects and opportunities for incomes and employment • Assumed (potential) competitive advantage of a particular sub sector in relation to the regional or world market			
Outreach (weighting 15%) • Number or significance of SMEs in the sub sector and their distribution along the value chain. • Estimated employment in the sub-sector • Location of major clusters in rural areas			
National Priority Ranking (weighting 20%) • Political priority sector as mentioned in speeches or government plans • Relevance or importance to programme partners • Potential demonstration effects, assumed spill-over effects, repeatability of 'lessons learned' in other sub-sectors			
Opportunities for Programme Intervention (weighting 30%) • Existence of constraints/ bottlenecks that could potentially be tackled by the programme • Ease of entry for the programme and openness of key actors (private and public sectors) towards cooperation • Likelihood of stakeholders to buy in and actively support programme interventions			
Relevance of cross-cutting issues (weighting 10%) • Likely high impact on poverty or socially excluded portions of society • Opportunities to impact on critical environmental and social issues			
Complementarity of Intervention (weighting 10%) • Existence of other major actors/donors' activities (opportunities for synergies, niches, coordination)			
Total score			

Source: GTZ PEC programme, Thailand

A consulting firm was hired to assist in doing the research necessary to make the selection. At first a list of 32 sub sectors was selected from published government statistics. In further consultations this list of 32 was further reduced to 15. These alternative options were presented in summary form in a workshop with programme staff and partners (Ministry of Environment and Natural Resources, Ministry of Industry, Ministry of Energy and all of the Departments likely to be involved in the future implementation of the Programme). In the workshop partners expressed their preferences for seven value chains: palm oil, tapioca, tangerines, longan, mulberry paper, shrimps/aquaculture, vegetables, and organic rice. The process of decision-making is summarized in the flow diagram in box 1.13.

Box 1.13 Case: Decision process used by the Thai-German PEC Programme, Thailand



Source: GTZ PEC programme, Thailand

The second option for choosing a value chain for promotion is an opportunity-driven and demand-based approach. This means, that the value chains are selected based on suggestions made by potential partners, be they private lead companies or government ministries. For each suggestion made, the public interest is checked following the lead questions in boxes 1.8 and 1.9. Similarly, the issue of potential outreach has to be raised clarifying how much effort and investment is expected from the public development agency.

As long as the pro-poor growth goal is observed and the proposed value chains offer the possibility of efficient public investment other criteria can be taken as a given. After all, the success of value chain promotion depends on the chain operators and partners suggesting the investment. A pragmatic approach has the advantage of engaging the chain actors as sources of information. This requires less analysis and yet delivers a valid basis for decisions. In practice, formal procedures and the pragmatic approach are often combined.

Sometimes, development projects have little choice in the selection of chains as the selection is already given by prior government decisions specifying priority sub sectors or made during the appraisal mission. In this case, the decision process may be simplified. However, although the political backing is an important argument in favour of the respective chains, development agencies still have to make sure that the political choice is in line with their own criteria. In any case, it is much preferable, if the choice of value chains to promote is left to decision makers on the ground - a development programme and its partners

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CBI (Centre for the Promotion of Imports from Developing Countries) Access Guide: www.cbi.nl/accessguide/

EU (European Union) – Market Access Database: http://mkaccdb.eu.int/

EU – Expanding Exports Helpdesk: http://export-help.cec.eu.int/

ITC (International Trade Centre): www.intracen.org/

Rapid market assessments: http://www.ruralroots.org/RMA/RMA.asp

WTO Market Access for Goods (World Trade Organization): www.wto.org/english/tratop_e/markacc_e/markacc_e.htm

ValueLinks Module 2



Analysing a Value Chain

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ValueLinks **Module 2**

Analysing a Value Chain

What this module is about

Following the definition in *ValueLinks* Module 1 (Box 1.1), a value chain constitutes an economic system organised around a particular commercial product. The coordination of business activities in a value chain is necessary to provide final customers with the right quality and quantity of the product. Enterprises have to collaborate to be successful. The value chain therefore:

- connects the different yet related business activities (production, transformation, marketing, etc.) necessary for serving customers, and
- joins and coordinates the enterprises (primary producers, processing industry, traders, etc.) performing these business activities.

In the course of economic development, the integration between different business activities and types of enterprises becomes increasingly important. On one hand, globalisation entails intense competition and pricing pressure. On the other hand, urban customers increasingly demand high-quality, fresh and fashionable products. Both trends call for an increasing level of integration. For example, an organic food product can only be brought to the market if farms are certified and the product is kept apart in the marketing chain. For their part, garment manufacturers work on well-defined orders and often subcontract others to deliver on time. And a particular tourist attraction can only be marketed if all related services – from transport to accommodation – conform to tourist expectations. Hence, the competitiveness of the national economy is not only a matter of the performance of individual enterprises, but also of the degree to which the different companies, both large and small, cooperate efficiently. Consequently, it is possible to speak of the “systemic competitiveness” of the value chain. Unless it improves, not much economic growth and even less *pro-poor* growth will be achieved.

ValueLinks Module 2 examines the interaction of enterprises dealing with the same product in a particular market. It uses the value chain concept as its analytical framework. Value chain analysis describes the economic system organised around particular product markets. It provides a model and situation analysis of the value chain in question. The module presents principles and guidelines, but does not go into methodological details.

Every enterprise or public agency working towards making value chains more competitive has to understand how it functions and learn from its failures. Chain analysis provides an overview and a good understanding of the specific economic reality. The results of these analyses are used to prepare decisions on objectives and strategies. Based on a shared value chain analysis, enterprises can develop a joint vision of change and determine collaborative upgrading strategies. Governments and public agencies use value chain analyses to identify and plan supportive actions as well as to monitor impact. Apart from its use in a development context, value chain analyses also help individual enterprises to take business decisions.

Value chain analysis resembles a subsector analysis, especially in terms of methodology. Whereas the latter looks at the structure of aggregate markets, value chain analysis focuses on specific products.

Tasks in Value Chain Analysis

Analysing value chains comprises a whole series of different methods. In this module they are grouped into three basic tasks. The most essential method and the core of any analysis

is value chain mapping. Building on a value chain map, additional analyses may become necessary, depending on the information needs.

In the following, we distinguish three tasks. For each of it basic principles and know-how will be provided:

- (Task 2.1) Value chain mapping
- (Task 2.2) Quantifying and describing value chains in detail
- (Task 2.3) Economic analysis of value chains and benchmarking

Value chain mapping means drawing a visual representation of the value chain system. Maps identify business operations (functions), chain operators and their linkages, as well as the chain supporters within the value chain. Chain maps are the core of any value chain analysis and therefore indispensable.

Quantifying and describing value chains in detail includes attaching numbers to the basic chain map, e.g. numbers of actors, the volume of produce or the market shares of particular segments in the chain. Depending on the specific interest, specific chain analyses "zoom in" on any relevant aspect, e.g. characteristics of particular actors, services, or the political, institutional and legal framework conditions enabling or hindering chain development.

Economic analysis of value chains is the assessment of chain performance in terms of economic efficiency. This includes determining the value added along the stages of the value chain, the cost of production and, to the extent possible, the income of operators. Another aspect is the transaction costs, which are the cost of doing business, collecting information and enforcing contracts. The economic performance of a value chain can be "benchmarked", i.e. the value of important parameters can be compared with those of competing chains in other countries or similar industries.

Market research is not included as a task in this module, but treated separately (see module 1, task 1.3). The assessment of demand conditions has to be taken up at the very beginning of any chain promotion project - even before a value chain is selected for promotion. However, market research is closely linked to value chain analyses, the mapping of market channels and economic analyses being important inputs into market research.

The **constraints analysis** prepares the formulation of an upgrading strategy and is treated in *ValueLinks* module 3 (see task 3.2).

Basic considerations on the methodology of chain analysis

Value chain analysis is not an end in itself, but its results feed into decisions of both private and public promoters of chain development. Private enterprises use results of value chain analysis to set out a vision and upgrading strategy for themselves and the value at large. Public agencies and development projects need results for implementing chain promotion projects and planning supportive actions. Chain analyses can also be used to formulate impact indicators and for monitoring value chain promotion projects.

Value chain analysis is closely connected to the process of chain upgrading and value chain promotion. As results should be useful to make progress, the questions to answer and the degree of detail should be chosen carefully. The question, *who* undertakes the analysis and *how* the results are utilized, is no less important than the methodological aspects of chain analysis as such. Generating information and using it have to be treated as iterative steps. Often, the need for in-depth analyses only arises as ideas for market development and upgrading emerge in the process. Overly ambitious chain studies at the outset can be quite counterproductive as they consume time and money and involve the risk of "analysis paralysis". Experience shows that initial surveys often enough do not even contain the information relevant for the decisions at stake. In any case, value chain analysis is part of the larger process of value chain upgrading, the principles of which are treated separately (see *ValueLinks* module 4).

Box 2.1 presents an overview of the kinds of information products and their use for different decision and planning tasks in value chain upgrading.

Box 2.1 Tool: Analytical methods to inform value chain promotion projects

Tasks in value chain upgrading and promotion	*Tools to guide participatory analysis & decision making*	*Topics of in-depth studies prepared by experts*
Selecting a value chain (task 1.1)	• Checklist or decision matrix with selection criteria	• Market research (see tools for task 1.3)
All following tasks	• Basic value chain map (see task 2.1)	
Agreeing on a vision (task 3.1)	• Strategy matrices • Basic value chain map locating the change anticipated in the vision (see task 3.1)	• Market research (see tools for task 1.3) • Economic analyses and benchmarking (see tools for task 2.3)
Setting objectives for value chain upgrading and preparing action (tasks 3.2 and 3.3)	• Attaching statements on constraints to elements of the basic value chain map • Basic chain map indicating points of leverage • SWOT analysis • Problem trees • Impact model showing anticipated path of chain development	• Detailed chain maps: - quantifying basic map - detailed thematic maps • Special studies on: - chain governance - conditions of marginal operators - conditions of the business environment
Value chain promotion in different fields of action (modules 5-10)	• see tools in *ValueLinks* modules 5-10	Special studies and detailed thematic maps
Monitoring (task 11.1)	• Impact model (see task 3.5) • Basic chain map showing indicators	

Source: own concept

(Task 2.1) Value chain mapping

Chain mapping is the core of VC analysis. It serves both an analytical purpose and a communication purpose, as chain maps reduce the complexity of economic reality with its diverse functions, multiple stakeholders, interdependencies and relationships to a comprehensible visual model. Chain maps can look quite differently depending on their "scale" and the particular aspect of the chain structure they show.

The quality criterion of any value chain map is that it should be comprehensible to the enterprises and other actors involved. The decisive point is to achieve the right degree of detail that delivers sufficient information to be useful, but still remains simple enough to be easily understood. Because chain maps are used for different purposes, we are not talking about just one chain map but about several maps that differ according to their respective purposes. Describing a value chain in detail produces a series of "thematic maps" covering particular aspects (see task 2.2). In fact, it is possible to arrive at a sort of value chain "atlas" in the end.

Drawing a chain map is an "art" rather than a rigorous methodology. Nevertheless, there are a few rules to observe. The *ValueLinks* methodology applies a series of mapping symbols. They are explained in the annex ("*ValueLinks* mapping symbols"). The most important thing is to keep the maps focused on the purpose and easily understandable. Any chain map should fit on one page. Consequently, a small-scale map of an entire sub sector can only show a rough overview. To achieve a more detailed resolution, the analyst has to pick out and enlarge a part of the first map. That part is mapped in greater detail and presented on a separate, second page.

Mapping always starts by drawing a basic map providing an overview of the entire value chain. The overview map should present the major links (segments) of the value chain. It should visualize

- the sequence of production and marketing functions performed (in hollow white arrows)
- the value chain operators taking these functions (in yellow boxes)
- the vertical business links between the operators (arrows)

These three elements represent the *micro level* of the chain, at which the value-added is actually generated. The service providers and meso level supporters can be included in the chain map as well.

If conducted in a participatory fashion, chain mapping is not only an analytical but a communication instrument as well: It helps to build trust between groups of operators, facilitates client-oriented services and improves the understanding of policy makers of private sector needs. Throughout this manual, a particular set of standard symbols is used for mapping value chains. The use of standards symbols has the advantage of facilitating the communication between the chain actors – and between different development programmes.

Drawing a value chain overview map - functions and operators

The first step in chain mapping is the determination of the product market served: It constitutes the destination of the product and the end point of the chain map. As product markets can consist of several sets of end-users, the actual costumers should be defined carefully. This issue is comparable to the definition of the scope of value chain promotion (see task 1.1 in *ValueLinks* module 1). To the extent possible, the chain map should extend to final consumers. However, it can be useful to take industry as final consumer, if the product in question only has small share in the value of the final product. For example, the final consumer in a cow leather value chain is the individual buyer of the leather products such as shoes or belts. Unless a specific quality of leather is required for the end product, e.g. a ladies´ hand glove made of fine goat leather, many different end products can be

made of the same raw material. In that case, it can make sense to define industry as the end user. The whole chain would then be separated into (a) the value chain of finished leather, and (b) the value chains of the specific products made of that leather, e.g. a shoe value chain, a value chain for leather jackets etc.

At the centre of a value chain map is a product's production, processing and distribution path showing the business activities (functions). The sequence of functions is visualized by a series of hollow arrows. Box 2.2 shows the generic categories of segments in a linear chain leading from the provision of the *specific* inputs for a particular product to primary production, transformation and marketing up to final consumption. The hollow arrows define the stages of the value chain. Each implies several productive processes that are mentioned in the second line, below.

The second part of the chain map assigns the functions to categories of enterprises visualized by yellow rectangles – the chain operators. The chain operators are placed exactly below the functions so as to show who performs which function. Although the generic map in box 2.2 shows a perfect correspondence between the chain stages and different groups of operators this will not always be the case in reality. Often, the same operators may cover two or even more stages.

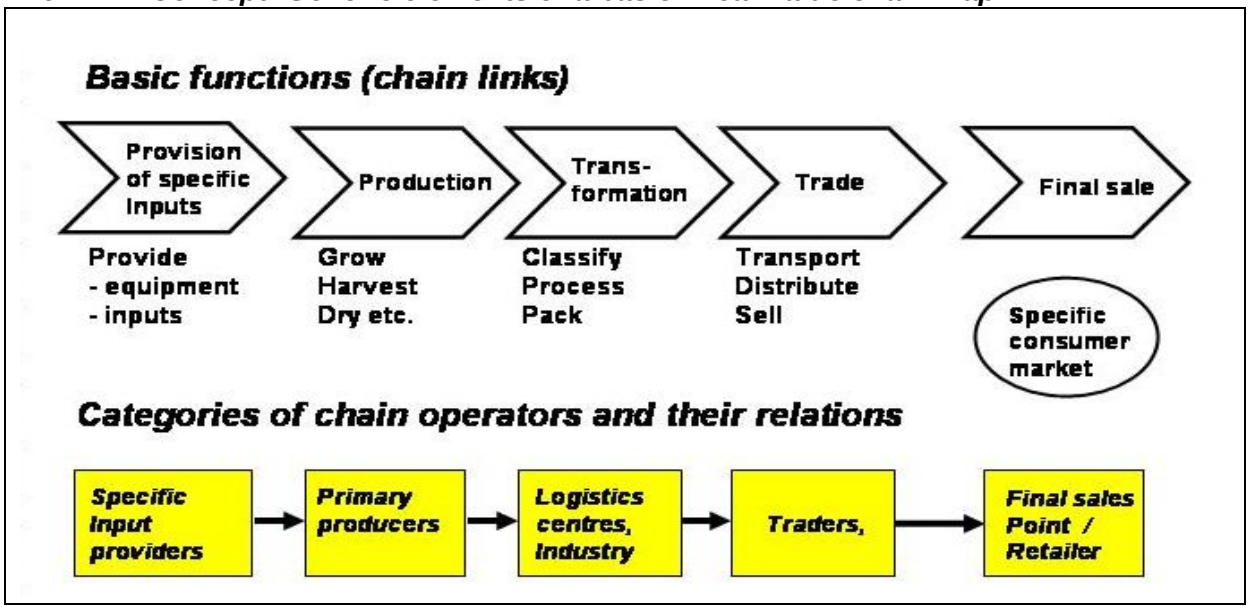
It is very important to separate functions and operators and present both lines in parallel. In most cases, a value chain has one functional sequence but several types of enterprises and different ways of organizing production and marketing channels. By separating functions and operators, the institutional change, e.g. a closer integration between operators, can be distinguished from the technical change, e.g. when new functions are added.

The chain map in box 2.2 should not be mistaken for a generally applicable template. Although the functions are taken from an ordinary agribusiness product, it is a model that just intends to show the principle in a highly simplified form.

An important question is whether final consumers belong in the value chain map or not. Given the fact that the final costumer pays the value added and hence the income of all operators and service providers in the chain, the answer is yes.

However, the costumer is not a "value chain operator" and therefore not depicted as a yellow rectangle. Instead, costumers and their demand are specified in an oval form at the final sales point of the value chain.

Box 2.2 - Concept: Generic elements of a basic linear value chain map



Source: own design

The map shown in box 2.2 has to be applied to any concrete case using the symbol language in such a way that it fits the case in question. For each value chain, the appropriate sequence of segments and the right categories of operators have to be identified. Box 2.3 explains the procedure of creating a basic chain map.

Box 2.3 - Practical hints: How to proceed in basic chain mapping

Steps in drawing an overview map of a value chain

(a) The first step always is the definition of the final product. Which product or category of product does the value chain produce?
(b) The end market / group of costumers is indicated by an oval box.
(c) The activities / functions currently performed to generate the final product are listed. It makes sense to start from the final sales point (outlet on the domestic market, or exporter) and go backwards listing the production and marketing activities necessary to sell the product on the market.
(d) The list of activities / functions needs to be aggregated establishing a sequence of 4 to no more than 7 or 8 chain links - from providing specific technical inputs up to the final sale.
(e) As a matter of principle, mapping input delivery and services at the upper end of the chain (before primary production) is restricted to highly specific inputs, making sure to clearly distinguish between the *specific* technology inputs - needed *only* for this product - and other inputs and services of a generic type. The latter are not included in the basic map but added later.
(f) After establishing the functional sequence, the main chain/channel is drawn by indicating the types of operators performing the functions. This delivers a linear progression from stage to stage (i.e. no arrows bending left and right). Secondary channels are drawn later, branching off from the main one. The procedure is different in the case of production networks in manufacturing sectors (see below)
(g) It is important to note that the value chain map only includes those operators who become owners of the product. If they source out or subcontract functions to other firms, these are regarded as “operational service providers”. They may or may not be mapped.
(h) If operators take more than one function, the box representing them is enlarged to cover the two or more functional stages they are in.
(i) In the case of export products, the border line is indicated between the domestic and foreign operators.

Source: own compilation

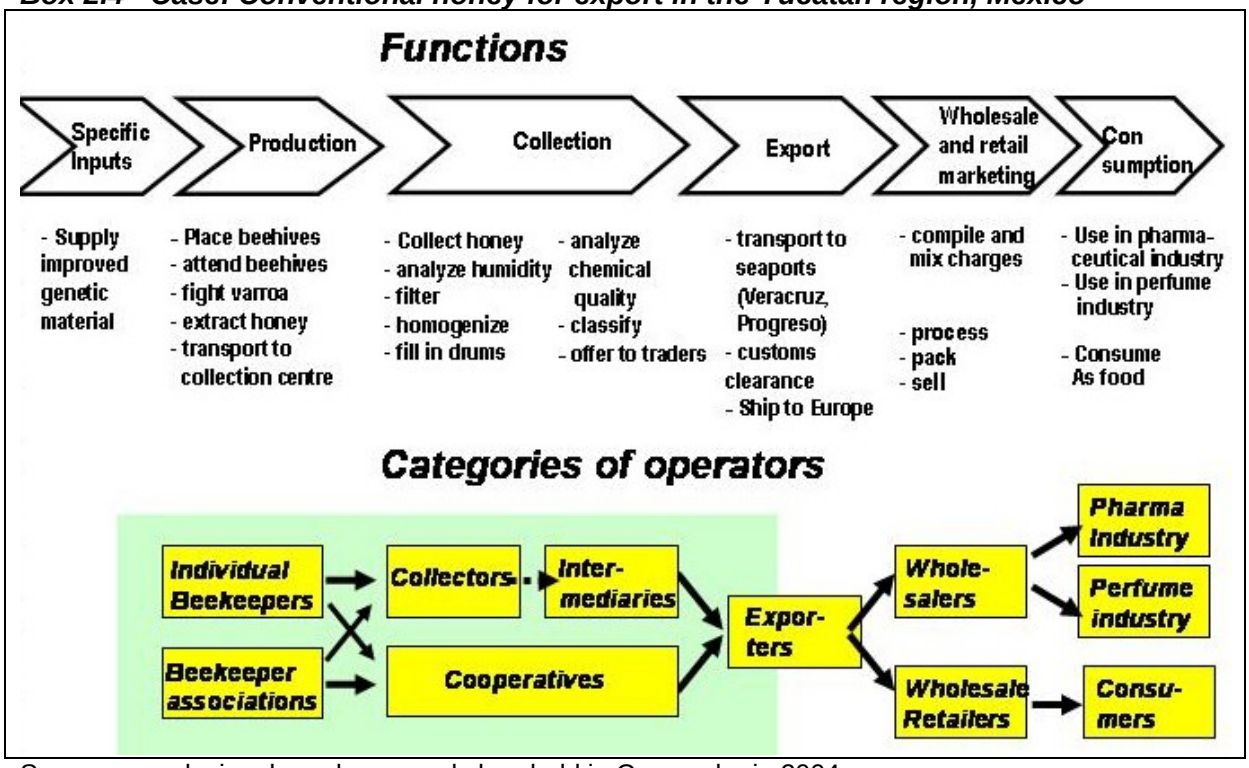
Box 2.4 presents the example of the chain map for conventional honey production in the Yucatán region, Mexico, designed according to the principles set out above.

The map is conceived as a general overview map and hence does not go into great detail.

Below the basic stages of the value chain and the individual business operations performed, it shows the major groups of operators. Two different forms of producing and collecting the honey are distinguished: The primary production is either done by individual beekeepers or by beekeeper cooperatives. The collection of the honey is partially taken over by honey cooperatives which also analyze and classify grades, or else by self-employed collectors who leave the quality control and sorting to intermediaries. Final consumers are two types of industry (pharmaceutical and perfume industry) as well as individual consumers. The map also shows which part of the value chain is located in Mexico in the shaded area.

Depending on the particular interest, this map could be differentiated further on the international marketing side, which might deliver hints on how to differentiate the market and specific other honey qualities in the future.

Box 2.4 - Case: Conventional honey for export in the Yucatán region, Mexico



Source: own design, based on a workshop held in Campeche in 2004.

Mapping sub value chains (channels)

The honey chain map already contains two versions of how the production and collection process is being organized. In fact, in many cases it will in fact be useful to differentiate the value chain further, adding detail. The overview map can be differentiated to show "sub value chains" according to product variations or distribution channels. This tells the reader what alternate supply chains or routes exist and their destination markets.

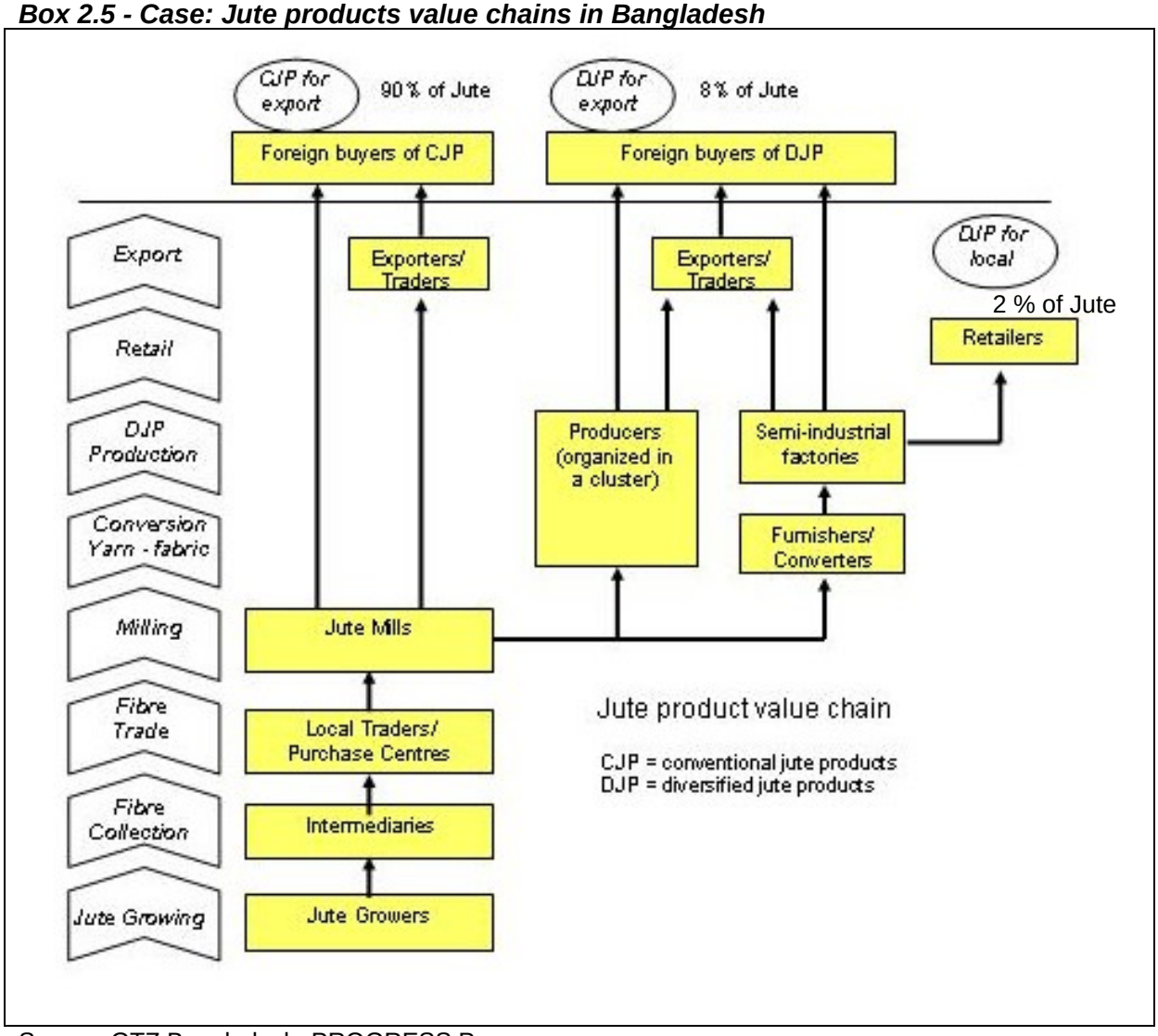
Showing parallel channels in the same value chain map is only useful if some part of the value chain map is identical across all variants of channels. Often this applies to the primary production stage remaining the same while different types of processing follow. Depending on market outlets, the sub value chains can branch out further into an even greater variety of marketing channels.

Box 2.5 presents the example of an overview map of the jute products value chain that is differentiated into two lines of jute products - "conventional" and "diversified". The chain serves both domestic and export markets. The jute example shows how a new sub value chain branches off from the main traditional sequence. It also shows different marketing channels of the jute products. Note that the sequence of functions remains the same, with some functions only being relevant in one of the sub value chains. Hence, the variation is visualized at the level of operators and not by adding parallel functional sequences.

Another important observation here is that this value chain map is oriented in vertical direction. In which direction the mapping is done, either vertically or horizontally, depends on pragmatic considerations. In presentations projected by a beamer or in participatory workshops it is more convenient to use the horizontal direction.

Wherever functional sequences are fundamentally different, an entirely new and separate chain map has to be constructed.

Box 2.5 - Case: Jute products value chains in Bangladesh



Source: GTZ Bangladesh, PROGRESS Programme

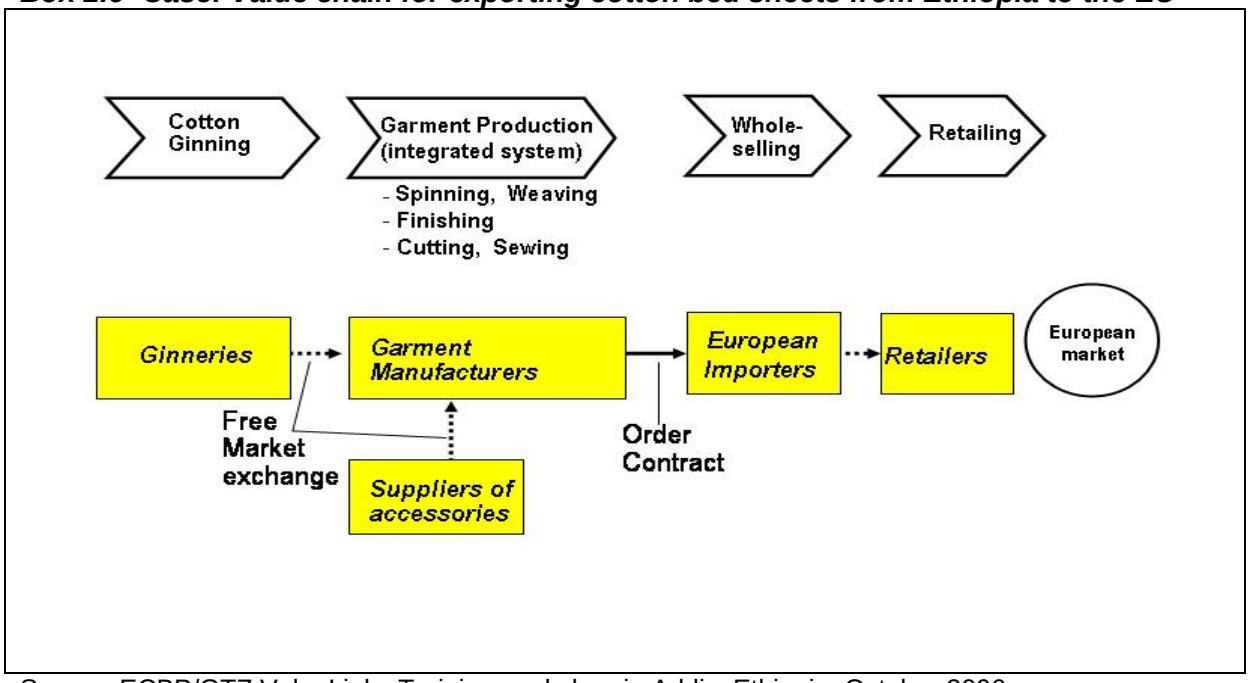
Mapping chain linkages and governance

"Chain governance" refers to the way in which the coordination of chain operators is achieved along the chain stages – the arrows between operators in the chain map. The relation between operators can be a free market exchange or binding contracts made in advance. The type of linkages depends on the quality and sophistication of the final product. Generally, un-coordinated transactions ("spot markets") are efficient in local markets, or in markets for products with few quality traits. Wherever final consumers ask for high and consistent quality, the control of supplies becomes a factor of competitiveness. As a consequence, the linkages between suppliers and buyers have to be more stable and tend to become formalized in contracts. Hence, a basic distinction has to be made between uncoordinated free market transactions ("arms-length" spot market relationships), persistent contract relationships and, at the other extreme, vertical integration between suppliers and buyers.

The different kinds of relations can easily be visualized in a chain map, as illustrated in box 2.6. The order contract between Ethiopian garment manufacturers and European exporters is shown as a single line, while the free sourcing of raw material and accessories is depicted as a dotted line. This type of mapping allows to identifying lead companies and the possibilities for introducing embedded service arrangements. A detailed treatment of the

different types of business linkages and service arrangements follows in the respective *ValueLinks* modules.

Box 2.6- Case: Value chain for exporting cotton bed sheets from Ethiopia to the EU



Source: ECBP/GTZ ValueLinks Training workshop in Addis, Ethiopia, October 2006

The case in box 2.6 also shows input suppliers (suppliers of accessories). They are not operators in the main line of the chain map but "operational service providers". They are mapped here, because operational service providers are important partners of garment manufacturers, not only in Ethiopia. Their relationship with chain operators in box 2.6 is a free market exchange. Another type of relationship would be subcontracting. If certain functions are sourced out in a permanent subcontracting arrangement, the linkage is indicated by a straight line with arrows at both ends.

Please note that the map in box 2.6 illustrates the principle of mapping chain relations. It does not show the complete picture of that particular value chain.

Mapping chain supporters (meso level)

The basic functions and chain operators constitute the *micro level* of the value chain, i.e. the businesses active in the respective market including the operational service providers. Apart from the micro level, value chains can also be described at the *meso level* that includes the agencies and business organizations representing the collective interest of the business community and providing support services. Chain actors at the meso level are termed "chain supporters" in the terminology of *ValueLinks*.

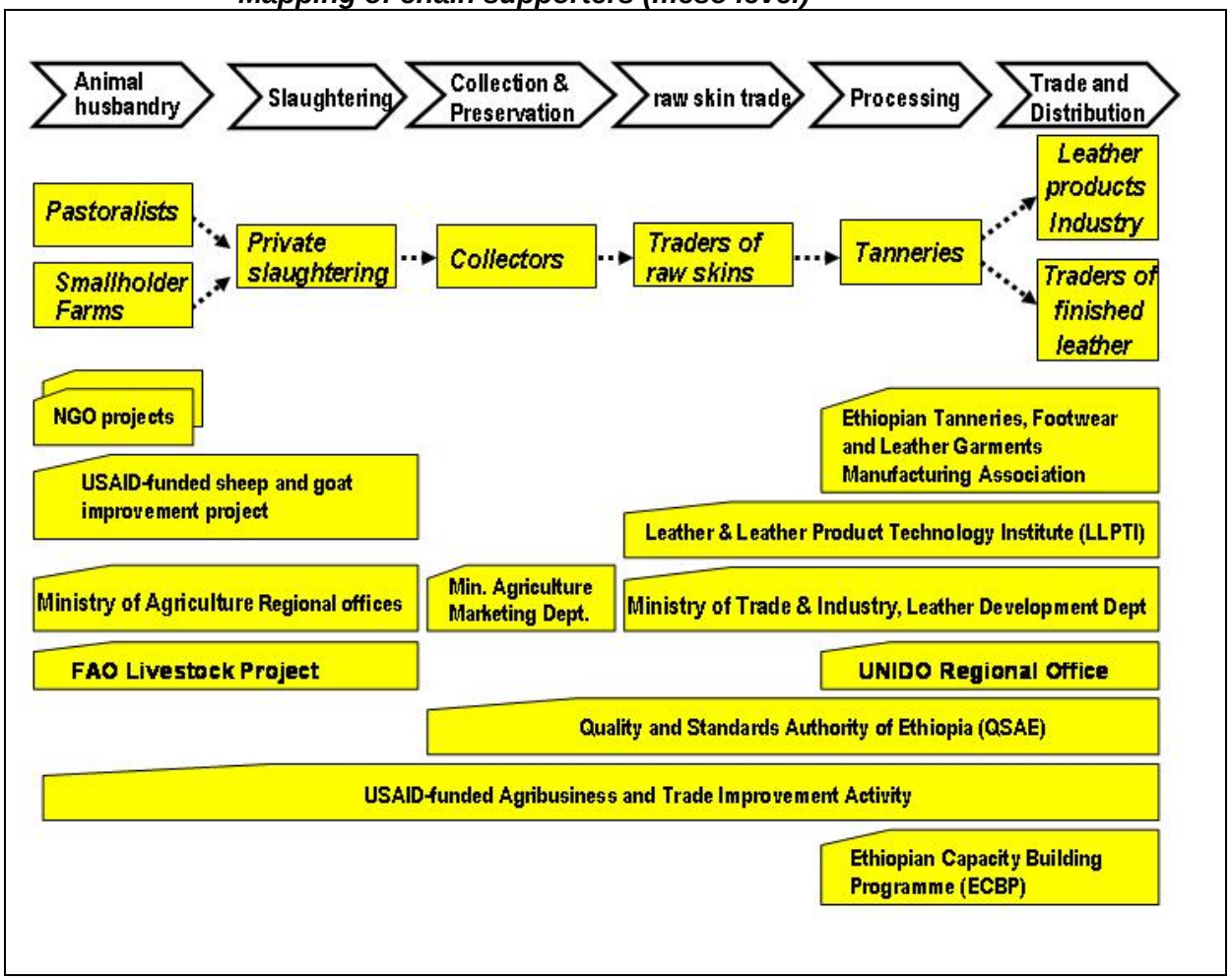
Value chain supporters having a direct relationship with chain operators can and should also belong in a value chain map. Chain supporters include business and industry associations, sector-specific agencies such as technology or training institutes, specialized departments or units in the public administration, foundations or development programmes. All these organizations have in common that they provide support services to the whole value chain and/or represent the common interests of the chain actors. Often, chain supporters cover several value chains, so that the mapping of the meso level cuts across different value chains. Therefore, it is useful to be specific about the tasks and clientele of each organization.

Box 2.7 presents an example of a specialized "thematic map" showing the most important supporters of the traditional finished leather value chain in Ethiopia. This map builds on a previous overview map of that sub sector which is not depicted here.

To provide orientation, the map reproduces the basic functional sequence of leather production in Ethiopia and the operators in the traditional system of sheep and goat leather production and marketing. The hollow arrows and the rectangles showing operators are taken from the overview map.

The graphic indicates support agencies and projects using yellow rectangles of which the upper left corner is cut off (compare the "*ValueLinks* mapping symbols"). The map also shows which segments of the chain the different support organizations cover. As can be seen clearly, there is a high number of supporters active at the animal husbandry and private slaughtering stages. Industrial support agencies cover the processing, trade and distribution stages. The stages in between - collection, preservation and raw skin trade – do not receive much attention.

Box 2.7 - Case: Traditional finished sheep and goat leather value chain in Ethiopia
Mapping of chain supporters (meso level)



Source: ECBP/GTZ ValueLinks Training workshop in Addis, Ethiopia, August 2006

This analysis is useful for analyzing the efficiency of support institutions, and for coordinating and planning new interventions. As the analysis gets into more details, the picture in box 2.7 could be developed into a matrix enumerating the services and capacity of each support organization.

Government and other public organisations responsible for shaping the business environment constitute the *macro level* of the value chain. This level should rather be

analyzed separately. It may be visualized in another thematic map but does not necessarily belong in an overview map.

Chain mapping in manufacturing sectors

The form of chain maps differs between sectors. So far, the examples presented in boxes 2.2 to 2.7 have used a linear form. Value chains of products which are based on natural resources (such as agricultural products, fish, forest products, natural building materials and the like) are always linear reaching from raw material production via one or more transformation stages to the final consumer. Raw material value constitutes a substantial proportion of the final product value.

By contrast, mapping in manufacturing is not exactly linear but comes closer to a network. Value chain mapping in services and tourism follows an entirely different model (see below).

Manufactured products are composed of many inputs from different sources. After all, a dress is more than “processed cotton”, even if it is made of 100% cotton – and an upholstered armchair certainly more than “processed wood”. The point is that many other inputs and services are needed to make these products. Hence, there is no single dominant input into manufacturing that would define the upstream (sourcing) stages of the value chain.

Before mapping such value chains, analysts should decide where to start the chain sequence. For example, mapping the value chain of hand-made Christmas decorations does not include detailing the value chains of the wood, paint, straw or glue that are needed as inputs. Hence, the value chain sequence begins with the coordinated provision of *all* inputs that have to be in place before producers can assemble them. As a consequence, manufacturing value chains are closer to “networks of suppliers”. Some products, such as shoes and leather articles are in between: High-quality leather and its local availability may indeed be a dominant input and justify mapping the complete value chain starting with animal husbandry.

The principle of mapping is shown in box 2.8 that present a model of the CMT (“cut, measure and trim”) production system in the garment sector. The CMT contractor sources all necessary inputs to make a particular article, upon the order of a buyer who most of the time is a retailer. Hence, the value chain starts with the series of inputs and operational services needed to manufacture the product. This is certainly not the only form of mapping garment production. Wherever the local sourcing of fabric is decisive, the map may as well be linear, spanning cotton production and textile making as well. The sourcing of accessories in the garment manufacturing stage can, but does not have to be mapped.

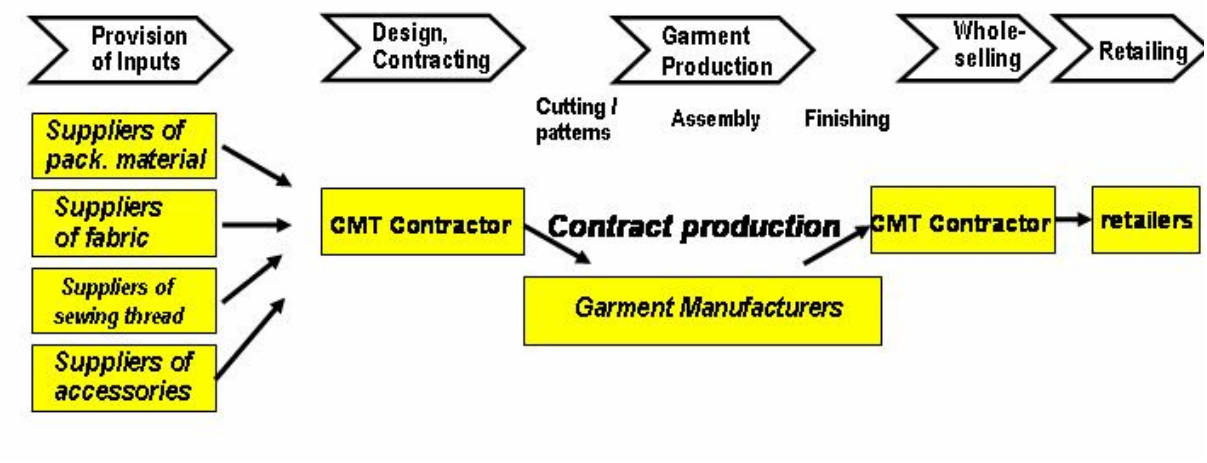
This is again a simplified “overview map”. It serves the purpose of indicating which companies are involved, how the system is organized and where the small and medium enterprises are located. For sure, this map has to be complemented with further maps, showing other variants of value chains in the garment sector and types of business linkages, or quantifying the value added contributed by each group of suppliers.

Nevertheless, even a simple map like this can have the important role of identifying operators and their position. This can be of great help in preparing and structuring value chain meetings.

Box 2.8 also shows another arrangement that is frequently found in manufacturing – the subcontracting of particular functions. In the CMT system, the contractor delivers all inputs to a garment producer for assembling. The finished product is handed over to the contractor according to the conditions stipulated in the contract.

Box 2.8- Template: chain mapping in the garment sector

Conceptual model of the CMT system in the garment industry



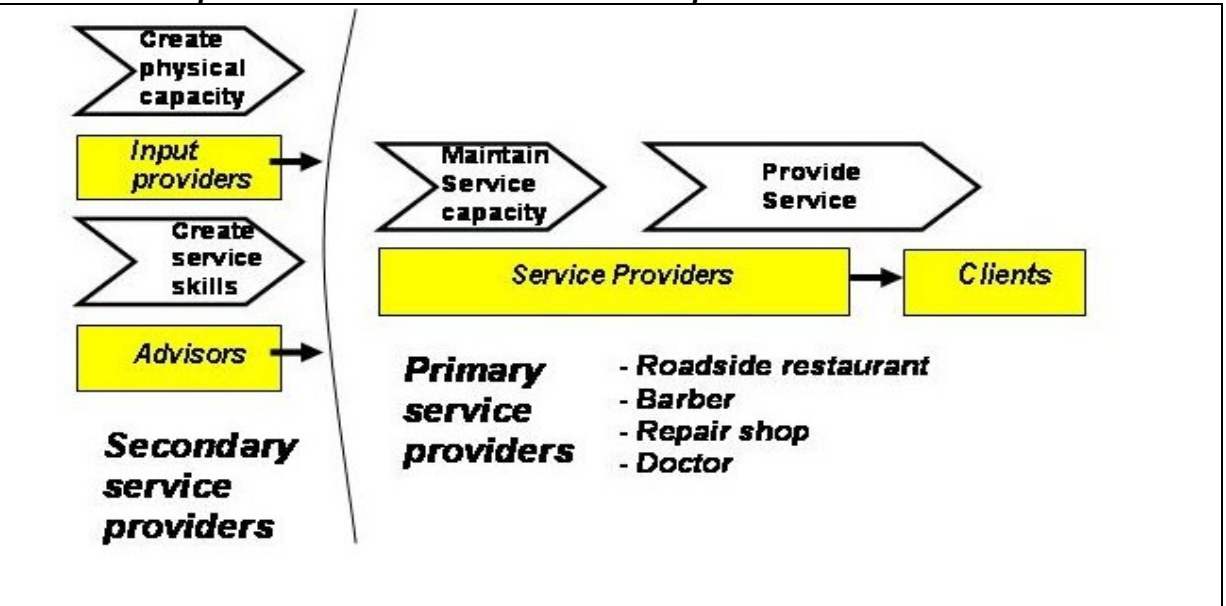
Source: own concept, based on conversation with Goshu Negash, ECBP Ethiopia

Chain mapping in service sectors

Service products have an increasingly important role for developing economies, especially service products related to tourism. Other important service products include advertising and information technology (IT) services.

The difference between physical and service products is the fact that a service is delivered directly to the costumer. Although services may be linked to physical goods, they are essentially immaterial and cannot be transported or stored. This means that the value chain map does not depict the flow of the product as it is gradually made, but shows the service interaction with the costumer

Box 2.9 Concept: Functions and actors in service provision



Source: own concept

Box 2.9 presents the principle of mapping an individual service product, such as a restaurant, barber shop, hotel or transport service. The primary service provider delivers the product directly to the costumer. For each service, there are secondary service providers providing the primary service provider with skills, technology and the physical capacity for performing

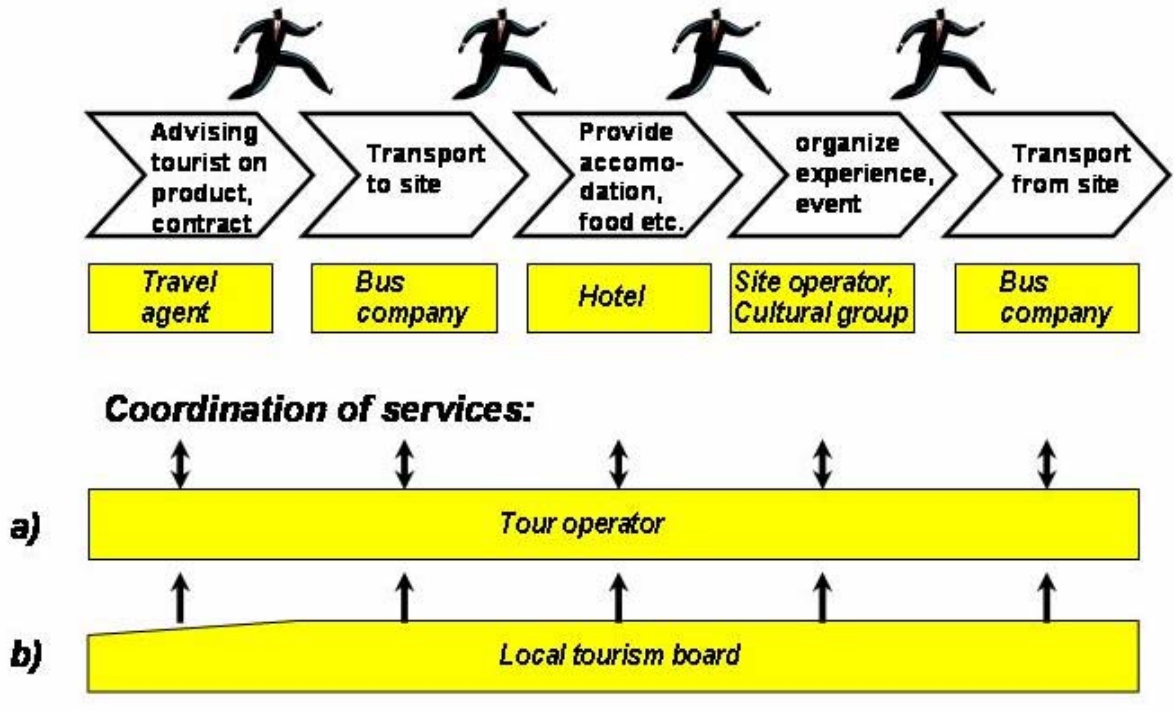
the service. Hence, the map depicts the participants in a service industry and constitutes a value chain. The respective overview map allows identifying who is included in the system.

In the tourism sector, several services have to be combined to serve costumers. Tourism products are a sequence of consecutive services as shown in box 2.10. This value chain is in fact an itinerary, in which the costumer – the tourist – moves through a series of interlinked services. The system only works if all services are available, at the right time and in the right quality. Here, the services are delivered by individual providers, so that a coordinating service provider – a travel agent or tour operator – is required.

The obvious difference with product value chains is the fact that it is the costumer – the tourist – is "processed" rather than a physical commodity. For each service the tourist consumes along the itinerary, further secondary service providers will be required, such as schools for hotel management, catering services, maintenance workshops etc. Hence, mapping the whole chain of, for example, ecotourism in a particular mountain province may get fairly complex. However, no tourist attraction can developed unless all elements are in place. At the least, a tourism value chain map serves as a checklist.

Box 2.10 Concept: chain mapping in the tourism sector

Chain map showing sequence of services provided to tourist costumer



Source: own concept

A similar service system exists in advertising: It consists of designing the publicity campaign and the promotional material, producing ads (e.g. posters, leaflets etc.) and publishing them. Often, an advertising agency coordinates the sequence as a whole. As in the production of physical goods, chain maps in the service sector disclose coordination needs and allow pinpointing weaknesses.

Organizing chain mapping workshops

All examples shown in the preceding boxes use the *ValueLinks* mapping symbols. This form of visualization has the advantage that it can be universally used. The symbols are defined

by colour and form. They can be applied in chain mapping workshops using ordinary cards for pin boards, in documents with colour illustrations or in black & white copies.

Chain mapping can be done by planners as a desk study. However, it is often more efficient to produce chain maps in a group exercise, in which private operators and chain supporters participate jointly. The following box resumes important steps in the procedure of participatory chain mapping.

Box 2.11 Practical Hints: Participatory chain mapping in workshops

Procedures and visualization techniques in chain mapping

Procedures to produce a chain map

- briefly present value chain theory, mapping symbols and a model chain map
- present further information on the specific value chain in question (results of market, economic and service assessments);
- facilitate a discussion in which functions and actors are named by participants along the line set out in box 2.3 OR present a preliminary overview chain map in plenary that has been prepared beforehand
- discuss in plenary (if not exceeding 15 people) or split into groups to validate and further improve the preliminary chain map;
- identify information gaps and decide on priority information needs;
- formulate key questions for more detailed chain analyses

Procedures using the chain map for determining a strategy (see *ValueLinks* module 3)

- identify an upgrading vision for the value chain
- identify constraints and opportunities related to the vision and according to chain functions and/ or chain operators and supporters,
- jointly select the most critical points and discuss alternative solutions to addressing them
- identify quick-start activities - as a means to gain stakeholders' commitment.

Visualization techniques

- use metaplan techniques (pin boards and cards) to visualize the chain map and for facilitating exchange and focused discussions
- Do not exceed the limits of pin board space in preparing the overview chain map. If space is not sufficient, prepare a second map enlarging the relevant part of the big map
- switch between power point and pin boards using the standardized set of *ValueLinks* symbols.

source: own compilation

(Task 2.2) Quantifying and analysing value chains in detail

The basic chain map is a descriptive conceptual model of the value chain. To become useful for decision making and planning, the value chain map has to be complemented by information that allows comparing the current state of the chain with potential alternative states. Therefore, the elements of the chain map are treated as variables which are changing over time. For example, functions may be performed more efficiently, the number and sizes of operators may increase, contractual relations be formalized, and chain supporters may change their behaviour. Many of these chain elements can be influenced by the (collaborative) action of enterprises and support agencies. In order to assess the potential impact of the different alternatives for upgrading, a "baseline" of the current state of the value chain needs to be established (also see *ValueLinks* module 11 on impact indicators). A straightforward method for characterizing the chain is to attach qualitative statements about any current deficiencies, such as insufficient services, technical constraints or coordination problems to the chain elements (functions and operators) concerned. Preparing a list of constraints and visualising them in the chain map helps to indicate the direction for improving the chain and provides the basis for an upgrading strategy (see *ValueLinks* module 3 on constraints analysis).

In the following, the focus is on complementing the chain map with quantitative information and detailed analyses of particular aspects. Further chain analyses are useful wherever particular elements or segments of the value chain become important for the upgrading strategy – always provided that the additional information is directly relevant for preparing action or verifying its effectiveness.

In the following, a few options for in-depth chain analyses are presented:
- Quantifying the basic chain map
- Zooming in on the basic chain map to generate "thematic chain maps"
- Special chain studies on the stakeholder groups relevant for *pro-poor* growth

Analyzing the competitive position of the value chain is particularly important for the formulation of upgrading objectives and strategy. The respective analyses are treated in *ValueLinks* modules 1 and 3: In particular,
- Market research is covered in Module 1 (task 1.2)
- Constraints analysis is covered in Module 3 (task 3.2).

The economic analysis of value chains and benchmarking follow in point 2.3, below.

Quantifying the basic chain map

Conceptually, quantifying the basic chain map is quite straightforward. Quantification means attaching numbers to the elements of the chain map, e.g.

- Number of operators (possibly differentiating size of farms and enterprises
- Number of jobs and employees for each category of operators (also according to gender)
- Number of poor operators in each stage
- Prices paid at each chain link between stages
- Volumes and turnover in each chain stage
- Shares of product flow of the different sub-chains / distribution channels
- Market share of the value chain (or sub value chain) defined as percentage of the sales value in the overall market.

Box 2.12 Case: Quantifying growth rates in Kenyan fresh milk value chain

Estimated annual growth rates of turnover in different segments of the milk value chain in Kenya and expected growth in production value:



Source: Technoserve: "Dairy in Kenya – can it drive economic growth?", presentation 2004

Each type of information produces another perspective, an "overlay" of quantitative information on the same basic chain map (quote Gemini guide). Quantification obviously depends on the availability and reliability of secondary data, especially statistics. Data therefore need to be cross-checked from different sources. This is particularly true for information based on statistics, which in many countries are just not reliable. Cross-checking will allow at least rough estimates, which are usually good enough for taking decisions.

Zooming in: Mapping chain elements and segments

The descriptive analysis can be elaborated in more detail by specifying particular parts of the basic chain map creating detailed "thematic" maps. For example, a thematic chain map may show support service providers, as in box 2.7, or it may focus on categories of operational service providers and their interaction with the operators in the main line. Detailed mapping is a matter of map scale: As in geographical maps the overview chain map is at a "small scale", while detailed maps on specific chain segments or distribution channels use a "large scale". It is generally useful to produce a series of chain maps instead of including too much information in just one.

Special chain studies

Any aspect of value chains can become the subject matter of specialized chain studies. The following topics are typical areas of concern for facilitators of chain development.

Analysis of business linkages and governance

The forms of chain governance range from spot market to vertical integration of the entire value chain (see *ValueLinks* module 5 and the explanation of the forms of business linkages). Analyzing the existing business linkages includes to judge the intensity and sustainability of cooperation, the existence of lead firms and their attitude and commitment. A related point is the analysis of conflicts arising from differences in negotiation power, asymmetric information and competition for resources between VC operators. Business linkage studies also include the degree of sector organization, especially the capacity of commercial business associations (e.g. producer groups and associations and professional organizations).

"Stakeholder analysis" :

Each category of operators and service providers has characteristics that may be relevant for their ability to participate in an upgrading projetc. A stakeholder analysis is particularly important in the case of poor and weak market participants. A relatively straightforward criterion is the number of chain operators classified as "micro", "small" or "medium". In the

case of agricultural producers, important aspects include off-farm income, number of household members, food security situation and the conmpetition of cash crops for farm labour and cash resources. Addressing their capacity to contribute to and benefit from upgrading also includes analysing their technical, entrepreneurial and marketing competence, current market access and capacities for horizontal and vertical cooperation. A source of templates for stakeholder analysis in value chains can be found in Bourgeois, R. and D. Herrera, 2000.

Framework conditions at the macro level:

The assessment of the macroeconomic and legal framework of chain development includes studying the relevant national and international trade policies and the existing legal provisions for the market in question. Attention should also be paid to the social and cultural factors determining business behaviour. The influence of trust, the behaviour and willingness of operators to cooperate are decisive factors. However, social norms are often excluded from the discussion since they are difficult to analyse and bear conflict potential. Research on the influence of social norms in business networks is quite new, even in industrialized countries. Some indications may be found in the proceedings of the conference on "Trust and Risk in Business Networks" and in a recent publication of GTZ on this matter (GTZ, 2007).

According to analytical focus and the availability of information, the spectrum of methods for special chain studies ranges from brief expert discussions and workshops to rapid appraisal methods and in-depth surveys. Action-oriented, participatory methods eliciting the knowledge of chain actors should be given preference over expert surveys wherever possible.

Box 2.13 Practical hints: Some methods and information sources for chain studies

Desk research assessing secondary information

- official statistical data, and internet research
- existing sub sector studies of World Bank and others

Empirical research: Participatory and rapid appraisals

- key informant interviews with lead farmers, local businesses and traders, researchers, or important service providers,
- focus group discussions with farmer groups or industry associations,
- stakeholder workshops, expert fora and value chain meetings;
- field visits/ observations, e.g. observing negotiation behaviour in rural markets, consumer attitudes in retail markets, transport problems on the road, enforcement of standards by market management;
- questionnaire surveys of chain operators

Source: own compilation

(Task 2.3) Economic analysis of value chains

The economic analysis of the value chain is an important input into the decision on development objectives and the upgrading strategy. After all, production costs are the single most important factor determining competitiveness. Assessing the cost structure allows identifying critical points that need to be addressed. Economic data also provide the foundation for the monitoring of the progress made in upgrading, both for the operators and the facilitators. Cost analyses deliver data that help to create awareness among operators about the potential for value addition, cost drivers and the leeway for price negotiations. In short, the economic analysis of value chains is highly important.

Economic analyses include assessing:

- overall value added generated by the chain and shares of the different stages
- the production and marketing costs at each stage of the chain, and the cost structure along the chain stages
- the performance of operators (utilization of productive capacity, productivity, profitability)

The problem is that all of these analyses are highly challenging, not only in developing countries or emerging economies. Hardly any farmer knows his costs of production, nor do the majority of transporters, traders or small-scale enterprises. Empirical research is costly and does not guarantee sufficiently accurate data. In most cases, analysts will have to be content with rough estimates. In view of the fact that economic analyses are used to facilitate business decisions bearing income risks for the operators, it is recommended to have cost calculations and benchmarking done by trained staff. Facilitators have to keep in mind that they are responsible for the quality of their recommendations and the economic data on which they are based.

In any case, economic data generated in the context of value chain promotion can only give indications. The entrepreneurial decisions have to rely on firm data, anyway.

Calculating value-added

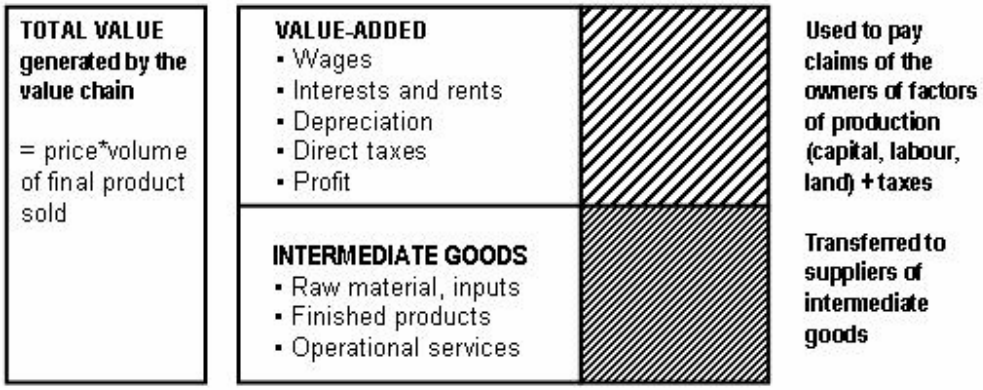
Value-added is a measure for the wealth created in the economy. According to the definition used in systems of national accounting, total value-added is equivalent to the total value of all services and products produced in the economy for consumption and investment (the gross domestic product - GDP), net of depreciation. To arrive at the value-added generated by a particular value chain, the cost of bought-in materials, components and services has to be deducted from the sales value. Box 2.14 shows the principle of calculating.

The sales value or revenue (price*volume) achieved by the value chain is divided between the value-added created by the operators constituting the value chain and the intermediate goods, inputs and operational services provided by suppliers who are not part of the core sequence of the value chain.

The calculation in box 2.14 does not refer to an individual firm but to all enterprises in the value chain taken together and including services and inputs provided by enterprises that are not part of the value chain. The growth of total value is a macroeconomic figure and a direct contribution to GDP growth.

Box 2.14 Concept: Calculation of value-added

Components of total value generated by a value chain:
(Value-added) = (Total sales value) - (Value of intermediate goods)



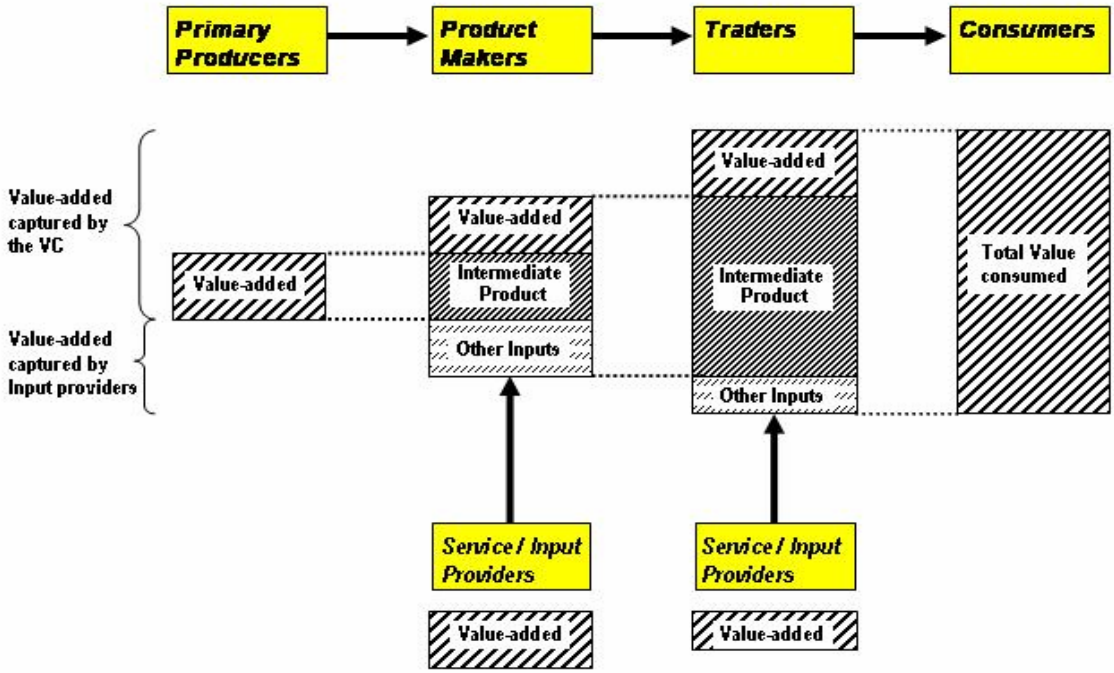
Source: own concept, based on

The calculation principle can be applied to each stage of the value chain as shown in the next box. The total value paid for and consumed by the final costumers is split between value-added and intermediate goods. The latter are further divided between the semi-finished or finished (intermediate) products provided by the operators in the previous segment of the same value chain, and the (other) inputs supplied by external providers. Hence, the graph shows how the value-added is distributed

- between the stages of the chain, and
- between the chain operators on one side and the external providers on the other.

Box 2.15 Concept: Distribution of value-added along the chain

Distribution of value-added between different types of chain operators and input providers:

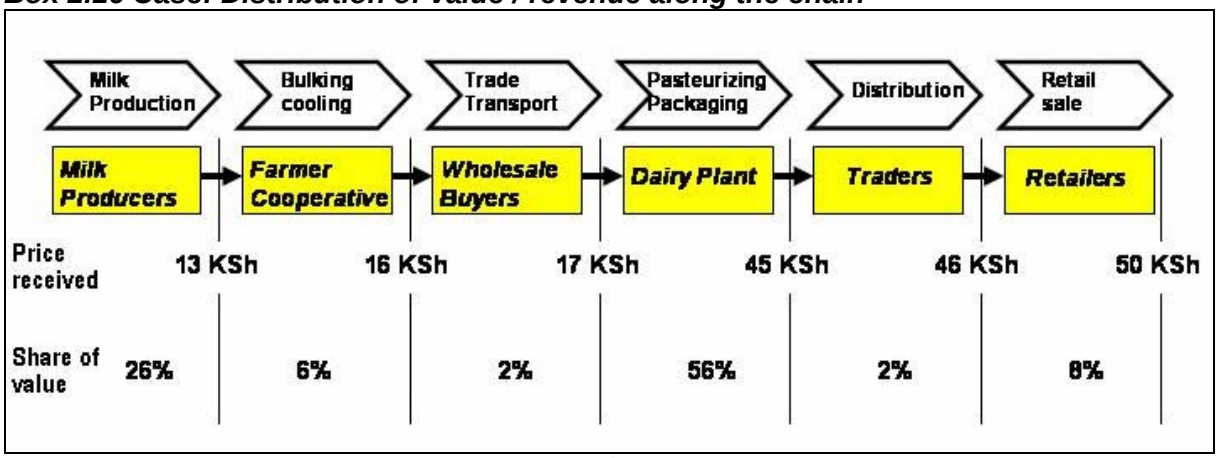


Source: own concept

The sum of the five small blocks with stripes indicating value added is equal to the total value added consumed. To be understood, income or profits make up only part of the value added. A large share in value added does not automatically imply high income. Nevertheless, from a macro-economic point of view, the value added is a more important parameter than the income of the chain operators. Eventually, the growth generated in related service sectors also counts in pro-poor growth.

Taking the graph in box 2.15 as a starting point, different scenarios of value chain upgrading can be envisaged: The most obvious is "value creation", i.e. higher sales volumes and/or prices – as a consequence of product improvement or cost reduction. Depending on the place in the chain where new value is being created, the distribution of the value-added changes. If, for example, traders manage to obtain higher prices by improving their marketing strategy, value is being created. The question is who receives ("captures") the value-added. As traders have to pay more to the product makers part of the value-added will go to the previous chain segment. Product makers may have to purchase more or more expensive inputs which, in turn, shifts some value-added to input providers. Putting numbers to the categories in boxes 2.14 and 2.15 is certainly not an easy undertaking. The absolute size of the value blocks in each stage of the chain can be determined by collecting data on the prices paid and the volumes traded. Box 2.16 shows price and thus value distribution in the milk example from Kenya (compare to box 2.12).

Box 2.16 Case: Distribution of value / revenue along the chain



Source: Hoeffler / Ogana: "Experiences with Kenya´s Dairy Value Chain Analysis", 2006

"Value creation" and "value capturing" are interlinked: Capturing value by improving the efficiency of input use increases value-added of the chain stage concerned, but reduces purchase of inputs and thus the value-added of input providers. At the same time, the efficiency gain is likely to translate into improved competitiveness ensuing a greater market share and thus value creation. The strategic implications of value creation and value capturing for the value chain and each group of operators are further developed in module 3.

The distribution between value-added and intermediate goods can only be derived from a detailed average cost calculation of the operators concerned.

Calculating production cost in value chains

The value categories shown in box 2.15 belong to the framework of national accounting. The calculation of production cost follows another categorization. In fact, in the accounts of individual operators, part of the value-added actually belongs to the direct and indirect costs – and no difference is made between the direct costs of purchased inputs whether bought from operators in the chain or from external service providers.

Nevertheless, firm accountancy data are also relevant for the economic analysis of value chains at large, because overall chain competitiveness depends of the cost of production in each of its segments. Calculating production costs in value chains implies

- aggregating cost of enterprises in a particular segment to arrive at average figures of the value chain or of the sector at large
- relating the data to the functions in the value chain. Here, it is not the firm that is the unit of accounting, but the sequence of production and marketing operations defining the value chain.

In order to achieve this, the functional sequence of the value chain has to be broken down into minor steps. Next, the unit cost of each operation is measured (or estimated). The procedure comes close to "Activity Based Costing" (ABC) analysis in which costs are assigned to business activities. ABC analyses incorporate causal relationships between production activities and costs or output. Those operations which are likely to cause exceptionally high costs are particularly interesting and may be singled out for a more detailed analysis. The cost calculation of a relatively short chain is shown in box 2.17, using an example of export rice production in Cambodia.

Box 2.17 Case: Cost calculation related to the rice value chain in Cambodia

Cost of performing functions in production of Neang Mali Rice for export, Cambodia
(in US Dollar / ton)

Rice Production	72,46	Post-harvest Operations	23,23	Transport & Shipping	33,44	*Costs fob* 129,13
- Land preparation	14,19	- Drying	3,35	- Transport to harbour	6,51	
- Seeding	4,15	- Milling	12,23	- Port handling	10,23	
- Transplanting	20,09	- Packaging	2,16	- Customs clearance	15,30	
- Fertilizing	26,00	- Fees & Levies	3,43	- Vessel loading	1,40	
- Harvesting	8,03	- Interest	2,06	- (Shipping)	(14,88)	

Source: World Bank / GDS: "Towards a private sector-led growth strategy for Cambodia", vol. 1, p.19

Unit cost calculation for each operation includes the direct costs in the first place, i.e. the cost of bought in material and services, energy consumption, wages, variable costs of machinery and the like. Fixed costs, e.g. interest charges or administrative costs are calculated for entire segments of the chain. The series of cost calculations is compiled along the chain.

Most likely, the data will have to be obtained indirectly, either as estimates derived from cost calculations in comparable enterprises elsewhere, or through model calculations of specific operations. For obvious reasons, the potentially best source of data - books kept by typical enterprises – is most difficult to access. The data used in the example above have been obtained through interviews.

Apart from the cost figures for chain functions, business activities can also be assessed in terms of the time needed to perform them. Other measures of economic performance are productivity indicators, e.g. the number of T-shirts produced per worker and day, the utilization of production capacity in percent, waste rates or the yield of agricultural products per hectare of land under irrigation. Such indicators are good proxies for the unit cost of production and may serve as a basis for competitive benchmarking.

Whichever the methods and result of cost analyses in value chains, the decisive question is how to interpret the data. Cost analyses can be used to

- identify cost driver across different stages of the chain and hence the potential for cost reduction potential of typical firms operating in the same stage

- assess the position of the value chain vis-à-vis the competitors, comparing unit cost with those of competitors (benchmarking)

Transparent calculation of production and processing costs also has a direct benefit for chain upgrading, as it helps to build trust between the partners in the value chain and provides a reference for negotiations. The following additional analyses set the basis for an interpretation of cost data thus providing the link to strategy formation.

Identification of cost drivers

Using the type of cost analysis presented in box 2.17, major cost components can be identified by calculating the cost distribution in percent. The example shows that the cost of fertilizers and the cost of transplanting constitute the two major cost items and therefore might offer a substantial cost reduction potential. In fact, a closer analysis reveals that fertilizers in Cambodia are of lower quality and not utilized effectively. Higher cost of transplanting can be explained by a low labour productivity. By analyzing important cost components in detail, cost drivers such as high waste rates, underutilized economies of scale or underexploited opportunities of using co-products can be identified.

Identification of exaggerated transaction costs

A type of cost that is particularly relevant in value chain analysis is the “transaction costs”. Transaction costs result from activities for (a) searching market information and screening market opportunities (b) negotiating contracts, (c) handling the produce (e.g. storage, transport, administrative costs and claims) and (d) monitoring and enforcing contracts (e.g. costs of quality control, insurance premiums). Transaction costs cannot be avoided but their amount depends to a large extent on a lack of information, market transparency, appropriate legal regulations and trust. Typical examples of important and tangible transaction costs are the costs of handling produce in a seaport, local taxes and administrative burden on road transport or the average rate of supplies that have to be rejected.

Competitive benchmarking:

Competitive benchmarking compares the value of key indicators of economic performance of the value chain in question with the value of the indicators in other, comparable value chains in other countries. Benchmarking can refer to the unit cost of production, labour productivity or indicators of technical efficiency. For example, the international benchmark for labour productivity in producing basic shirts is 18-25 pieces per day, while the respective figure in Ethiopia is 8-10 pieces per day.

Besides these economic parameters, benchmarks can be established for any other quantitative or even qualitative aspect of the value chain, including, for example, growth rates, investment in technology, research or staff training, existence of market regulations and standards etc. Benchmarking allows comparing the value chain at stake with an industry average or best practices of competitors. The comparison helps to identify upgrading needs and potential and identify new market opportunities.

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ValueLinks Module 3



Determining the Chain Upgrading Strategy

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ValueLinks Manual - The Methodology of Value Chain Promotion

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ValueLinks **Module 3**

Determining the Chain Upgrading Strategy

What this module is about

Formulating a strategy to develop a value chain always has two dimensions. The first concerns what the actors in a value chain must do to become more competitive and to generate greater value added in the future. The joint improvement of the value chain by private enterprises and their associations is called “value chain upgrading” in the remainder of this manual.

The second dimension of strategy concerns the role of external facilitators, i.e. government and donor agencies running an economic development programme. External facilitators do not engage in upgrading directly. Rather, they facilitate upgrading and provide assistance without becoming chain actors themselves. This activity is called “value chain promotion”, and logically refers to the upgrading strategy pursued by the operators.

Following this distinction, we talk about two types of strategies: an upgrading strategy and a promotion strategy. This module is devoted to the chain *upgrading* strategy; see *ValueLinks* module 4 for an examination of *promoting and facilitating* the chain development process. Consequently, it is very important to clarify *whose* strategy we are talking about. Strategy building starts by taking the perspective of the value chain actors – the enterprises, service providers and specialised public agencies constituting the chain. Unless *they* become active, external support by government or donor agencies does not make any sense.

Hence, formulating an *upgrading strategy* comes before formulating a *promotion strategy*. Nevertheless, development agencies can and should play a role in facilitating the search for a promising upgrading vision and strategy. Thus, they may become engaged as facilitators early on. However, a public development agency should only take the next step and promote the *implementation* of the upgrading strategy if (and only if) the vision and strategy of chain upgrading conforms to public development objectives. The upgrading strategy agreed upon by private enterprises should generate public benefit as well before it can be promoted.

Whenever development agencies enter the scene, secondary strategic and planning tasks need to be addressed as well. Two aspects of the upgrading strategy are of particular interest to development agencies. One is the identification of chain actors which will assume responsibility for upgrading (Task 3.4). The second concerns the construction of an upgrading impact model (Task 3.5). Both aspects help development agencies to make a decision on whether to go ahead with promoting upgrading in the future. The procedural questions as such – i.e. how development agencies should behave as external facilitators – are dealt with in *ValueLinks* Module 4.

The formulation of a chain upgrading strategy is a pivotal element in the overall structure of the *ValueLinks* methodology. It uses the information generated in value chain analysis (Module 2), and points towards the different fields of upgrading actions treated in *ValueLinks* Modules 5-10.

Tasks in building an upgrading strategy

Building a value chain upgrading strategy involves a sequence of steps: It starts with determining the outlook for the value chain in general - the vision of development of the value chain in future. In light of that vision, the second step is to review value chain constraints as well as opportunities. Further on, the vision is operationalized to arrive at objectives. A concrete action programme is required specifying fields of action and the chain actors

responsible for implementing. Finally, the development logic of chain upgrading should be presented in a results framework or impact model. The first four tasks in this module set the basis of the upgrading strategy:

- (Task 3.1) Agreeing on a vision and strategy for value chain upgrading
- (Task 3.2) Analyzing opportunities and constraints to chain upgrading
- (Task 3.3) Setting operational objectives and preparing upgrading action
- (Task 3.4) Identifying actors implementing the value chain upgrading strategy, and
- (Task 3.5) Anticipating the impact of value chain upgrading

The first four tasks rely heavily on the chain actors. It is them who need to take the relevant decisions. The fifth task is probably less interesting for enterprises. It involves constructing an impact model that shows the likely results of upgrading in terms of the expected development. At the same time, it provides development agencies with a project logic they can refer to. The impact model shows how external interventions could relate to the upgrading strategy.

(Task 3.1) Agreeing on a vision and strategy for value chain upgrading

Value chain promotion needs a strategic perspective. The upgrading vision describes the aspired change of the value chain answering the question: How should the value chain at stake look five years from now? Determining the desirable future of the value chain is an indispensable task because

- Visioning defines (or confirms) what the endeavour to develop the chain is all about. Beyond the selection of a particular value chain, visioning defines the actual justification for promotion.
- Visioning provides strategic direction. Unless the perspective for chain development is clear, it is difficult to prioritize action and to keep focus. In fact, some key elements of an upgrading strategy only appear after a systematic check on what it takes to realize a vision.
- Visioning is the basis for a consensus among stakeholders on the way forward. Motivation and the willingness to cooperate presuppose that stakeholders share the view on the future.

At the outset, every value chain actor has a partial picture of the value chain and of the desirable future. It is very important to make sure that the vision and strategy is formulated and shared by the chain community. To the extent that government agencies participate in the realization of the vision, they also need to agree. Visioning therefore requires meetings to build a common understanding among the chain actors. In large value chains the different business groups need to be represented. In order to arrive at a realistic vision that is widely accepted, facilitators are well advised to work with those chain actors occupying a key position in the chain (see box 4.17). Ways of organizing and facilitating the process of visioning and decision-making are treated in *ValueLinks* module 4.

The upgrading vision refers to the overall goal of chain development in the interest of operators. Thus, the vision always refers to

- improving chain revenue (value creation), i.e. generating a higher sales volume and/or achieving better prices, and
- the income of chain operators (value capturing).

From the perspective of development agencies, distributional aspects, especially a greater value captured by poor groups or additional jobs for the poor are also part of the vision. However, no enterprise is in business because of its motivation to alleviate poverty. It is not very appealing to chain actors if facilitators manipulate visioning towards an emphasis on poverty alleviation. Rather, visioning should address the competitive issues first – from the perspective of the enterprises. It is the task of the public development agency to determine whether the vision holds opportunities for the poor as well. If yes, this aspect of the vision should be made transparent. While promoting the upgrading vision external facilitators will focus on those parts of the strategy that have the greatest impact on poverty alleviation.

Building on the vision, the upgrading strategy describes how the vision can be reached by improving processes, the capacity and relationships of operators.

The potential for value creation is determined by the conditions of the target market on one side, and on the competitive position of the value chain vis-à-vis that market on the other. The management literature offers a number of useful tools to determine strategies to identify and address the potential combining both aspects. Strategic management thinking can also be applied to determine the broad strategic direction of value chain development. Two classic and widely quoted instruments for strategy choice are reproduced in box 3.1, Michael Porter's "generic strategies matrix" and Ansoff's "product/market matrix" (other tools include SWOT, Porter's "diamond", and the "Boston matrix").

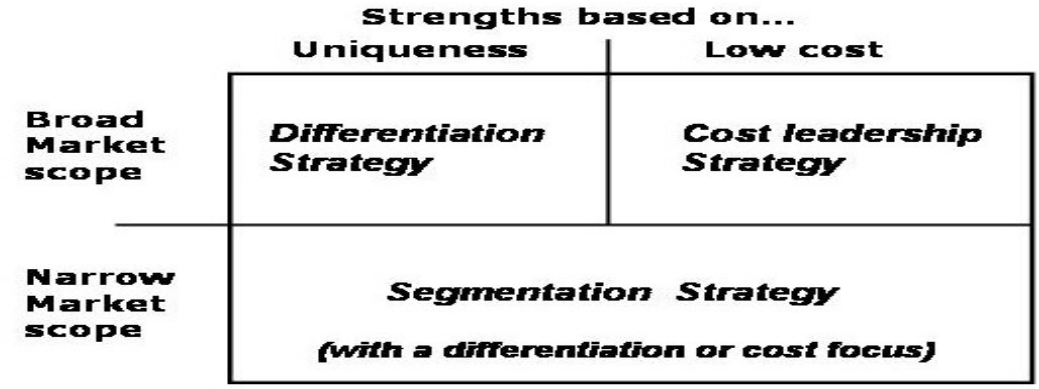
Porter's matrix distinguishes two broad strategic orientations according to the relative competitive strengths of a firm or sub sector, either the *uniqueness* of the product or a *cost* advantage. Accordingly, the strategic vision refers to product differentiation (quality improvement and/or product innovation) or to cost reduction (better operational efficiency). These visions are seen as two alternatives in a broad market with a large turnover. A third type of strategy/ vision turns around the specialization on market segments focusing on the needs of particular market niches. In this case, increasing competitiveness requires product innovation as well as an adequate operational efficiency.

Similarly, Ansoff's matrix combines the market dimension with the business opportunities that are within reach. The issue is to assess which combination of current or new products and markets stands the best chance of succeeding. In order to select a strategy, analysts have to assess the competitiveness of the value chain in relation to the opportunity: What is the production cost compared to those of competitors? What are the risks involved in moving into a new market or product?

Strategy matrices offer one important trait: They take the potential as the starting point and thus derive the vision from a positive view on the future of the value chain, rather than from the current problems.

Box 3.1- Concept: Matrices to guide strategic choice

Michael Porter: "generic strategies matrix"



Source: See, for example: http://en.wikipedia.org/wiki/Focus_strategy

Igor Ansoff: "product / market matrix"



Source: See, for example: http://www.12manage.com/methods_productmarketgrid.html

However, from a development perspective, the upgrading idea cannot solely be based on competitive advantage but has to "pro-poor" at the same time. Facilitators have to make sure there is a potential for improved distribution of the additional chain income across groups of operators. Poor producers (including subcontractors, home workers and/or employees) should have the chance of getting their share of the value created.

The pro-poor considerations may involve a role conflict of the development agency in facilitating the formulation of a vision. Private enterprises have the responsibility to implement the upgrading strategy. Hence, they also have to "own" the vision and development facilitators clearly have to promote that sense of ownership. At the same time, development agencies pursue a public policy agenda and cannot remain entirely neutral. This does not have to be problem, if the operators in the value chain belong to poverty groups. However, companies have to give priority to the competitiveness issues rather than social aspects.

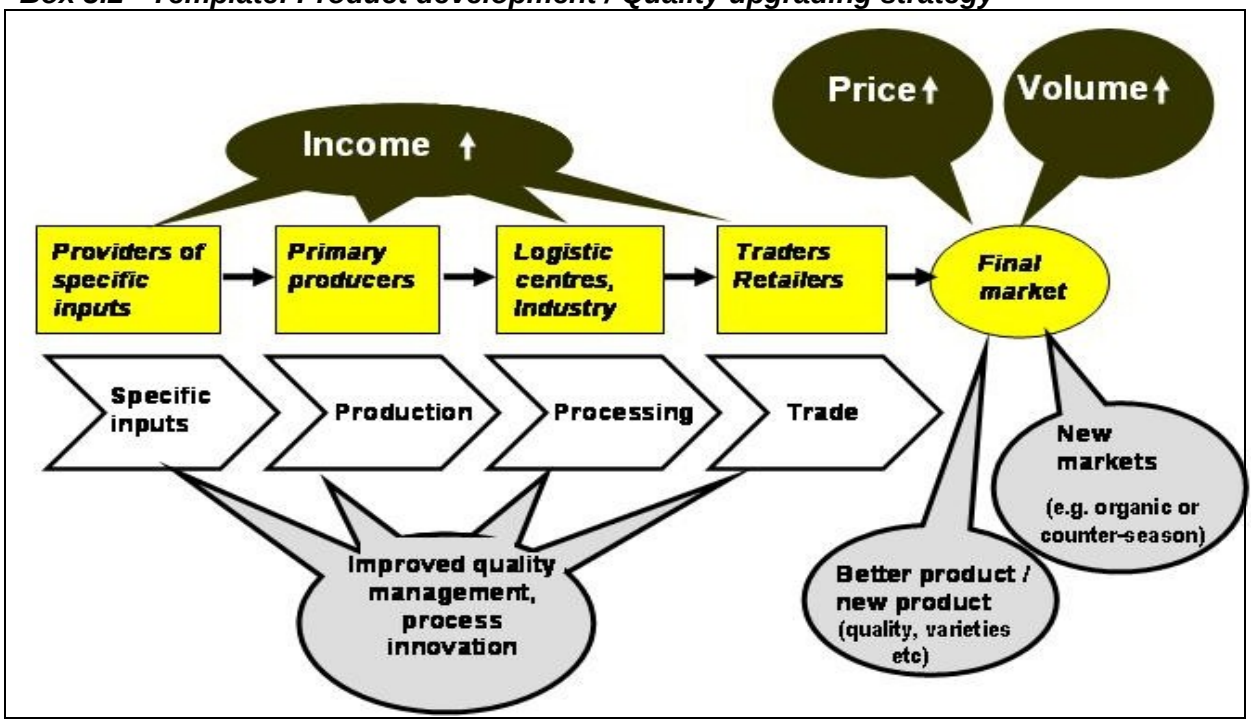
Facilitators can only resolve the conflict by separating the roles: On the basis of an honest and neutral account of interests, it is the public side that has to judge whether the vision is likely to generate pro-poor benefits – and make a decision whether to support its implementation. Private entrepreneurs will not object to taking on social aspects as long as they benefit as well, or at least are not affected negatively. An example of a vision in which both sides gain, is a strategy that lowers production costs of lead firms by shifting primary processing tasks to their poor suppliers who receive a higher price in return. It is not necessary to always spell out the pro-poor objective with private sector stakeholders. Rather, public promoters can follow a market oriented vision and facilitate the process to be pro poor focusing their support activities on the poverty groups within the chain.

The upgrading vision and strategies can be visualized in the value chain map by combining the anticipated aggregate change - the vision, (e.g. "increased chain revenue") with the strategies (e.g. "improved product", "better quality management"). The following boxes 3.2-3.5 present typical combinations of vision and strategic objectives. These visions and strategies roughly correspond to the generic options introduced above:

- a product development or quality strategy
- a cost reduction / market penetration or market development strategy
- a (foreign) investment strategy (mainly for market penetration)
- a value redistribution strategy

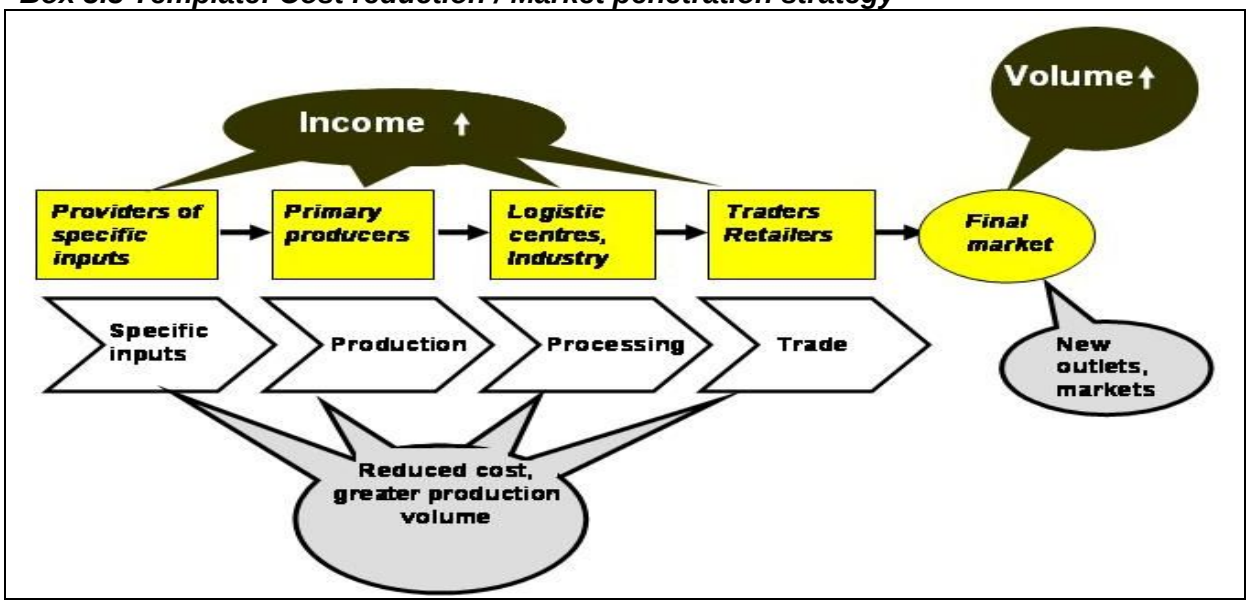
Each graph shows the operators to which the visions refer, as well as the points in the chain where strategies would set in. The chain map can be used to exactly locate the objectives. The wording is kept generic. When applying these templates in practice, the formulation of visions and the strategic objectives have to be worked out properly.

Box 3.2 - Template: Product development / Quality upgrading strategy



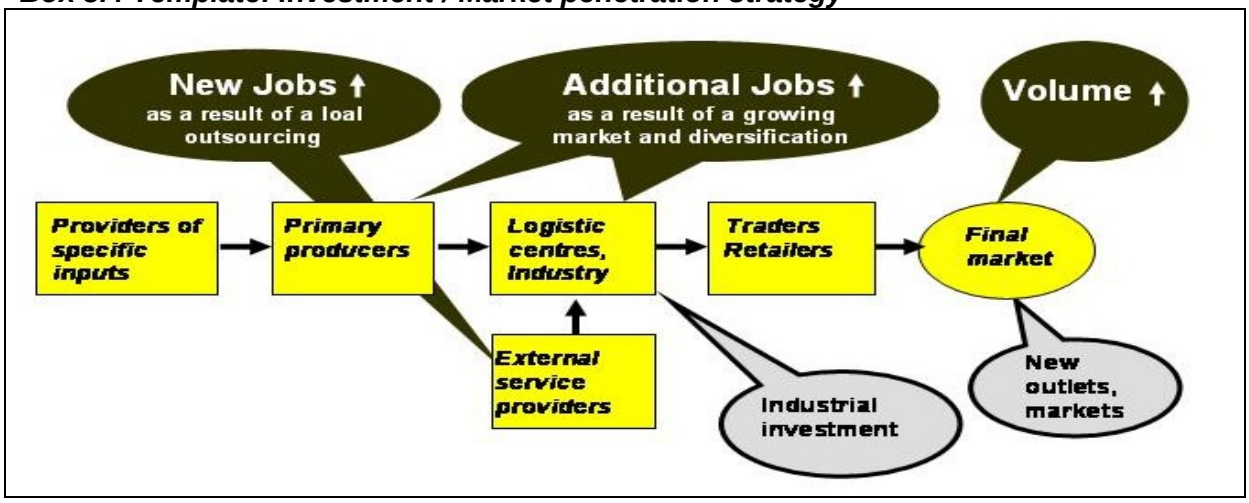
Source: own concept

Box 3.3 Template: Cost reduction / Market penetration strategy



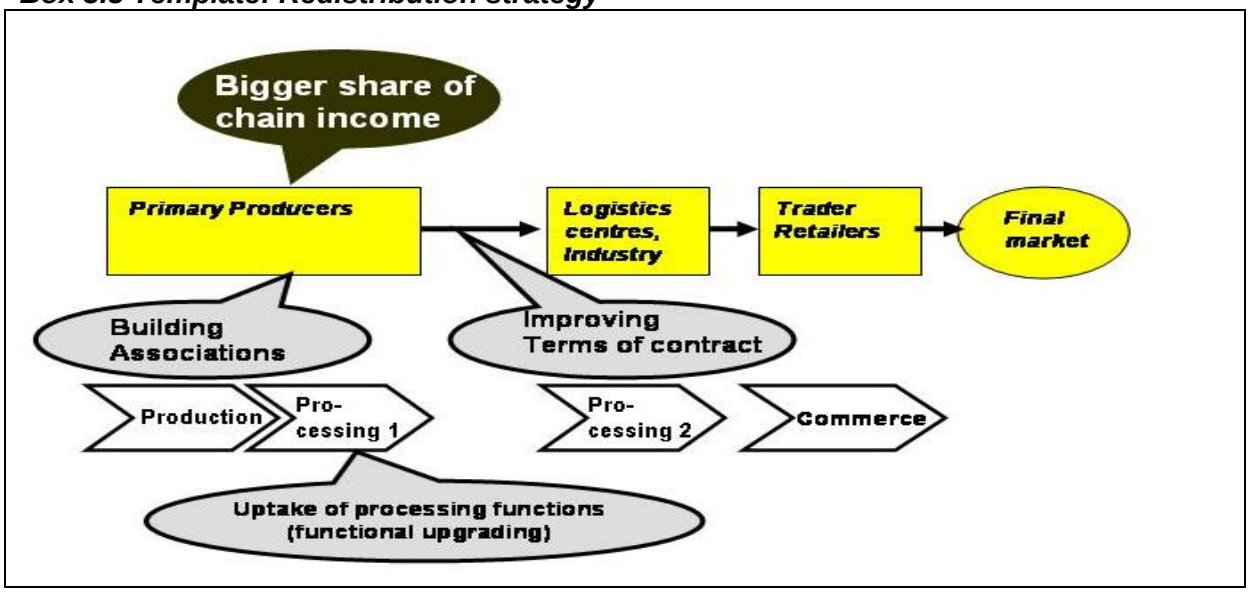
Source: own concept

Box 3.4 Template: Investment / Market penetration strategy



Source: own concept

Box 3.5 Template: Redistribution strategy



Source: own concept

The last template (box 3.5) operationalizes an explicit poverty reduction vision, in this case a "bigger share of the chain income" for primary producers, e.g. in agriculture. Three potential objectives are derived, e.g. building associations, improved terms of contract and the uptake of (part of) the processing functions. Here, the strategy concentrates exclusively on value capturing by primary producers. The other templates focus on value creation. They are only pro-poor to the extent that poor operators have an equal chance to capture the value or that additional jobs are being created benefiting poverty groups. In any case, development agents must make sure that the opportunities are accessible to the poor as well.

Of course, these visions and strategies are not mutually exclusive. In each case, a specific formulation will have to be found. As business ideas evolve and more stakeholders get involved, the initial idea will increasingly take shape. In many cases, several iterations are necessary between different versions of the vision using the increasing knowledge about the value chain.

It has to be understood that there is no need for consensus across the board. Different groups of operators in the value chain have different incentives to either cooperate or compete. The issue is to differentiate the value chain and determine which set of actors is willing to cooperate. Nevertheless, facilitators have to live with the differences and recognize that it may not be possible to get everyone to agree to the vision.

At the beginning of a promotion project it is sufficient to indicate the broad direction, e.g. *"Higher sales prices through an improved product quality"* or "*Secure marketing through forward contracting with processors*". Box 3.6 presents a concrete example (for other visions see boxes 3.12 and 3.13).

Box 3.6 - Case: The vision for the grass cutter value chain in Western region, Ghana

Value chain situation:
Grass cutters *(Thryonomys swinderianus)* are wild rodents of the West African savannahs traditionally hunted as bush meat. Grass cutter meat is a local delicacy and in high demand. As the population of wild animals is decreasing, a new technology for breeding and rearing grass cutter in captivity was introduced from Bénin to Ghana a few years ago – and rapidly picked up by private breeders and farmers. Grass cutter rearing is a profitable business with no marketing problems, but it requires specific skills and equipment and considerable investments to start. The Western region of Ghana is a high potential area for grass cutters, yet breeding animals and specialized services are still in short supply. The number of producers is small.

The vision:
In a regional meeting in November 2005, farmers, the provincial Ministry of Agriculture, a few agriculture-related businesses, and representatives of support organisations met to discuss the way forward. They came up with the vision to increase the volume of grass cutter meat production in the region within the next five years by massively investing in the business. This includes the foundation of a regional producer association facilitating the access of members to breeding stock and to loans. The association will also provide the platform for skills training funded by donor agencies.

Source: GTZ Ghana

Visions describe change at the most aggregate level of the value chain analysis. Although the vision may not necessarily reach as far as specifying a desired income distribution, it makes sense to again check on the arguments with which the value chain was selected in the first place. The vision also needs to be verified in regular intervals to ensure that changing frame conditions are incorporated.

(Task 3.2) Analyzing opportunities and constraints

Apart from being owned by stakeholders, upgrading vision and strategy have to be made concrete. Setting strategy objectives already means operationalizing the vision as each strategy corresponds to an objective and provides the direction for developing action ideas. The strategic objectives have to be broken down further to arrive at a detailed model of how the vision could actually be achieved - the operational objectives and fields of action. For example, actually improving product quality management may presuppose an agreement on quality standards first. The anticipated change at the micro level (in technology, linkages and business services) often presupposes change in the regulatory environment and the overall institutional capacity as well.

The formulation of operational objectives uses the chain map as reference, along with the results of economic and market studies (see modules 1 and 2). The data generated in the chain analysis provide a baseline against which the anticipated change can be made clear. Therefore, objectives can only be as concrete and detailed as the available baseline information. Thus, the methods of chain analyses also provide the data needed to quantify the objectives.

Operational upgrading objectives can be derived by looking at the prerequisites and implications of the vision: What does it take to actually arrive at the vision? The question to start visioning ("How should the value chain look five years from now?") is again used here, but this time applied to the different functions, actors and relationships within the value chain. In order to come up with solutions, planners identify critical points of the system, either referring to the current structure of the value chain or in light of the vision for its future development. It is important to note, that the objectives should not just be inferred from *current* chain problems but from the opportunities and the necessary change implied in the vision. Based on the results of the value chain analyses, symptoms and underlying reasons of constraints should be discussed. The following lead questions intend to provide a strategic focus for the discussion.

Box 3.7 - Principle: Lead Question to identify constraints impeding chain development

Three lead questions to guide chain analysis

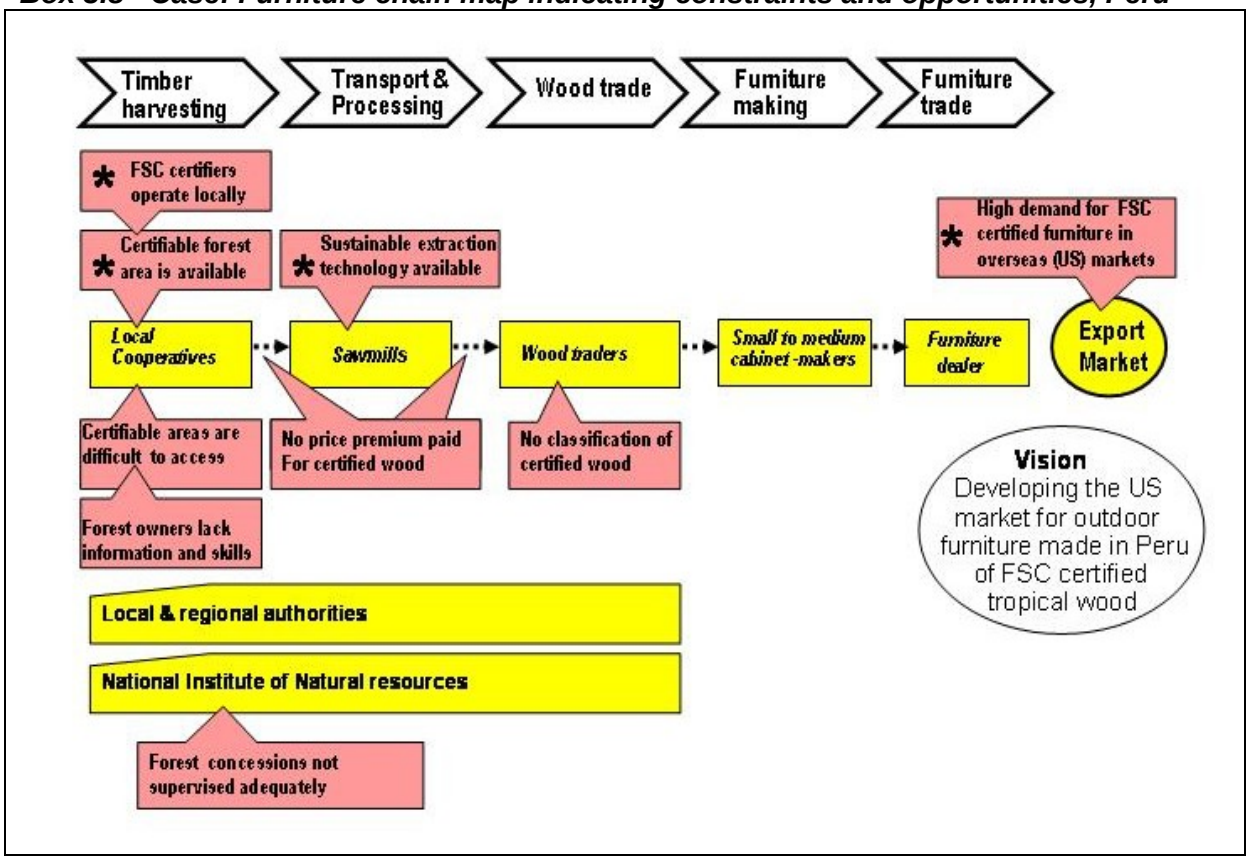
- What are the reasons for the chain to stagnate?
- Which gaps exist between the requirements on a value chain derived from the vision and its current structure and performance?
- Which constraints reduce the competitiveness of poverty groups (target groups) and prevent their integration into the value chain?

Source: own concept

The objectives of value chain upgrading are formulated in view of the answers to the lead questions. Whether or not these answers are based on a detailed value chain analysis, the task is to present the information in a form directly usable in collaborative decision-making. The most straightforward possibility for listing and visualizing constraints and opportunities is by introducing descriptive statements into the basic chain map as is shown in box 3.8.

The reference for constraints analysis is the chain map. The case in box 3.8 shows the principle of visualizing opportunities and constraints within a value chain map. The example comes from a workshop exercise: First, a development vision for the furniture value chain in Peru was formulated. The overview map of the chain was then used to indicate the exact location of the issues identified during the discussion using the mapping symbols of *ValueLinks*. The red cards stand for constraints or opportunities (if marked with a star and placed above the sequence of operators. Results created on a pin board are transferred into a MS powerpoint slide.

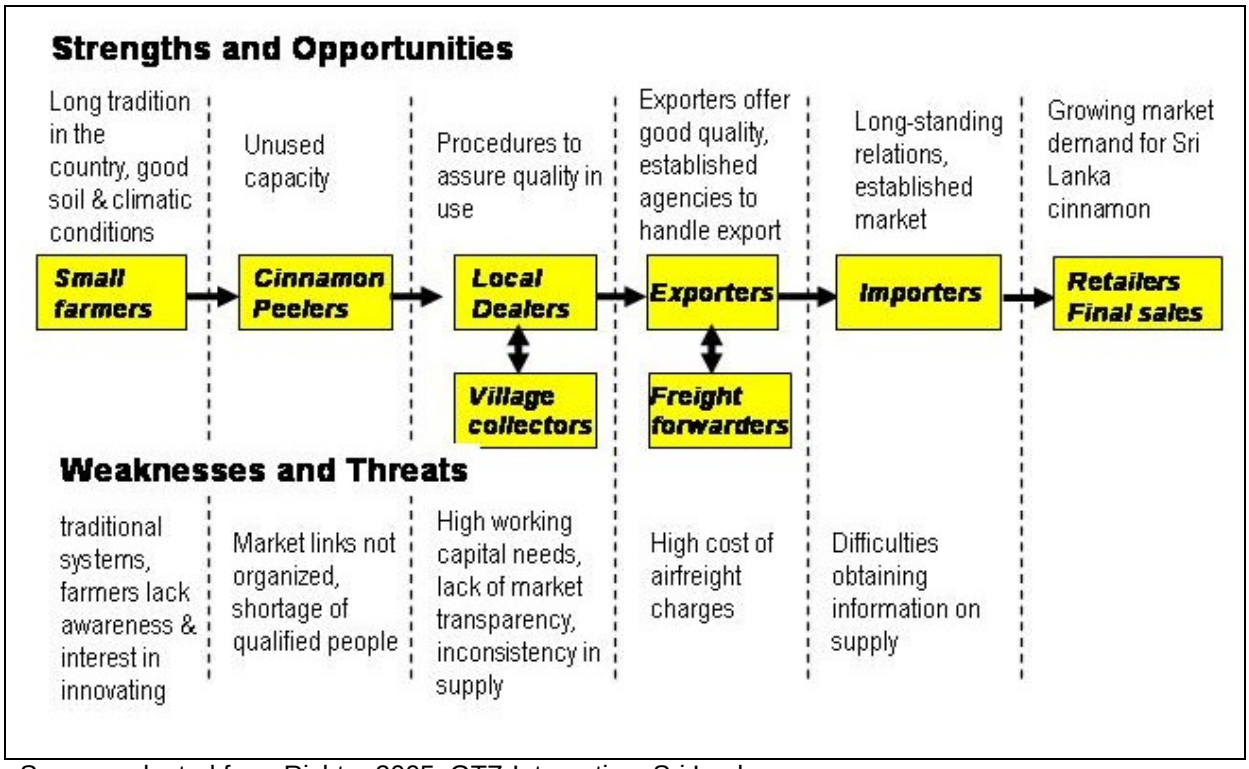
Box 3.8 - Case: Furniture chain map indicating constraints and opportunities, Peru



Source: based on a case developed in the ValueLinks Training Course, Quito, Ecuador, March 2006

This is a diversification strategy to creating value and capturing a good share of the value in Peru. The constraint analysis shows that the major bottleneck is the supply of certified wood. Both the chain map as well as the analysis of opportunities and constraints is simplified.

Box 3.9 - Case: SWOT analysis integrated into cinnamon value chain map, Sri Lanka



Source: adapted from Richter 2005, GTZ-Integration, Sri Lanka

Another form of presenting the information is by linking the chain map with a SWOT analysis that summarizes the insights of the different value chain studies. Box 3.9 shows the principal stages of the value chain in the middle row, complemented with results of a SWOT analysis above and below, thus linking operators at different value chain stages to weaknesses/ bottlenecks and strengths/ opportunities identified in a SWOT analysis.

The results of the SWOT analysis can in turn be combined with the identification of potential strategies. An example is the fish subsector in Kenya shown in box 3.10. Here, strengths, weaknesses as well as opportunities and threats are noted in a SWOT format. The analysis is used to derive actions.

Box 3.10 Case: SWOT analysis and strategies to upgrade fish sub sector, Kenya

Associations representing the Value Chain *- National Fisheries Federation (NFF) & member associations:* *- Inshore Fisheries Association,* *- National Inland Canoe Fishermen Council,* *- Cooperative Fishermen Association*	**Strengths** Associations exist, representing the fishermen clear objectives & commitment of NFF Executive Council potentially high lobbying power due to 5% share in GDP service offers available for entire value chain increasing investment in processing and marketing	**Weaknesses** limited human/ financial capacities weak buyer-seller linkages knowledge on quality is limited, despite training out-dated technology of artisan and industrial vessels lobbying power not fully exploited insufficient access to finance
Opportunities Access to EU market new products (e.g. deep sea fresh fish, value addition, aquaculture) new technologies for improved fishing (fibreglass vessels) new technologies for improved processing and waste reduction	*Short term strategy* Raising awareness on opportunities improving post-harvest handling simple system to facilitate information flow between the chain links joint procurement and marketing ventures	*Medium term strategy* strategy to better exploit lobbying power improving information and training on quality, hygiene, waste reduction etc. Communicating success stories to promote membership in associations measures to build trust between chain actors
Threats rising fuel prices artisan fishermen poverty stricken insufficient storage and port infrastructure overfishing increasingly ambitious standards of buyer markets deficiencies of the vocational and higher education system inadequate legal provisions (e.g. restrictions on excluding non-members from service offer of cooperatives)	*Medium term strategy* System with templates for grant applications by fishermen associations joint processing / marketing ventures (priority: ice storage) design of industry self-control system for quality, environmental and social standards (code of practice, internal control, certification)	*Long term strategy* strengthening organizational structures of associations development/ improvement of service offer of associations internal conflict management/ arbitration procedures to manage conflicts of interests along the value chain implementation of industry quality-control system along the value chain enforcement of standards capacity-building for training of artisan and industrial fishermen

Source: GTZ-MOAP, Kenya, adapted by M. Will

(Task 3.3) Setting operational upgrading objectives

Vision and strategies have to be translated into concrete and realistic action plans. In preparing upgrading action it is important to distinguish between the roles and responsibilities of enterprises, supporters at the meso level and the external facilitators. The action to resolve constraints and address the opportunities has to be taken by the enterprises and chain supporters. Consequently, these actors also have to set the operational tasks for upgrading. This involves assigning concrete responsibilities, either to individual actors or to representative bodies if solutions have to be generated in a joint effort. The contributions and facilitating role of an external development agency is determined later and follows a different logic (see *ValueLinks* module 4 on the external facilitation of value chain upgrading).

Formulating operational objectives includes synthesizing the analysis of opportunities and constraints and turning them into action proposals. Action proposals should name the functions and operators they refer to. The proposals can be aggregated into “fields of action”.

Identifying areas of upgrading

There are several possibilities for operationalizing upgrading objectives. The question is which activities should be scheduled. Generally, potential actions can be systematically inferred by

- determining possibilities to remove the barriers hindering progress towards the vision,
- determining possibilities to fulfil the requirements connected to the vision, and by
- checking on “points of leverage” in the value chain.

The first two methods are fairly straightforward: The procedure is to gather all available information related to the strategic objectives, the opportunities, constraints and their causes. Screening this material provides clues about potential solutions and the necessary investment. In essence, this means analyzing the constraints in greater detail to arrive at a suggestion for action. The second approach starts from the strategic objectives and breaks them further down into manageable tasks.

The third method identifies those elements of the chain where action might produce the greatest effect. The procedure is to focus on those constraints and opportunities in the chain that are critical success factors and have the potential to advance or impede upgrading. Critical issues are found at the “points of leverage”. Points of leverage are the key business links (bottlenecks) in the value chain affecting the overall performance or key services and sources of technology without which the chain cannot advance. Points of leverage can be identified as part of a value chain mapping exercise. Planning the upgrading action would then focus on the points of leverage, together with the actors at the respective stage.

Apart from these systematic screening methods a simple brainstorming of stakeholders often produces new insight. Planners should always be open to unforeseen opportunities. After all, upgrading has to builds on creative business ideas and solutions.

The proposed actions may be visualized in the value chain map by indicating the stages and actors of the chain they refer to. However, it is not useful to overload the value chain map with all kinds of indications. Presenting the action alternatives better uses a table format.

Taking these steps may yield a large number of potential actions. Before a decision on the way forward is taken, the proposed actions should be critically reviewed. Box 3.11 presents criteria to set priorities across proposed actions for upgrading.

Box 3.11 - Tool: Criteria for a priority assessment of the proposed actions

Criteria regarding the significance of actions:

Relevance: Does the proposed action actually contribute to the vision and to the objectives? Is it a necessary improvement?
Effectiveness: Is the action likely to produce results? This includes checking whether actions address intermediate objectives or aspire to realize the vision as a whole: How long into the future do we look?
Feasibility: Is it in line with available resources and with the current capability of enterprises and agencies? Determine the feasibility of a chain development project according to market and upgrading potential!

Criteria regarding the correlation of actions:

Comprehensiveness and consistency: In value chain development we are often faced with inter-related issues (e.g. cutting cost *plus* marketing or quality management along the chain). Is the combination of activities sufficiently complete to reach the objective? Are the proposed actions complementary, do they support each other?
Correct sequencing: Do the actions build on each other in a process of incremental improvements? Does the action provide momentum in the current stage of the process?

Source: own compilation

Defining the upgrading programme: Fields of action

The many possible actions to improve value chains can be clustered into generic "fields of action" as they will be called in the following. *ValueLinks* differentiates three such fields (see box 3.12):

- Improving business linkages, associations, and partnerships
- Strengthening service supply and demand
- Introducing standards and improving policies and the business environment of the chain.

This classification is not haphazard. The fields of action correspond to important categories of leverage points in value chains. Value chain analyses recurrently point to certain critical factors on which overall system change depends. Box 3.12 relates the three fields of action to the upgrading strategies

Box 3.12 - Template: Fields of action and their link with upgrading

Fields of action	***Relation to value chain upgrading strategy***
Business linkages and partnerships	• (Collaborative) quality management • Greater production volume • Formation of producer associations • Improvement of terms of contracts • Industrial investment
Service supply & demand	• Quality improvement • Greater production volume • Cost reduction • Diversification, product innovation
Policies and market regulation	• Quality improvement by introducing standards • Reduction of transaction costs • Improvement of contractual security

Source: Own compilation

The fields of action operationalize the upgrading strategies:

Business linkages

Market links and the form of chain integration not only determine the growth potential in sales but also the distribution of chain income. At the same time, they are accountable for the volume of transaction costs. And it's through business links that an important part of the information and technology is channelled. Improving horizontal and vertical business linkages helps to establish new market contacts, reduce production and transaction cost, manage quality and improve terms of contract between producers and buyers.

Services

Value chain services include both business services and financial services. Service providers often are leverage points in the value chain. Without services delivering technological solutions, investment capital or training, no economic progress of the chain is conceivable. Service providers are multipliers who convey innovations to many chain operators. Developing service supply and demand improves and innovates products, reduces production costs, helps to expand production and sales and to manage quality.

Market regulation and policy

The regulatory environment, economic and trade policy influence the value chain as a whole, just quality standards or grades have implications for operators at all stages. Formulating policies and introducing standards provides the foundation for joint quality management, helps to reduce market transaction cost, and to improve contractual security.

Within these three fields, actions are strongly interconnected, so that it would be possible to conceive a "linkage strategy", a "service strategy" or a "market regulation" strategy of chain promotion. Distinguishing the fields of action serves to structure the know-how of chain promotion and helps to conceptualise chain promotion projects. Therefore, the topics of *ValueLinks* modules 5 – 10 correspond to the fields of action (see the overview of *ValueLinks* modules). They provide details on individual actions, the possibilities for supporting them as well as the respective modes of delivery.

Box 3.13 - Cases: Examples of chain upgrading objectives and actions

Palm oil in Southern Thailand

Vision: Greater competitiveness by reducing costs at the primary production stage
Objectives: (a) to increase average oil yields by improving the fresh fruit bunch (FFB) yield and the oil extraction rate (OER) in oil mills - to match benchmarks of Malaysian plantations; (b) to enhance oil extraction profitability by generating electric power (as well as biofuel) using biomass residues.
Main actions: (a) introduce energy policy providing attractive feed-in tariffs for local sources of electric power; (b) create business links between oil mill owners and providers of power generation technology; (c) improve plantation management practices; (d) enhance and improve supply of farm services.

Maize in Xayabouri Province, Laos

Vision: Expansion of maize production and sales
Objectives: (a) to introduce more contract farming arrangements with buying companies; (b) to qualify maize farmers associations to become contract partners
Main actions (a) regulate current contract problems with the publicly owned RD Ltd. Company (b) grant market access for private companies interested in contract farming; (c) found association of maize growers in 2 districts.

Source: GTZ Laos and GTZ Thailand

The classification is not meant to limit the possibilities for reaching the chain development vision. It should be taken flexibly - as a possibility of providing orientation. After all, each upgrading programme looks different depending on the conditions of the case. Boxes 3.6 and 3.13 present typical visions and upgrading strategies for a series of value chains in different countries. Each case presents a particular combination of vision, objectives and action areas.

As a general rule, one or several chain operators or chain supporters should take the responsibility for carrying out the upgrading action. However, in many cases it will be difficult to mobilize lead companies, business organizations or chain supporters for the action, as the chain organization may be weak and key actors often lack the capacity. This is the reason why external development agencies may come supporting joint action of chain actors and strengthening the capacity of key actors – the topic of the following task.

Ultimately developing a combination of vision, strategies and fields of action is identical with the impact model of an upgrading project. In fact, it is at the stage of strategic planning that the impact model should be established. The task 3.5, further below, provides methodological hints on how to achieve this.

(Task 3.4) Identifying actors implementing the upgrading strategy

Obviously, any strategy remains incomplete if it does not specify *who* implements the action programme. As a general rule, the responsibility for upgrading action has to be taken by the chain operators (groups of enterprises, lead companies or business organizations) and by the meso-level organizations in the respective value chain. Unless the chain actors assume this responsibility, external support will not be successful – and no impact be achieved. A key task in planning chain upgrading is to carefully identify those value chain actors who are capable and willing of taking the project ahead. To the extent that these actors need support themselves, they become partners for an external development agency during implementation. Chain actors bearing responsibility for the upgrading action should

- fully subscribe to the upgrading strategy including the expected public benefit, and
- be able to contribute to upgrading the value chain.

Reviewing the capacity of chain actors to implement the upgrading strategy

The extent to which the chain can be advanced towards the vision hinges on the capacity of the chain actors to actually implement the strategy. A realistic upgrading strategy is in line with the actual capacity of chain actors to carry the upgrading project forward. After all, chain upgrading often takes place *without* any public support. It might well be that once a vision and strategy has been formulated, there is not much left to do for an external facilitator as the enterprises move ahead on their own. In a well-organized value chain, operators already collaborate in business associations addressing issues of collective interest. Important firms take a leadership role.

However, in the cases that are of relevance here chain upgrading will require some form of public support to initiate collective action. Even if the enterprises have an idea about where the industry should go as a whole, they do not necessarily have the resources, the know-how and the organization required. Especially the small and medium enterprises may not be able to keep up. Therefore, it is necessary to review the capacity of value chain actors to tackle the opportunities and constraints. This review is done by going through the list of upgrading actions identified beforehand. For each field of upgrading action, value chain actors and facilitators should determine

- who among the chain actors (enterprises, associations or business organizations) takes the lead in the respective upgrading action,
- whether this enterprise or association is capable of completing the task with own resources, or
- whether the intended action requires external support by a value chain promotion project.

A lack in capacity of chain actors to move ahead with the upgrading project is the reason why public development agencies may come in to support.

It is clear that external facilitators should not behave as businesses and do the job themselves. They take a facilitation role only, building the capacity of chain actors to pursue the upgrading action themselves. Capacity means both the individual capacity of chain operators and service providers as well as the ability of stakeholders to organize themselves and resolve their common problems jointly. While chain actors pursue an upgrading strategy, the most important strategy of development agencies is capacity development. Consequently, the upgrading strategy has to be complemented with a strategy for the effective facilitation of the upgrading process and the planning of respective external support activities. Identifying useful support activities is the strategic task of development agencies in addition to planning the upgrading action. Associations and chambers can facilitate chain development as well. It often coincides with their mandate.

In any case, facilitators need active partners in the value chain, before they should engage in a chain promotion project. The selection of chain actors as partners for development agencies is the subject matter in *ValueLinks* module 4 (see task 4.4 - “organizing a chain promotion project and scaling up”). Module 4 also treats the principles and tasks of external facilitation.

Operational action planning

Once the upgrading strategy is clear, i.e. a combination of actions has been found that will lead to the objectives and contribute towards realizing the vision, operational planning follows. The actions have to be described by specifying responsibility and providing implementation details. *ValueLinks* does not suggest any particular format for this, as upgrading strategies may look quite differently with actions ranging from short-term activities to comprehensive sub sector development projects. Also, project formats depend on the peculiar administrative conventions applied in each case. Generally, operational action planning should specify:

- the reference to the objectives (expected results),
- which segments and levels of the value chain are going to be addressed,
- who is going to be responsible for the action, and
- the corresponding timeline, milestones and resource requirements.

(Task 3.5) Anticipating the impact of chain upgrading

Wherever a public agency engages in promoting private sector development, be it a development agency, a ministry of economic development, or an export promotion bureau, tax money is spent to achieve a political objective. In the present case, the rationale of the public support is to foster pro-poor economic growth (PPG). It is assumed that PPG is achieved by strengthening the organization and the capacity of key chain actors in value chains that have been selected for their PPG potential (see *ValueLinks* module 1).

The value chain upgrading strategy is a “theory of action” combining analytical insight and action orientation. Every chain promotion project implies hypotheses about the impact that the public interventions will have on economic structure, incomes and their distribution. This paragraph provides hints on how to structure these hypotheses. More particularly, the question is how the services provided by a development agency to the chain actors or to the whole business community translate into a structural, sustainable change of the value chain in question. This relationship is expressed in an “impact model” or “results framework” which traces the sequence of events leading from interventions to the desired development impact.

Impact models are used all along the project cycle, from the design of chain promotion projects, monitoring, to the evaluation and reporting on results. The most important use of the impact model probably is impact monitoring. This includes defining indicators for the different levels of the model, so as to trace the progress along the impact model. This is the subject matter of *ValueLinks* module 11.

However, development agencies need to be oriented towards impact from the very beginning. Impact orientation has become a crucial concern for any public programme. Therefore, formulating an impact model is a task that clearly belongs to the formulation of an upgrading strategy. It should not be postponed to ex-post evaluations.

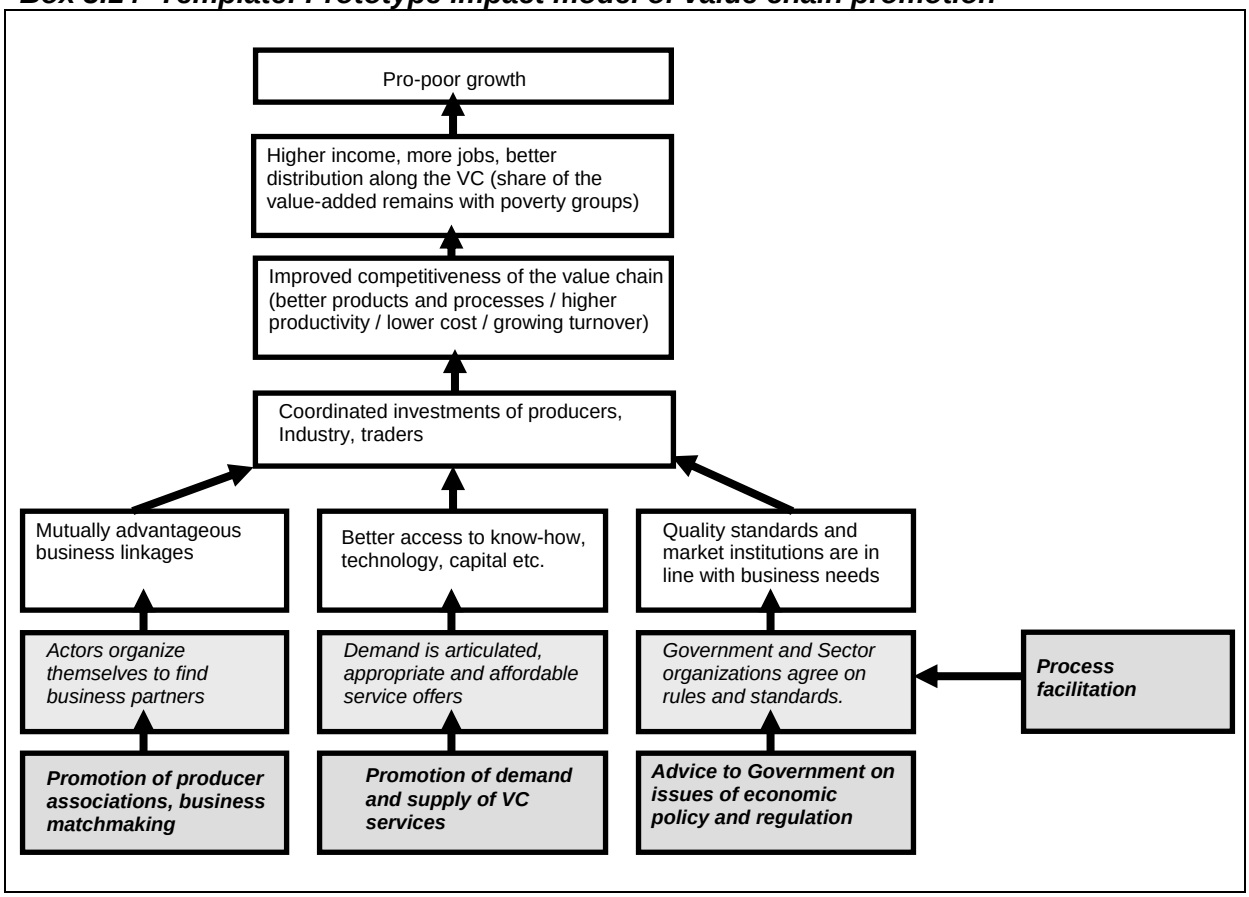
Box 3.14 presents a prototype impact model of value chain promotion. This is a generic model which can be used as a template adjusting it to the chain promotion case at stake. The impact model may be read from top to bottom or vice versa. Starting at the bottom, it specifies the three “fields of action” explained earlier (see box 3.12). The dark grey colour indicates that these are actions undertaken by chain actors with the support of the development agency (outputs). The next level shows the use of these services by chain actors being facilitated by the development agency (use of outputs). The white coloured boxes further up all indicate direct or indirect benefits (impact) of the chain promotion effort as they build upon each other. The higher the level, the more aggregate the benefit, and the weaker the attribution of these changes to the initial chain promotion effort. Nevertheless, all benefit levels (with the exception of the topmost “pro-poor growth”) could be regarded as direct impact of a chain promotion project.

Which level of development may finally be reached depends on the economic potential and the institutional capacity at the outset and on the overall dynamics of the sub sector.

Procedure to construct an impact model

Although the prototype impact model is an approximation to a wide range of chain promotion projects, every such project has to come up with a formulation of its own. Basically, the procedure of constructing an impact model is to work from the vision and objectives downwards identifying the logical preconditions for the benefits. The procedure is very similar to operationalizing the chain vision into upgrading objectives as described in task 2 of this module. The difference is that the impact model specifies the whole sequence of events between the action at the bottom of the model and the benefits by adding the intermediate steps. Each step explains and illustrates the logical connection between the interventions and the expected impact.

Box 3.14- Template: Prototype impact model of value chain promotion



Source: own concept

Most development programmes support several value chains in parallel. As a matter of principle, these programmes have to establish a separate impact model for each value chain promoted. This is necessary because objectives, fields of action and the size of the effort are likely to differ. However, this does not mean that a separate impact monitoring system has to be established in each case. The specificities of impact monitoring in value chain promotion are treated in *ValueLinks* module 11.

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Weblinks

Collection of strategic management tools: http://www.12manage.com/i_s.html

ValueLinks Module 4

Facilitating the Chain Development Process

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***ValueLinks* Module 4**

Facilitating the Chain Development Process

What this module is about

The value chain is not only an economic concept. Value chains also constitute *social systems* in which people interact – in line with the given social norms and according to their own differing or common interests. To the extent that chain development requires improved coordination between chain operators and new forms of contractual relations, the behaviour of actors also has to change. Therefore, value chain upgrading is not just a matter of organisational and technical optimisation, but is about learning and social relations as well.

The preceding two *ValueLinks* modules have focused on chain upgrading irrespective of the division of tasks between chain actors on the one hand and external facilitators on the other. However, there is a systematic difference between the commercial interests of chain operators and the public interest of development or government agencies. The objective of chain *promotion* is not identical with the objective of chain *upgrading*: While chain operators pursue a particular commercial objective, the public agenda is to build the institutional and economic capacity of value chain actors to face future challenges. The objective of a public development agency, on the other hand, is to enable value chain actors to make the upgrading efforts by themselves and to enable them to continue to develop new business opportunities in the future. If chain actors have acquired that capacity, the chain development project can then withdraw, even if the particular upgrading objective has not yet been fully achieved. In addition to contributing to the achievement of the upgrading objectives, chain promotion also follows the development logic of facilitating social and institutional capacity building.

Therefore, chain promotion needs a strategy and implementation principles of its own. This *ValueLinks* module presents know-how and tools which can guide external facilitators in their task of promoting and facilitating a process of value chain upgrading. This includes bringing chain actors together, identifying opportunities, and enabling private enterprises to organise themselves and take action.

This module exclusively deals with facilitation, although the principles outlined do indeed apply to all modules in this guide, from the selection of a value chain to the monitoring of results. Facilitation is needed all the way along the development process until this objective is reached. Unless people fully subscribe to the upgrading project, the chances of achieving a sustainable improvement are slim.

Tasks in facilitating the process of chain upgrading

The initial section presents basic considerations on the process character of chain upgrading. It establishes a series of standards for promotion and facilitation to be applied in all tasks presented in this manual. Based on this general understanding, the module further treats the following tasks of facilitators:

- (Task 4.1) Clarifying public, donor and private roles, i.e. the roles of operators, supporters and enablers and the role of an external facilitator
- (Task 4.2) Designing the upgrading process sequence and determining appropriate entry and exit points
- (Task 4.3) Organizing a chain promotion project and scaling up from micro to meso levels
- (Task 4.4) Institutionalizing collective action - in core groups and other formats

Apart from these key aspects in facilitation, there are specific “modes of delivery” in each particular field of action. They are taken up in the respective *ValueLinks* modules 5-10.

Basic considerations on capacity building and facilitation

The point of departure is the comprehension of a value chain as a social system, placing the human being - the attitudes and behaviour of chain actors - in the centre. Box 4.1 resumes important conditions for chain projects to produce a lasting success. All have to do with social behaviour and the ability to cooperate. Together they determine whether the value chain upgrading effort will be sustainable.

Box 4.1 Principles: The conditions of success facilitating chain upgrading

Conditions of success	
Clear roles	All chain actors understand and assume their roles effectively
Leadership	Certain actors (change agents) take the lead - others follow
Ownership	Operators act upon their own interest, individually and collectively. Chain actors assume responsibility from the start.
Win-win situation	All actors benefit from upgrading, leaving others part of the gains
Will to advance	Positive and negative experience is taken as a basis for progress

Source: own concept

These conditions cannot be taken for granted - they have to be actively promoted. Generating ownership and leadership takes time and will only be achieved in a process of gradually increasing understanding and mutual adjustment.

Value chain upgrading as a process in time

In an ever changing economic world upgrading is a continuous process. The dynamic character of value chain upgrading is particularly present in three processes of social and behavioural change inherent in value chain development - learning, coordination & collective action, and the resolution of conflicts. It is hard to predict how long these processes are going to take. Fundamentally, any social development process is open-ended. It makes sense, therefore, setting intermediate objectives and structuring the process into phases (see task 4.2, below). Below, we review key aspects of social change which facilitators need to relate to.

Value chain upgrading is a long-term learning process

As has become clear in *ValueLinks* modules 1 and 2, chain operators have to face considerable uncertainty given the dynamics of consumer markets and with regard to the behaviour of other actors in the chain. Information about market demand and the reaction of partners and competitors only emerges over time – as the business unfolds. At the same time, operators need to become conversant with new technology, understand relationships and the expectations of others, and come to terms with their own role. This implies learning by doing and the willingness and capability to learn from mistakes.

The evolution of the chain continues while chain promotion projects only last a limited period of time. There must be opportunities for enterprises to revisit experience and close the learning loop - and thus become able to apply the knowledge in subsequent upgrading activities.

Value chain upgrading is a process of coordination and collective action

The development of value chains relies on synergies between the actors, their common objectives, coordinated decision-making and action. Realizing the benefits of cooperation presupposes mutual respect and trust. Behaviour has to be predictable. However, there will always be substantial differences in perspective. This applies to operators at different stages of the value chain, as it applies to private and public actors who often represent different universes of values, attitudes and communication. To bridge the gap, chain actors have to talk to each other identifying common and differing interests, agreeing on objectives and rules to be respected and committing themselves to a shared vision. Communication is the key to mutually adjusting expectations and contributions – and to mobilizing collective action.

Value chain upgrading implies the resolution of conflicts

Value chain development cannot be expected to advance smoothly at all times. After all, interests of suppliers and buyers often are in conflict, as are the interests of private operators and the public administration. Distributional issues may trigger passive or hidden resistance. Here, the key is transparency. To resolve conflicts, neutral mediators are needed who are able to elucidate the positions and provide opportunities to analyze them. As non-conforming behaviour becomes evident, the origin of failure and the present institutional set-up of the VC have to be laid open to draw the necessary lessons. Obviously, there is no energy to loose in destructive conflicts. However, a crisis may also constitute an excellent opportunity for a neutral facilitator to promote change.

Apart from the objective issues, there are psychological factors behind coordination problems and conflicts. Fears, aspirations, discrimination or striving for social acknowledgement may drive or hamper progress in the development of value chains. Dealing with these emotions requires sensitivity on all sides, and especially from external facilitators.

Principles of facilitating a value chain upgrading process

Process facilitation is not just another technical task in chain upgrading but an endeavour that follows rules of social development and capacity building. By its very nature it is not a permanent regular function in the value chain but a development task that is limited in time. It must always be borne in mind that facilitation can only contribute to a process of change already underway, the dynamism of which determines its chances of success. In fact, economic development is the result of the efforts and investment of hundreds of producers and firms.

Box 4.2 presents the most important principles to observe.

Box 4.2 Important principles of promoting and facilitating chain upgrading

Facilitators of chain upgrading should

- Make the role of an external facilitator transparent
- Act upon demand of the value chain operators or their representatives
- Serve the clients and manage the process with impartiality toward content, sharing results
- Build on the initiatives taken by value chain actors and existing organisation and institutional set-up
- Stick to a clear division of tasks between chain actors (also see below, task 4.1)
- Enhance an environment of respect and safety where all participants trust that they can speak freely and where individual boundaries are honoured. Respect the culture, rights and autonomy of all participating groups
- Build on market and development potential working toward viable/sustainable market structures
- Place the focus on practical implementation and rapid and visible results and impacts.

Continued…

- Build on the own initiatives of chain leaders, private enterprises or business associations
- Cooperate with partners who behave as change agents and leaders (also see task 4.3)
- Openly acknowledge any potential conflict of interest
- Create a balance between participation and results.
- Coordinate efforts of different donors along the chain

Source: own compilation

Facilitation requires good communication skills, personal strength and human empathy for weaknesses, strengths and aspirations – including those of the facilitator himself.

(Task 4.1) Clarifying public, private and donor roles

Defining the roles of value chain actors participating in upgrading is a very fundamental task in value chain promotion because of two concerns:

Value chain promotion builds on cooperation and therefore requires a division of tasks between chain actors. The different roles should be clear. As a matter of principle, private and public functions need to be kept apart. Lasting market success and economic viability can only be achieved in the absence of distorting interventions into the functioning of business. The criterion for distinguishing private from public functions refers to the question whether the result of an activity can be fully privatized or produces benefits for the entire value chain or for the public interest at large.

Second, the chain operators are responsible for upgrading the chain. They have to invest into productive capacity, product improvement and business linkages. In a well organized chain, the private sector also extends to association at the meso level. Once external (!) facilitators engage in the upgrading process, their responsibility has to be negotiated with private enterprises. Facilitation has to respond to demand and is limited in time.

As a general rule, roles can be distinguished according to the responsibilities of each group of value chain actors, as listed in box 4.3.

Box 4.3 Concept: Roles of actors in value chain upgrading

Description of roles

- **Value chain operators** are the private enterprises performing the productive, processing, logistic and commercial activities. They occupy the key role in the value chain assuming the risks and generating the economic value. The viability of their business in the long term is the basic condition for the success of chain promotion. The efficiency of the commercial activities is the sole responsibility of the operators.
- Among the chain operators, **lead firms** take it on to organize the coordination along the value chain – in their own interest, and in the interest of the collective ("systemic") competitiveness of all operators being coordinated. This is a private function as well.
- **Chain supporters** perform services of common interest and provide collective goods for groups of chain operators or for the entire chain or sub sector, such as joint marketing or joint research for technical solutions. These may be private business membership organizations or semi-public organizations such as chambers and technology institutes. Similarly, professional organizations of economic operators assume service functions for their members.
- **Chain enablers** comprise governmental institutions, such as line ministries and departments and regional governments active in economic development. Their role is to create favourable conditions for economic development in the interest of job creation and a larger tax base, e.g. facilitating the organization of a particular sub sector, regulating the legal framework of the chain and providing infrastructure (roads, market places etc.).
- **Professional organizations of economic operators** (producers, trade, transport) and inter-professional organizations constitute a specific case. According to their scope, they can assume economic[1], supporting [2] or enabling [3] functions.
- Where significant general public interests are at stake, such as consumer safety, environmental protection, or economic stability, **national government** has the role to orient or regulate production, offering additional public services and taking over the role of a facilitator of value chain upgrading.

[1] e.g. Processing, packing etc.
[2] e.g. business matchmaking, market information
[3] e.g. Participation in policy dialogue.

- **Donors and development agencies** or external to the value chain system. Their main role is to facilitate upgrading and provide support to the upgrading action undertaken by the VC actors - in the international public interest (poverty alleviation, protection of resources of international interest). At times, they also provide financial support to investments.

Source: own compilation

Ideally, there should be complementarity between public and private actors (also compare the value chain map in box 2.7 that shows operators and chain supporters).

How to facilitate role taking by value chain actors

Achieving an agreement on the roles of actors in practice must involve all parties concerned. As the economic operators at micro level are the core of the value chain, discussing the division of tasks has to start at the micro level. The roles of supporters, enablers and facilitators refer to their needs.

Box 4.4 Practical hints: Clarifying the roles of chain actors in practice

Possibilities of clarifying roles

- *Workshops* with broad participation of chain actors can serve to clarify the objectives of operators, the services of supporters and the mandates and activities of chain enablers. For that purpose, representatives of different actor groups would give short presentations that are visualized by the facilitator. Reactions of the audience serve to quickly perceive clashes of interests that may hamper consensual decision-making.
- *Documents:* In the case of public agencies and service providers, roles can be derived from statutory mandates, possibly determining gaps between mandate and reality.
- *Action:* The acknowledgement of the respective roles in VC promotion will be achieved more easily if private sector partners underpin their interest and commitment by contributions in cash, kind and know-how.

Source: Own compilation

The role of external facilitators (development programmes, government agencies of economic promotion, international development assistance agencies) is to accompany the upgrading process. Box 4.5 lists typical facilitation tasks.

Box 4.5 Concept: The role of facilitators

Typical tasks of facilitating value chain upgrading include to

- Create awareness and understanding on the importance of chain development
- Help stakeholders get to know and acknowledge each other
- Draw attention to economic objectives and business opportunities
- Facilitate (joint) value chain mapping and analyses
- Provide appropriate tools and methods
- Help building a shared vision of the future
- Forge a consensus on the objectives and strategy of VC upgrading
- Identify change agents and process facilitators, and build alliances
- Facilitate planning and decision-making
- Assist implementation of actions
- Continuously monitor the process and provide feedback
- Mediate in case of conflict
- Facilitate exchange and joint experimental learning of VC actors
- Document and share experience with the wider business community
- Facilitate the coordination of different support agencies active in the value chain

Source: own compilation

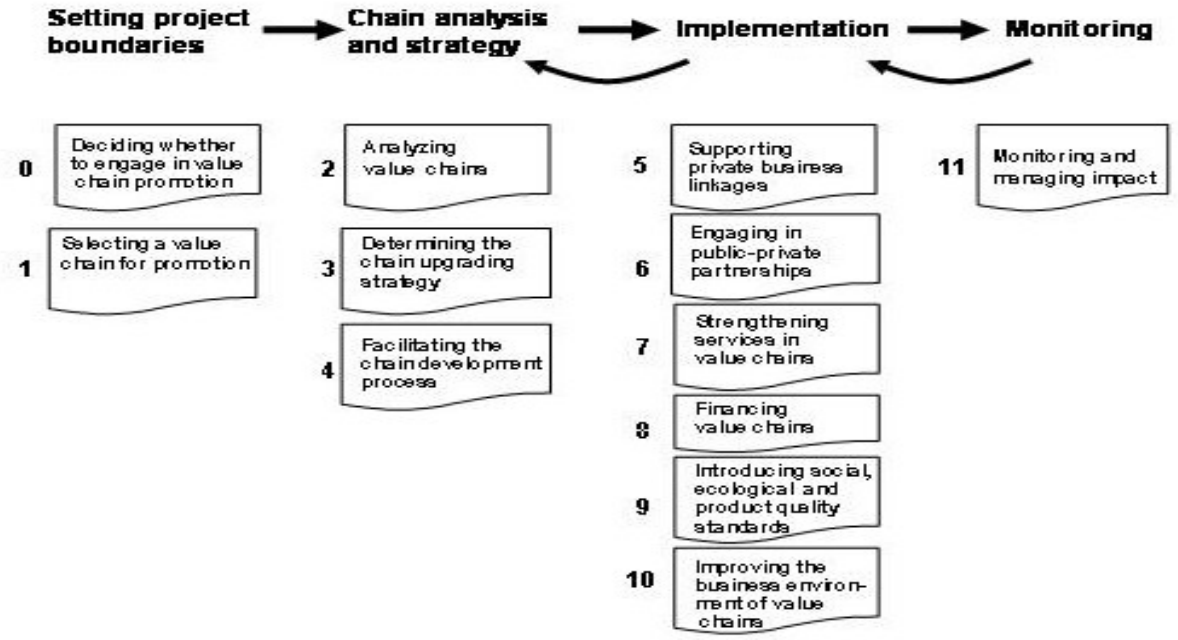
(Task 4.2) Designing a process and setting entry and exit points

Following the clarification of roles it should be clear that the value chain actors have the responsibility for actions to upgrade the value chain. In fact, in a well organized value chain there is no need for external facilitation at all, as private investment and the continuous improvement of systemic competitiveness is coordinated by business groups or by support service providers such as business associations. However, in a development context characterized by weak economic structures, external facilitation is likely to be required to get the value chain moving. The following considerations refer to value chain promotion projects specifically designed to achieve upgrading objectives and in which external facilitation plays an important role.

As a whole, value chain promotion projects follow the project cycle, which also provides the basic structure of this manual (see box 4.6). Hence, those involved in a chain promotion project have to observe the basic sequence of selecting the chain first, conducting a chain analysis, derive objectives and strategies, and, finally, take action to upgrade the value chain. The upgrading project is a joint undertaking of the chain operators and supporters. It involves the external facilitator only to the extent necessary.

Box 4.6 Concept: The project cycle of value chain promotion projects

Correspondence of ValueLinks modules with the project cycle of value chain promotion



Source: own concept

The facilitation effort to be invested and the time needed in each phase of a promotion project vary. Setting the system boundaries is the task of the initiators of a public economic development programme, because it is a decision on the use of public funds. The initial decision whether to engage in value chain promotion at all is a matter of economic development policy. This applies to the selection of value chains as well. Although the interest and initiative of the operators are important criteria of selection it is the public side that has to make the choice. The same is true for impact monitoring that is done in the interest of the public side mainly.

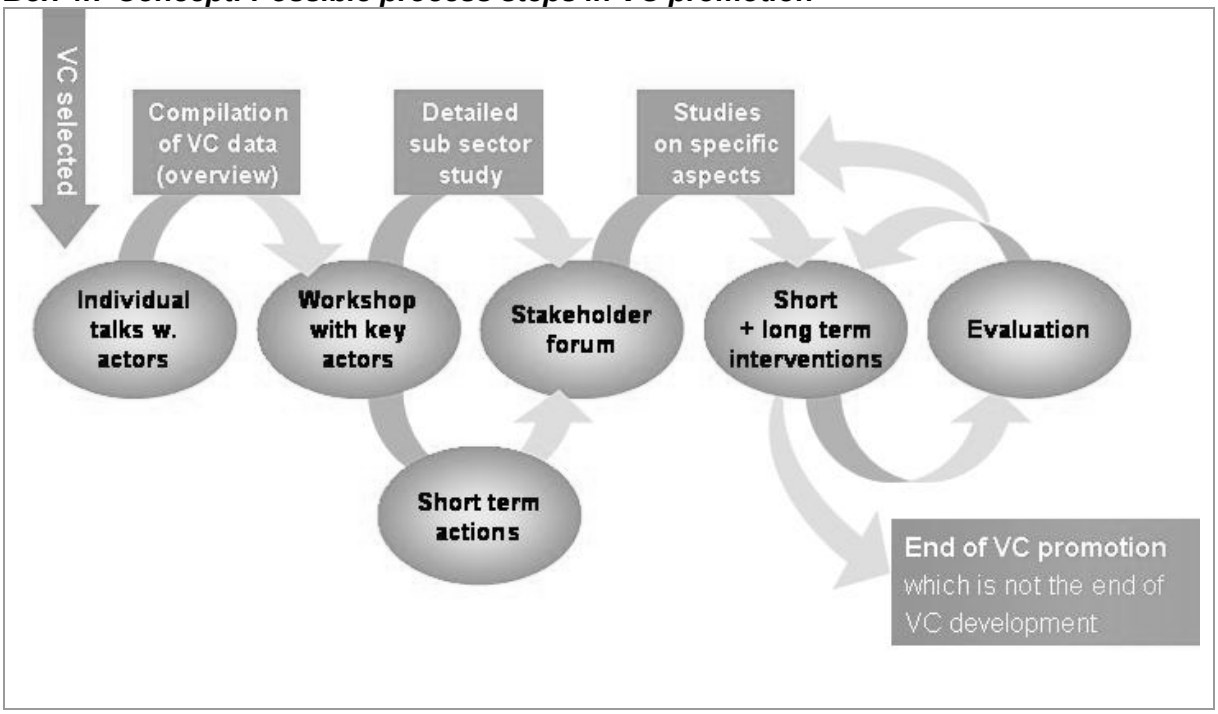
The actual facilitation of an upgrading project starts once operators embark on a business and upgrading idea and take ownership of the upgrading project. Hence, chain analysis, visioning, strategy building and implementation are all private tasks that have to be facilitated.

Getting a chain promotion project started and going

Unless there is a clear decision and commitment on the side of the enterprises to get ahead with upgrading, there is no chain promotion project and no role for facilitators either. Economic and development policy makers may consider the upgrading of a particular value chain desirable, but success entirely depends on the action taken by operators. Chain development is a process in which the operators determine the direction and speed of change. Facilitators have to take these conditions into account and adjust their interventions accordingly. In a situation where the ambition of public development programmes differs from the perspective and capacity of private enterprises the start of a value chain promotion project is a highly critical step.

In order to keep the right balance between pushing the process with external inputs and cultivating the ownership and commitment of actors, facilitation needs to build up gradually, leading from quickly visible action to more complex tasks of chain development, from small meetings to big events and from compiling basic data at the outset to detailed studies where required. Facilitators should only become active to the extent that external interventions are demanded by the implementing partners (or a coordination body) and needed to get the upgrading activities going. Hence, facilitators need to formulate criteria for initiating a chain promotion project and for either continuing or terminating promotion every time a new step is taken in the process. The process character of chain promotion is visualized in box 4.7.

Box 4.7 Concept: Possible process steps in VC promotion



Source: own concept

The graph in box 4.7 shows just one possible process sequence of value chain promotion. The idea is to visualize two important aspects of the promotion process in principle:

- the gradual built-up of process steps, and
- the division of the process into individual actions, each constituting a small “project” in itself with a defined starting point and objective

Subdividing the process into a sequence of separate actions has the advantage that the division of tasks between chain actors pursuing the upgrading activities and the external facilitators can be adjusted in line with the advancing upgrading. Possibilities for subdividing the process into minor steps are treated in the next section. The beginning and the end of each action constitute entry and exit points for facilitators of chain promotion.

When starting the promotion project and passing from one stage to the next, facilitators need to consider the progress and the quality of the process achieved: The question is whether actors take over responsibility, actually cooperate and whether mutual learning takes place. If this is not the case it may be useful taking a step back or even break up if the fundamental conditions for success are no longer in place. Boxes 4.8 and 4.9 provide criteria describing the conditions for entering into or continuing chain promotion, as well as the criteria for exiting the process. In the interest of impact and sustainability, these criteria have to be taken seriously. A common mistake in chain promotion is to rush chain actors into an upgrading project.

Box 4.8 Tool: Conditions for entry into a chain promotion project

As an external facilitator: Start or move on…

- when operators take own initiatives to upgrade the value chain
- when there is a clear demand of chain operators for a facilitation function
- if previous steps show positive results confirming the upgrading vision
- as soon as intermediate objectives for upgrading have been agreed upon

Source: own concept

Box 4.9 Tool: Criteria for stopping value chain promotion

Stop facilitating…

- when the objectives of a particular upgrading step have been achieved, and new routines are established
- as long as there is no agreement on the objective of a next upgrading step

Source: own concept

Facilitators should withdraw completely if the conditions of success (box 4.1) are no longer met. This will be the case if one of two opposing situations arises: Either the upgrading objectives have been reached – or the chain operators are no longer willing to pursue it. A degressive public support may constitute an excellent transition to exit the VC promotion.

Box 4.10 Tool: Criteria for exiting value chain promotion altogether

Exit the facilitation role…

- when the chain operators can assume full ownership and responsibility on their own without external facilitation and further collaboration and process facilitation is institutionalized by chain supporters
- if the operators and supporters loose interest in the upgrading idea or would not agree on an objective.

Source: own concept

To get accepted in their role, external facilitators also have to show their own competence. Value chain projects have to be able to offer world class market intelligence; models of how other similar upgrading project have worked; knowledge on technologies; dedicated facilitator manpower and finally some money to kick start a process. To build credibility, facilitators need time. In practice, the engagement with chain actors starts with a “first generation” of interventions that are not perfect but move the process forward. As the knowledge and contacts that the development project can offer increases, facilitator can become more ambitious with more far reaching interventions.

Sequencing steps in a value chain promotion project

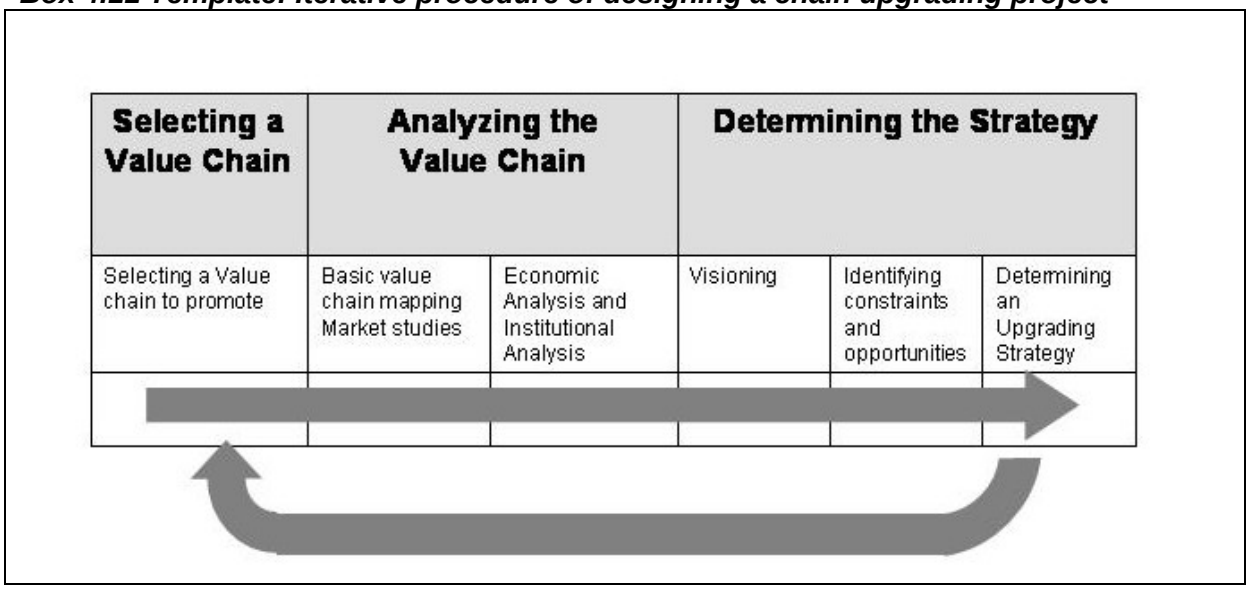
Besides the criteria describing the state and quality of the upgrading process, there are also some methodological aspects to consider - following the logic of the project cycle. Obviously, the selection of a value chain (module 1), the situation analysis (module 2) and the formation of an upgrading strategy (module 3) form a sequence, with the chain analysis falling into secondary steps. Box 4.11 shows the logical order of analyzing and planning upgrading projects.

The formulation of an upgrading project includes a series of elements that need to be consistent with each other:

- The *chain map* should refer to the final product (or aggregate category of products) for which the market opportunity has been identified,
- the *vision* has to relate to this opportunity and refer to the *reasons for selecting the value chain* in the first place, and
- the *upgrading strategy* should show all parts of the value chain that have to upgrade.

In line with the market potential and according to the vision for chain development, different fields of action will become relevant. Therefore, the third column in the project cycle shown in box 4.6 (modules 5-10 of ValueLinks) does *not* constitute any particular order but is the collection of building blocks of an upgrading strategy.

Box 4.11 Template: Iterative procedure of designing a chain upgrading project



Source: own concept

The decisive point in box 4.11 is to understand the iterative nature of the process. In fact, the sequence may also be reversed at times:

- Determining the upgrading vision it may be turn out that another value chain (or a variant of it) offers greater prospects of success, and hence the selection of the specific value chain should be revisited.
- Specifying the upgrading strategy may mean getting back to chain mapping, so as to make sure all relevant functions and actors are included.

While it is clear that coordinated investment and action to upgrade the value chain has to build on a joint vision and strategy, some quick and visible improvements may be possible without a long-term plan. Hence, action to upgrade the value chain can already start during the analytical phase. This will not only generate “quick wins” and immediate benefits but also help to gain momentum, strengthen the commitment of actors and build trust into the feasibility of the upgrading strategy. Quick actions also serve as pilot tests and allow to spot coordination and implementation problems early on.

Formats for organizing collaborative action of chain actors

Value chain upgrading is a collaborative undertaking. For example, the introduction of grades and standards only makes sense if all operators abide by the rules. In most cases, the chain strategy will specify several fields of upgrading action that have to be dealt with in parallel, by different chain actors. Therefore, chain upgrading calls for coordinated decision-making and action. Unless some coordination mechanism of the value chain actors is already in place (compare to task 4.4, below), enterprises and chain supporters will have to gather to agree on the analysis and the steps that are to be taken. However, coordination is costly and it has to be clear that the extra time and effort attending meetings and workshops will pay off eventually. Business people have no time to loose. Therefore, facilitators have the important task to design coordination mechanisms that are most time-efficient.

Two principles apply:

- The form of coordination has to develop along with the value chain promotion project and according to the growing outreach and commitment of actors. Typically, the process starts with informal and individual consultations which are quick and therefore low-cost and only later moves on to more formal meetings involving a larger number of participants.
- For each of the different coordination necessities the right format (informal consultations, meetings or workshops) should be chosen, serving the purpose at least cost.

Box 4.12 presents some potential formats for organizing the collaborative action of value chain actors in the context of a chain promotion project. It should be noted that there are no universally applicable solutions for organizing coordination. In every case, the formats and the sequence of events have to be designed specifically. The most important point is to use any existing coordination structure avoiding unnecessary meetings.

While all relevant actors have to be included in the process in one way or another, participation in meetings on technical tasks should be reduced to not more than 15 people. Beyond that number it becomes difficult to jointly complete specific analytical tasks or prepare action plans. Detailed analyses have to be given to individual experts anyway, who would report their results to value chain meetings.

Box 4.12 Tool: Coordination necessities and formats

Stage of value chain promotion project	**Coordination tasks**	**Potential formats**
Sensitization of chain actors	Agreement to engage in value chain promotion	sensitization workshop (or national sector conference) (see box 4.13)
Joint planning and decision making	Joint chain mapping	Expert meeting (see box 4.13)
	Joint visioning and decision-making	Value chain workshop (kick-off workshop) (see box 4.15)
	Joint problem analysis and elaboration of upgrading strategy	Expert meeting (see box 4.13)
Implementation of upgrading activities	Coordination of upgrading activities	Working group or expert meeting

Source: own compilation

The following three boxes (4.13 – 4.15) provide ideas on the specific formats for coordination events. Sensitization workshops often refer to an entire sector of the economy or at least cut across different value chains. A value chain workshop (or “stakeholder workshop”) is a format specific to value chain promotion programmes. It should be prepared by informal consultations and expert meetings using services of individual consultants if necessary.

Expert meetings may be organized by support service providers in the value chain, such as business associations. This format may be institutionalized in the form of a standing committee, especially if further upgrading is envisaged. In fact, by institutionalizing the coordination function in business core groups or sub sector councils, the institutional structure of the value chain is strengthened. The last section (4.4) in this module is devoted to medium and long-term institutional arrangements for chain promotion.

Box 4.13 Template: Format of a sensitization workshop

Objectives: create awareness of the value chain approach, obtain political backing, initiate first contacts between potential partners.
Participants: public sector decision makers, representatives of the business community, up to 150 participants
Duration: ½ day
Programme:
Presentation and discuss the idea of value chain upgrading, including examples
Presentation of political programmes

Source: own compilation

Box 4.14 Template: Format of an expert (working group) meeting

Objectives: generate situation analysis and prepare decisions
Participants: representatives of the value chain operators and supporters, sector specialists and relevant development agencies, 8-15 people depending on the size of the value chain
Duration: 1-2 days, may be repeated
Programme:
collection of sector information (establishing needs for in-depth studies, preparation of Terms of Reference (ToR) for sector specialists and review of consultant's inputs)
value chain mapping and analysis (based on existing knowledge and inputs)
preparation of proposals for value chain workshops
initiation of quick actions

Source: own compilation

Box 4.15 Template: Format of a value chain workshop

Objective: exchange of ideas across chain stages
Participants: full representation of chain actors, 25-50 participants
Duration: 1 day
Programme:
Presentation of preliminary chain maps (refining some elements)
Presentation and discussion of key findings of sector and chain analyses
Identification of constraints/ opportunities based on inputs
Agreement on upgrading strategies
Agreement on quick actions and on the start of upgrading actions

Source: own compilation

Facilitators and leaders of chain promotion projects have to adjust the formats and find the best sequence of events according to the entry and exit conditions set out above. The first meeting of business representatives at the outset of a new programme is particularly important and needs to be put on meticulously.

Workshop organizers should follow the practical hints presented in box 4.16.

Box 4.16 Practical Hints: Facilitating workshops with value chain actors

Things to do

- Involve the major players in the preparation stage;
- be explicit on objectives and explain the concrete benefits of cooperation to interested partners;
- involve the private sector systematically since real-life entrepreneurial risks and decisions are at stake, provide time to make contacts;
- assure a balanced mix of private and public sector actors (majority private or at least a 50:50 presence), competent and legitimate representation of all relevant groups of actors;
- conduct the meeting as focused as possible to keep opportunity costs low;
- prepare and provide benefits to participants, especially information and
- assure right timing; provide attractive venue and efficient services and use pin boards and cards facilitating exchange of ideas. Visualization techniques help structuring the discussion and save time.
- conclude workshops with an evaluation and action plan for the follow-up;
- Produce real time documentation to keep track of decisions.

Things to avoid

- Do not organize additional meetings if there is a chance of including the coordination issues in other events; avoid duplicating value chain facilitation and coordination efforts;
- Do not give per diems to participants, especially in the case of private participants.

Source: own compilation

(Task 4.3) Organising the chain promotion project and scaling-up

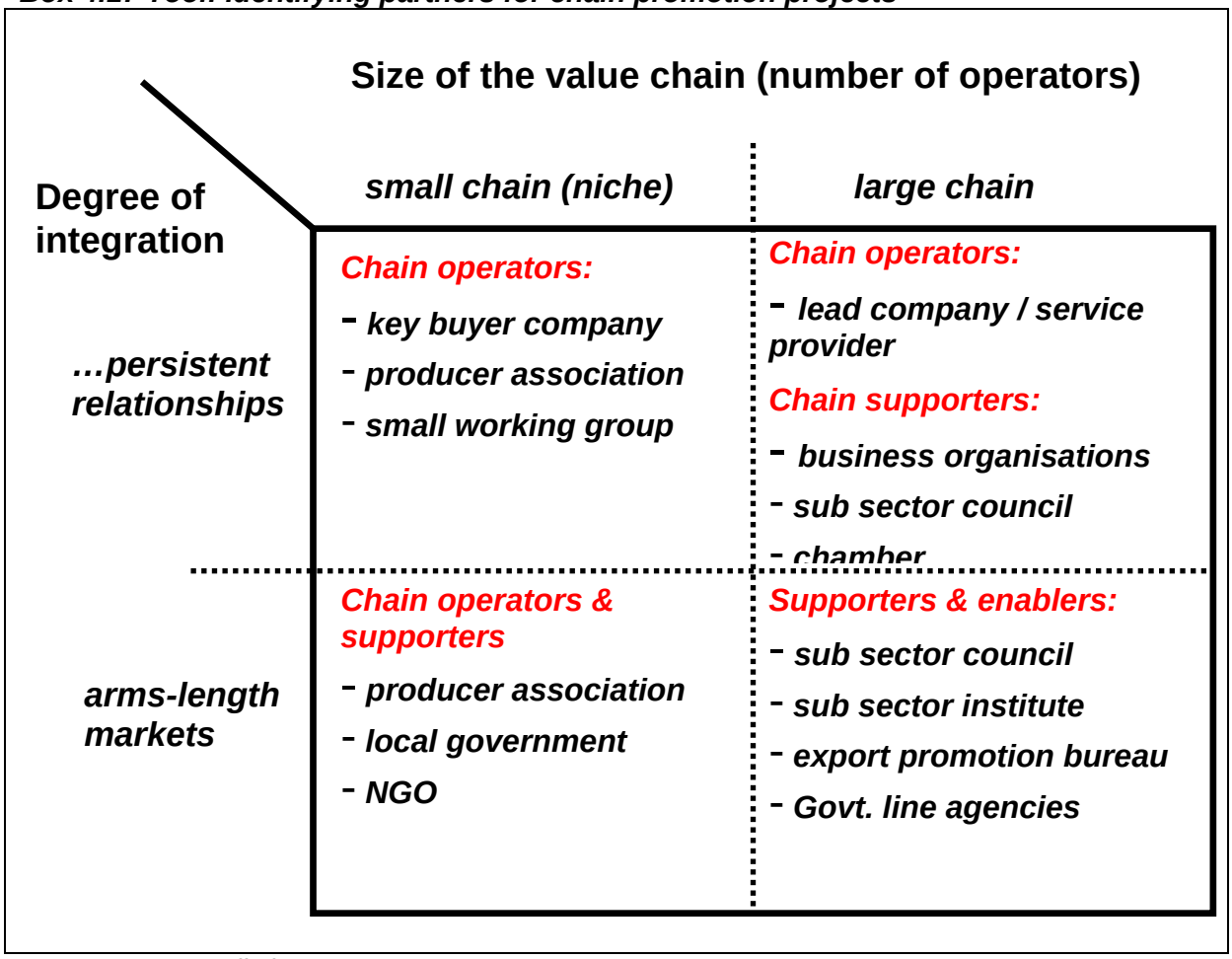
To perform the facilitation function, external development agencies need a temporary project organization linking them to the value chain actors. In the definition of *ValueLinks*, a "chain promotion project" is the set of interventions performed by a development organization to promote the upgrading of a value chain. The chain promotion project refers to the upgrading vision, but is limited to facilitating and supporting partners in the value chain. In line with the division of tasks spelled out in box 4.4, the upgrading action is the responsibility of the chain actors.

The organizational design of a chain promotion project thus is closely related to the choice of partners implementing the upgrading action. One important criterion to consider is outreach, i.e. how to reach a significant number of chain operators who are affected by upgrading in one way or another. As it is hardly possible to address all enterprises individually, actors in chain upgrading should be in a leverage position in the value chain or should have the potential to take over that role with the assistance of the development agency. The identification of the partner(s) depends on:

- the number of chain operators in the chain (its size), and
- the degree of horizontal and vertical integration of the value chain.

Box 4.17 contains a tool for identifying chain actors occupying a key position in the chain – and hence the potential partners of development projects.

Box 4.17 Tool: Identifying partners for chain promotion projects



Source: own compilation

In a small value chain with few operators the lead role often falls to the most important operator (buyer, producer association or industry). The same is true in well integrated chains dominated by a lead company. In big and/or less well integrated chains, the likely implementer of upgrading action is a chain supporter, such as a sub sector association, a chamber or a specialized public agency. The leverage position of the collaborating partners in the value chain is one aspect. Another factor in the effectiveness of external chain promotion is the leadership quality of particular chain actors. To the extent that chain actors are leaders of the upgrading idea, they may in fact take over facilitation tasks themselves and become "change agents". Change agents are individuals or organizations (public or private) assuming leadership within the chain, introducing innovations, multiplying know-how and providing good examples to others. It is highly important to identify such potential leaders. Box 4.18 lists characteristics of change agents.

Box 4.18 Tool: Checking on the characteristics of change agents

Value chain actors are change agents in a value chain if they have

- an industry-wide overview (and hopefully a vision for it)
- genuine own interest in change
- the willingness and capacity to promote change and invest resources,
- leverage position in the value chain, and
- the capacity to perform facilitation functions themselves.

Source: own compilation

Those chain actors showing some of the characteristics in box 4.18 are preferable partners to work with. In the absence of any change agents, it can become a task of external facilitators to build the capacity of those who might assume that function or facilitate the creation of institutions representing the collective interest (see next section and box 4.19).

Box 4.17 names actors at the micro level (chain operators) and at the meso or macro levels (chain supporters and enablers) depending on the characteristics of the value chain. The distinction between micro and meso/macro is the main design variable of a chain promotion project. Facilitators can work and provide capacity building support at all levels of the chain. There are a number of typical micro-level arrangements. In a micro-level chain promotion project, the facilitator may collaborate

- with a buyer or processing company engaging in new relationships with their suppliers (i.e. contract farming);
- with a producer association that helps its members establish new business relationships, and provides marketing or knowledge services;
- with groups of producers, processors and traders that invest resources and time into the solution of common problems or into new opportunities.

Micro-level arrangements are suited for niche markets, highly integrated chains with very few key companies, or markets where producers are well organized. However, where these conditions are missing, targeting the micro level exclusively is futile because of its limited outreach. It can even cause damage because it means giving preference and public money to just a few operators disregarding their competitors.

In large or weakly organized markets, the collaboration with selected partners at the micro level is only justified if it has the character of a pilot project. Pilot activities generate practical examples and help to enhance visibility in relatively short time. In order to serve as an example for upscaling, the conditions have to be realistic, and the collaborating chain operators should make contributions in cash or kind.

Going to scale: Collaboration at the meso and macro level

The experiences of pilot activities referring to individual (groups of) companies have to be brought to other enterprises as well. In any case, the experience at the micro level needs to be scaled up to achieve a wide outreach of a chain promotion project. The arrangements at

meso level include chain supporters and enablers as mentioned in box 4.17. Where individual partners are available, the external facilitator can conclude a cooperation agreement with

- the national export promotion bureau. The desk officers responsible for the product at stake assumes a coordination and facilitation role for the entire value chain;
- a business association organizing the operators in the value chain and assuming an advocacy, service or coordination role on behalf of their members and the value chain at large,
- a specialized public agency, such as a technology institute,
- specialized units in government ministries, or
- a coordinating body such as a council, core group or committee (see below, task 4.4)

The last option is particularly interesting here: Many value chain promotion projects work through entities organizing the collective interest of the chain operators such as core groups or task forces taking over a leading role and multiplier function. As a consequence, a specific institutional structure implementing the chain promotion project is created. Whether or not this structure should be in place in the long term is a question of the vision for developing the value chain. In the interest of sustainable institutional development, it is advisable that one of the meso-level organizations mentioned above become involved as well (see the next section 4.4 and box 4.17 on this point).

A particularly important (micro or meso level) arrangement is the collaboration between facilitators and private lead firms and key companies. Wherever the investment of lead firms provides a benefit for the chain at large or where big companies are motivated by “corporate social responsibility, public-private partnerships (PPP) are on the agenda. Mobilizing private capital and cooperating with the private sector is such an important collaboration instrument, that it is covered by a separate module (see *ValueLinks* module 6). The individual collaboration arrangements in different fields of action will be taken up in modules 5-10.

(Task 4.4) Institutionalizing collective action of chain actors

Value chain development is centred on the cooperation between chain actors. Many issues can only be addressed effectively if all chain operators (or even all chain actors) are involved. Coordination is not only required in one upgrading project but in the long-term. As upgrading continues, the organization of collective action thus needs to be institutionalized. Beyond the series of meetings and workshops organized for any specific upgrading project, a more permanent coordination mechanism helps to create ownership and allows taking on additional upgrading ideas. In any case, meetings of leading value chain representatives and stakeholder workshops will give rise to the formation of networks for implementation. After all, facilitation tasks can and often are taken by chain supporters at the meso level. In fact, the description of facilitation tasks in box 4.5 can be used to assist chambers and business associations defining their own role as facilitators.

There are specific formats for institutionalizing long-term collective action. Box 4.19 provides the most important institutional set-ups.

Box 4.19 Concept: Formats for institutionalizing coordination and collective action

Typical institutional arrangements for sub sector and value chain coordination:

- *Sub sector council:* sector-wide and formal committee of major institutions of an important economic sub sector, sometimes entertaining an own secretariat
- *Interprofessional value chain association ("interprofession" in French):* Formal committee of sector representatives in important export chains, often led by government. Most examples are from francophone Africa (e.g. AIC Benin, CIC Burkina Faso)
- *Value chain core group:* Value chain-specific grouping of around 10 leading actors (firms and support agencies) taking responsibility to coordinate different upgrading actions
- *Enterprise working group or task force:* Group of leading enterprises representing different stages of the value chain and working on specific problem areas. The idea is to find and share solutions for common constraints.
- *Nucleus approach:* A specific form of a working group of 10-30 small and medium enterprises with similar characteristics and interests (e.g. of similar size and operating in the same chain stage) organized by a chamber of industry and commerce (for the case of Sri Lanka, see http://www.nucleussl.com/). The nucleus approach is further explained in *ValueLinks* module 5 (horizontal cooperation).

Source: own compilation

The forms of committees listed in box 4.19 have the permanent task to coordinate investment and regulate issues of common interest. Wherever such institutions already exist, they are a natural partner for calling and organizing meetings and workshops.

In the absence of a committee, external facilitators can take the role of mobilizing the chain actors and assist with the formation of a committee. Obviously, a decision has to be made first on the size of the business community to be represented. Similar arguments apply as in the discussion on the organization of a value chain promotion project (see preceding section). Certainly, forming committees in large value chains or entire sub sectors presupposes the existence of representative structures at the meso level, especially business associations and specialized institutes. It has to be clear, also, that the business community is interested to actually move ahead.

In order to ensure an operational composition of coordination committees, the following criteria can be of use:

- All relevant change agents, especially leading firms, business associations, sector-specific promotional institutions (e.g. a tourist board), apex bodies and specialized research, technology and training institutes need to be included.
- Representatives of business associations should be effectively legitimated / mandated by their basis.
- The group size has to be operational, with a range between 10 and 20 members.
- Private sector representatives (enterprises and associations) should have the majority.
- Government and important donors should be on board (possibly as observers) in case the major sources of investment funds are public.

If particular service providers or representatives of the logistical infrastructure (ports, airports, customs, transport enterprises) are important for the upgrading vision, they should be invited as well, albeit not necessarily on a permanent basis. Ideally, the committee should be hosted by a business association or by a chamber. Second in priority would be a public agency, such as a specialized unit in the line ministry. External facilitators should stick to an enabling function but refrain from setting the agenda.

The core group formed in the spice sector in Sri Lanka (box 4.20) constitutes an excellent example of an operational coordination committee.

Box 4.20 Case: the concept of a value chain ´core group´, Sri Lanka

Concept of value chain core groups

The Value Chain Promotion Component of the programme "Capacity Building for Competitiveness and Qualified Employment" in Sri Lanka cooperates with value chain "core groups". A core group is a voluntary and temporary association of actors representing all important players of the value chain. It follows shared objectives, jointly develops upgrading ideas and assumes the responsibility for implementation.

Core groups can either be led by public agencies or by private firms. The strength of a private sector led approach is the active role of business leaders pressing ahead and contributing their know-how and own resources, as well as the flexibility and speed of decisions. The activities are carried out by smaller working committees. Success factors are a "democratic" approach in which all interested parties are invited. It is also important to establish clear rules and obligations for the core group members. Quick successes demonstrate that the effort and time of participants is well invested.

Composition of the core group in the spices value chain in Sri Lanka

- Large exporting enterprises (the lead firms)
- Important suppliers of raw material (plantations/cooperatives)
- Sector Associations and associations representing the SMEs or smallholders/rural producers
- Ministry of Agriculture
- Specialized public research institutes
- Specialized BDS-providers (certification and testing laboratories, accreditation agencies)
- Foreign buyers
- Development agencies including GTZ
- Consultants

The core groups received considerable technical and some financial support.

Source: Private Sector Promotion Project, GTZ-Integration, Sri Lanka

Besides responding to an obvious coordination necessity, gathering enterprises and supporters in core groups or committees has manifold further advantages: The grouping establishes personal and professional links among the actors. It helps to progressively build trust and confidence and fuels the learning process. The institutions created for collective action in value chains also are a precondition for deepening the private-public dialogue. At the same time, core groups and councils provide a platform for coordinating the different

donor contributions. From a facilitator's point of view, it is important that the value chain actors become active in making proposals and influencing the portfolio of publicly funded programmes of technical and financial assistance to the value chain.

Box 4.21 Case: Regional cocoa roundtable in the Amazonas region, Ecuador

Background and organization of the roundtable

In the context of the cocoa value chain development project supported by GTZ, a regional roundtable for certified specialty cocoa was established in the Amazonas region in 2003.

32 private and public organizations participate regularly – every 3 months. Producer associations and local government are represented best. Participants pay their own expenses for participating. The meetings are called and organized by a committee with 2 representatives of associations, 2 of local government, 1 NGO, and 1 of GTZ. The roundtable defines and implements strategies of common interest. It is also a forum of exchange of experience and coordination.

Activities and results

Initially, participants found out that they share common problems of competitiveness and that there was enough common ground to start joint action. Five fields of action were defined:

- Improvement of productivity and technical innovation
- Improvement of product quality
- Strengthening producer associations
- Marketing, especially the access to buyers requiring certification
- Strengthening support services

For each topic of collaboration, a particular working group was created, and a leader-facilitator chosen among participants. The working goups develop concrete project proposals to be funded through public-private partnerships. In addition, they organize buyer-seller meetings, fairs as well as training events and workshops.

After three years of value chain upgrading, the number of cocoa producers has risen from 7.200 to 21.000 families. Production area has tripled and the export value has doubled.

Source: GTZ PAC programme, Ecuador

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ValueLinks Module 5



Strengthening private business linkages and associations

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ValueLinks **Module 5**

Strengthening private business linkages and associations

What this Module is about

The coordination between different chain operators is at the core of the value chain concept. This module is about improving business linkages. Linkages exist both between operators at the various stages of the value chain (vertical business linkages) and between operators working at the same stage (horizontal collaboration).

As value chains evolve, the supplier-buyer relationships become ever more intensive as the requirements in terms of quality, reliability and volumes of supply continue to increase. Managing product quality and complying with standards both call for collaboration across production stages. The vertical organisation of the value chain as such becomes a factor of competition. Under the conditions of globalisation, even local market producers can no longer rely on established market channels. Market expansion and regular upgrading imply that new customers and outlets have to be found. In short, improving vertical coordination and linkages is an essential element in any chain upgrading effort.

These vertical business linkages are closely related to horizontal collaboration, especially in the case of small enterprises and farmers. In developing countries, the low degree of organisation among producers often limits effective vertical linkages as well. Small and medium-sized farmers and enterprises have to organise themselves effectively. The organisation becoming a producer association is often a precondition for obtaining access and strengthening the organisation's position in the market.

This module compiles information and case material on business links between (small) suppliers and (larger) buyers, such as contract farming and the strengthening of commercial associations. It also covers cooperation and business matchmaking at the meso level.

Tasks in strengthening private business linkages

The main tasks in the strengthening of private business linkages are

- Brokering vertical business linkages at the micro level – that is facilitating supplier-buyer contracting (5.1),
- Fostering the horizontal collaboration of small value chain operators in response to market requirements (5.2), and
- business matchmaking at the meso level improving the business contacts and sales opportunities of business groups or of the entire value chain community (5.3).

While the first two tasks focus on the micro level, business matchmaking is a task at the meso level, not directed towards individual enterprises. Main purposes, tasks, challenges and benefits related to these approaches of support are presented in the following.

Basic considerations on business linkages in value chains

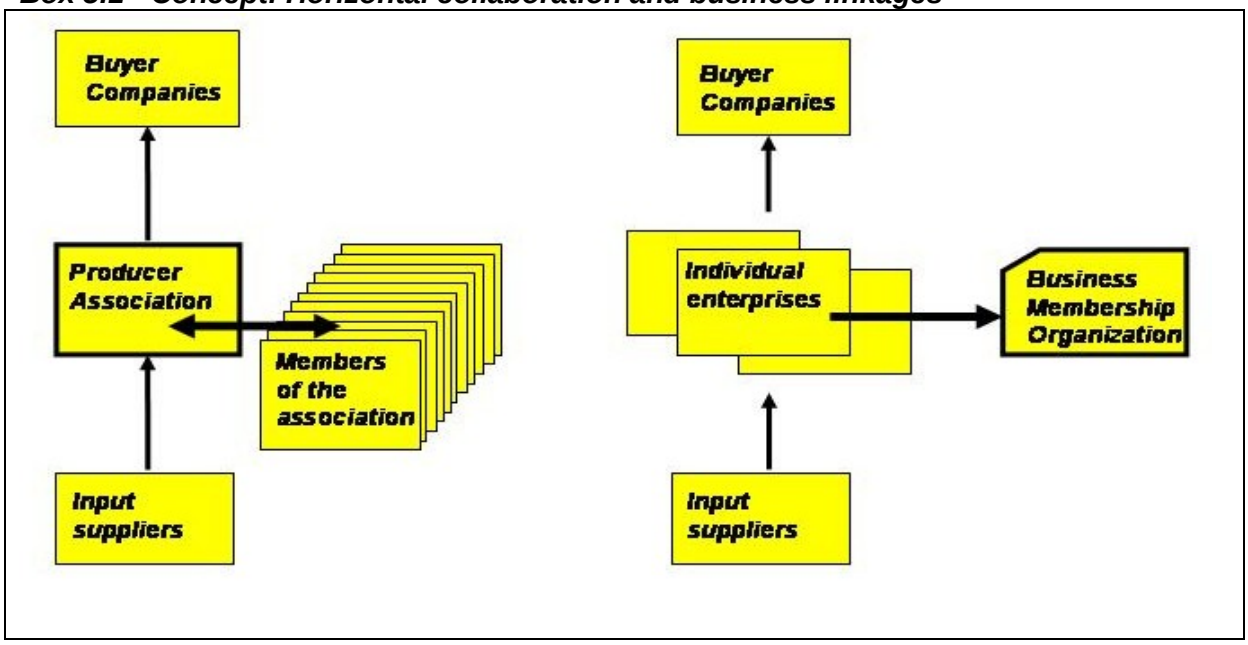
Business linkages are the commercial transactions between enterprises. They are classified as "vertical", when the transaction (mainly buying and selling) takes place between enterprises at different stages of the value chain, i.e. along the direction of the arrows in value chain maps. "Horizontal" business linkages refer to the transactions between enterprises operating in the same functional segment of the value chain. These are, for example, joint purchase and sales activities and joint use of equipment and facilities. To the

extent that horizontal collaboration is organized in producer groups or business associations, the internal relations between the members are business transactions as well.

The usual terminology of “horizontal and vertical” does not necessarily coincide with the directions used when visualizing the linkages. Many diagrams in this manual show the value chain turned through 90 degrees, so that vertical linkages in fact appear as horizontal. This has pragmatic reasons and is due to the fact that *PowerPoint* presentations use the landscape format. It does not have any significance for the definitions introduced above.

Box 5.1 presents two types of horizontal relations in visual form. On the left side, small enterprises form an association which operates on their behalf. The horizontal linkage is the relationship between association and members and among the members. Right, a business membership organization or enterprise network organizes and serves common interests of members.

Box 5.1 - Concept: Horizontal collaboration and business linkages



Source: own concept

The commercial interests of associations are often linked to their common interests in the public sphere - and collaborative commercial activities tend to lead to support services and lobbying activities at the meso level. Although closely related, support services are not “business linkages” in the proper sense. When acting as a representative of common interest, an enterprise network or association ceases to be an economic operator at the micro level of the value chain and becomes a meso level actor instead. Often, producer associations are micro as well as meso level actors at the same time.

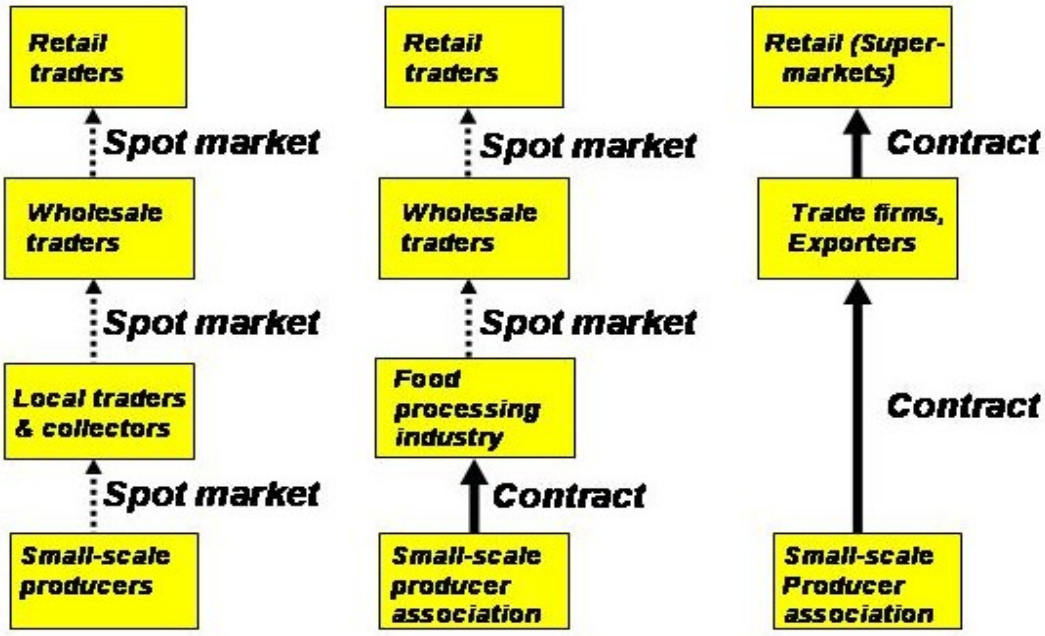
A related motive for collaborating is advocacy. Associations also pursue joint political interests. By formulating the common interest of their industry, they can mobilize political power. In the following, the focus is on the horizontal collaboration of operators for their joint business interests in production and marketing. The political and advocacy function of second-tier associations and professional organizations will be taken up separately, in *ValueLinks* module 10.

Vertical business linkages are sales contracts relating the operators at different stages of the value chain. In value chain maps they are indicated by the arrows between operators, as shown in box 5.2. In the context of value chain upgrading strategies the linkages between primary producers (farmers, handicraft producers or small enterprises) and important buyers (retail companies, exporters or industrial processors) are of particular interest. Upgrading towards higher quality and market penetration often involves moving from spot markets to production by orders placed by much bigger buying companies. As these buyers have the

power to enforce the type of contract, they behave as “lead firms” in the chain – and small suppliers have to adjust.

Box 5.2 shows different forms of organizing vertical linkages: The chain map on the left shows a typical traditional agricultural market. The chain maps in the centre is partially and the one on the right fully integrated by contracts.

Box 5.2 - Concept: Important vertical business linkages of primary producers



Source: own concept

The move from markets to the coordination of vertical business linkages by lead firms has given rise to the concept of “value chain governance” that describes “a pattern of industrial organisation somewhere in-between the entirely market-intermediated organisation of production and vertical integration” (Altenburg, 2006). The pattern of chain governance also dictates the form of horizontal collaboration between suppliers. The different forms of contracting are discussed in section 5.2, below.

(Task 5.1)
Brokering vertical collaboration: Supplier – buyer contracting

Strengthening vertical business linkages serves several purposes: One is to link small enterprises to high-value markets brokering contracts with domestic or international buyers. This includes strengthening the contractual position of small producers so as to improve the distribution of benefits in favour of enterprises providing income to poor people. A second objective is the improvement of efficiency, reducing the costs of contract supervision and the information costs, and building trust between business partners.

As value chains upgrade from traditional to high-value products, the types of contractual relationships between suppliers and buyers evolve: Standard commodities, such as maize or wheat, are mostly traded in spot markets ("arms-length" transactions), as the standard quality can be met by many producers. Both suppliers and buyers can easily switch between trading partners.

In the case of high-value, perishable or branded products with differentiated characteristics more sophisticated forms of contracting are required to assure quality and reliability of supply. Hence, product upgrading involves the "upgrading" of contractual agreements imposing demands and discipline on the partners, and especially on suppliers. The different forms of contractual arrangements are listed in Box 5.3, below. The list is organized in order of an increasing degree of detail and mutual obligations.

Spot markets are anonymous and fragmented, whereas the other contracting arrangements are characterised by the important role of buyers and written contract documents. Outgrower schemes and contract farming are frequent in export horticulture and in some agroindustrial crops. Handicraft and garment manufacturing often involves regular forward contracting.

Box 5.3 - Concept: Forms of contractual arrangements

Intensity of relationship ↓	*Spot market (arms-length transaction or "wet market")*	Transactions are completely market-based. Contracts are verbal and often anonymous.
	Forward contracting	A cash transaction in which a commercial buyer and seller agree upon delivery of a specified quality and quantity of goods at a specified future date. The price is agreed upon in advance.
	Regular subcontracting of suppliers / preferred supplier arrangements	Buyer has a list of preferred suppliers with whom forward contracts are made regularly. This provides security and reduces search costs on both sides.
	Outgrower Schemes	A big farm contracts with neighbouring farmers to complement the own production volume. Outgrowers receive technological services but may sell to other buyers as well.
	Contract Production / contract farming	The supplier works for one buyer exclusively. Product and technology are clearly specified and suppliers receive the necessary inputs (see case in box 5.6)

Source: own compilation

In order to be sustainable, contractual relationships must be mutually beneficial and allow both sides to advance. Even the contracting between small suppliers and large buyers or processors offers advantages for both parties: Large companies can enhance their flexibility, reduce the time for responding to orders and reduce their costs by keeping lower inventories

and adjusting to different scales of production. In turn, small enterprises get access to more secure and bigger markets are able to specialize in particular activities, and get access to technology.

However, the more specific and detailed the arrangement, the greater the demands on the productive and organizational capacity of suppliers. Responding to new forms of contracting can pose problems to small producers. Linking a large number of small-scale producers or manufacturers to leading firms of a chain (e.g.: vegetable producers supplying the frozen foods industry) is a constant source of difficulties in chain development. Single small suppliers are unable to meet the volume requirement of the leading firm. Contracting also requires mutual trust, indeed a condition that quite often cannot be counted on.

Box 5.4 Case: Typical problems of cross border sales agreements

Demand and supply perception of the same export contract:

The buyer's view: A new supplier is given an order. He fulfils the first shipment, delivers the second shipment with time delay, and is unable to deliver according to specifications in the third shipment incurring losses for the importer. The buyer decides to break off the relation.

The supplier's view: The supplier receives a new order. Upon the order, consignments are sent to the new customer overseas. The first consignment is accepted, the second consignment is partly rejected and only partially paid for, and the third consignment arrives abroad, but there is neither an answer nor any payment. Significant claims on the buyer remain but cannot be collected.

The difference in perception can only by explained by an insufficient communication between the partners. Building a lasting contract relationship requires clear and frequent communication. This reaches far beyond the specification of the terms of product delivery. It includes providing relevant and realistic information about the capacity and the constraints on both sides.

Source: Wilhelm Elfring, personal communication

The fragmentation of supply, the low degree of market organization and widespread mistrust often prevent investment in contracts. Even local retailers often source their supply from abroad instead of buying from local suppliers. An example is the retail firm Metro in Romania and Bulgaria receiving most food products from outside the country. Metro is willing to purchase locally, but cannot find the right suppliers locally. Hence, moving from spot market relations to more sophisticated forms of contracts involves time and money looking for potential partners, negotiating and making sure mutual obligations are understood, building supplier capacity, and finally, monitoring the relationship.

Facilitating business linkages: Basic considerations and instruments

External facilitators can be useful by facilitating new contractual relationships. However, it has to be kept in mind that business linkages are commercial relations between private operators and hence an entirely private task and responsibility. From the discussion of roles in chain promotion (first task in module 4) it is clear that external facilitators are not supposed to interfere in actually making contracts. However, under certain conditions intervention into micro level contracting can be useful. Facilitators have to carefully reflect their role in supporting private business linkages. They should only go ahead

- if the support to contracting facilitates market entry of *all* interested suppliers in the respective value chain In order to avoid market distortions, operators have to be treated equally. In many cases these means working through second-tier associations organizing and representing the business as a whole.
- If pilot contracts can serve as a model for others and their use be scaled up easily.
- if the external support to contracting is essential for opening up a new market, and if this investment into market development is covered by the expected returns in growth of turnover and incomes (hence a favourable cost-benefit relationship).

Box 5.5 has a few practical hints in that respect.

Box 5.5 Practical Hints: Activities to avoid in supporting business linkages

*In the interest of an efficient use of public funds and a sustainable impact of support measures, facilitators should **not**…*

- take over any marketing or other commercial functions themselves
- become a party in any commercial contracts, e.g. providing guarantees
- give any preferential treatment to individual operators

Source: own concept

As it stands, these conditions can only be fulfilled in small markets or segments that already are or can easily be organized in cooperative structures or in markets which are dominated by one or very few buyers and highly integrated chains. Two types of interventions promoting business linkages at the micro-level are in order. They include

- Brokering contracts between small-scale suppliers and important buyers or traders
- Facilitating contract production / contract farming with leading industry

The first type possibility is the facilitation of contracts between lead firms and their suppliers. Brokering business linkages with buyers and lead firms includes actively seeking firms, checking on preconditions for contracts to be operational and advising on terms. Development agencies contribute know-how, contacts, and support either side of the contract (with knowledge about the country and supply side as well as knowledge about the market). This involves advising weaker business partners on contracting and on bargaining business contracts. The approach can be combined with advice on the design of embedded services (see module 7). External facilitation helps to keep risk manageable and takes over part of the information cost. The facilitator does not intervene directly into the business contracts, but assumes a brokerage role thus helping to overcome the initial entry and investment barriers for small producers.

Box 5.6 Case: Fostering the access of small producers in Ecuador to the global markets for specialty coffees

Situation of the value chain

FAPECAFES is a second-tier association of small coffee producers in Ecuador entertaining commercial relationships with the German company “Interamerican Coffee (IAC)” since a couple of years. IAC imports and markets speciality coffees in the high quality segments of the coffee market and has demonstrated great interest in developing new coffee brands with marks of origin from the production zone of FAPECAFES. Hence, the upgrading idea is a product and branding innovation.

Business linkage strategy

The GTZ programme NAMARES facilitates the promotion of the specialty coffee value chains in Ecuador. In order to support upgrading GTZ has formed an alliance with IAC in which IAC agrees to launch a new coffee brand in the market (“Café de Vilcabamba”, the valley where people get old by drinking coffee) provided that the association guarantees continuous high quality and a regular supply of the required volume. GTZ supports the inclusion of groups of small producers from the area who all belong to the association so as to kick off their access to the international market for specialty coffees.

Source: GTZ-NAMARES programme, Quito, Ecuador

The second important intervention is to facilitate contract production between producers and processing industries. This is particularly important in agribusiness: Contract farming is a system in which agro-processing or trading companies enter into a written agreement with a group of farmers to produce a specified quantity of a crop in a particular quality and at previously agreed prices. Usually the buyer provides inputs, technical advice and credit while the farmer sells exclusively to the buyer. Contract farming can be of great benefit for small

farmers who would not be able to invest in high-value production on their own. It provides them a secure market, access to technology and short-term finance. The benefit for the buyer is that he has control over quality and quantity of the supply.

Box 5.7 Case: Contract farming in Kenya

A typical example for a contract farming arrangement was established by the East African Growers Ltd. (EAGA). EAGA developed a fruit quality enhancement project, which they implemented with the support of Kenya Business Development Services Program (Kenya BDS), funded by USAID. The Embu and Meru Districts were selected as project area for intervention. EAGA produced a very elaborate contract, which clearly specifies the terms and conditions under which the passion fruit producer and the company work together.

The contract defines the company's and the farmer group's responsibilities, ethical trading requirements as well as penalties and bonuses. In addition it contains measures about dipute measurement. The annex lists quality and grade specifications as well as a recommended list of pesticides. A consulting company involved in the Fruit quality enhancement project, provides external support in various fields and for instance organized a trip for farmers to see the EAGA facilities in Nairobi. EAGA provides the farmers with cartons as transport material, which they should pack in a standardised way with 48-50 passion fruits. Every group member packs his/her carton individually and labels it for traceability with his/her member code. The group members transport their passion fruits once per week to a central collection point in Meru town. There, a grader from EAGA is present already before the driver arrives and inspects the produce.

The grader notes the weight at farm gate on the so-called Produce Collection Note, which is later verified through a final weighing procedure in Nairobi. If fruits are rejected in Nairobi, the farmer can pick these up the following week in Meru. EAGA writes the rejection reasons down on the original delivery carton and furthermore the company writes a letter to the farmer group stating the reasons for the rejection.

Source: Strohm, K/Hoeffler, H. (2006).

External facilitators can be useful by advising on model contracts, qualifying and empowering farmers to enter into a contract farming arrangement and by supporting access to additional services required to get the arrangement going. A frequent problem in contract farming is the initial lack of trust, often due to previous experience with farmers cheating on the contract and selling the produce to other buyers. While a facilitator can help to mediate conflicts, it is important that he does not become a party in the contract arrangement himself.

Brokering vertical linkages between a buying lead firm and small-scale suppliers has to be combined with horizontal cooperation between small-scale suppliers. Farmers and SME can only be integrated into high value market when acting collectively. This is the following topic.

(Task 5.2)
Fostering horizontal collaboration of value chain operators

Enterprises collaborate for two main reasons – business advantages and common economic interests. The business motive is to overcome the limits set by the size of enterprises. Small and medium enterprises achieve economies of scale through bulk purchase, bulking of produce and joint sorting, grading and marketing. Economic advantages are also gained through sharing resources (e.g. phone/fax, storage capacity or equipment). Business partners prefer to negotiate with few suppliers and expect reliable supply and quality. Often, forming an association is a precondition for obtaining sales contracts, especially with supermarkets and for export. By associating, small enterprises qualify as business partners and increase their bargaining power vis-à-vis buyers. A related purpose of collaborating is the joint access to support services. Beyond the direct business advantages, entrepreneurs benefit from cooperating by resolving common problems, by organizing upgrading action and by joint learning. External facilitators need horizontal associations as multipliers of information to a wider group of people. Farmers and micro enterprises do not qualify as clients of public support individually. This purpose can be achieved in enterprise networks – or by associations that are sufficiently big to organize service provision for their members. Accordingly, the types of horizontal collaboration differ between associations acting as businesses (chain operators) and associations that perform a supportive role. In both cases informal groups and formal organizations can be found. Box 5.8 classifies typical forms of horizontal collaboration.

Box 5.8 Concept: Types of horizontal collaboration

	Micro level Chain operators	***Meso level Chain supporters***
Informal association	- Agricultural or handi-craft producer group	- Enterprise network or working group
Formal association	- Formal producer association (cooperative)	- Second tier (umbrella) association - Business membership organization - Association of professionals

Source: own concept

Associations at the micro level (left column in the table of box 5.8) engage in commercial (production and/or marketing) activities. Cooperation starts with the creation of informal groups for joint marketing of products, e.g. at village level. As groups grow and multiply they have an incentive to found a legal entity performing functions on behalf of their members. The formal association is a company and therefore becomes an operator of the chain itself. Formality includes a legal statute, a Board of Directors and management positions

(treasurer) and an accounting system. It is often a prerequisite for obtaining contracts with larger buyers.

The support service function is the domain of horizontal networks, second-tier associations, or business membership organizations (BMO) at the meso level. Second-tier associations and BMO also provide operational and support services to members and other operators in the value chain. The provision of own association-based services is a form of "embedded service" (see the treatment of association-based service arrangements in module 7).

Promotion of commercial producer groups and associations at micro level

The main argument in favour of promoting small producer associations is the distribution issue: In a value chain promotion context, strengthening associations of farmers and small enterprises is a key intervention to ensure that chain upgrading delivers pro-poor effects. Public agencies invest in the organization of poor producers so as to enable their entry into the market and help them realize the economic benefits mentioned above. It is the poverty alleviation objective that justifies supporting specific operators of the value chain

The promotion of producer associations appears to be particularly relevant in food value chains and in handicraft and small-scale manufacturing where farmers and small producers have the greatest potential of realizing economies of scale. In agriculture, bulking the produce at village level often is a minimum condition for finding a buyer. Hence, association development focuses on rural business activities in the agricultural and handicraft sectors in the first place. References to other sectors are provided in the list of resources, below.

However, for the promotion of associations to be successful and sustainable, a number of preconditions or "critical success factors" need to be considered. Unless cooperation makes economic sense, individual enterprises have no incentive to join associations. Box 5.9 resumes the major conditions that need to be in place for associations. Among them, market orientation is an imperative precondition for success.

Box 5.9 Tool: Checklist of factors determining the interest in commercial cooperation

Critical success factors include

- market and commercial orientation of all (potential) group or association members
- comparable endowment of members with productive resources
- specific demand of buyers in terms of quality and quantity that individuals cannot satisfy (includes bulking in the case of farm produce)
- the possibility of obtaining economies of scale in production, processing, marketing and purchasing, e.g. dealing with perishable products
- that benefits from cooperating exceed the costs of cooperating - including time invested

Source: own concept, compare to Berdegué (2000)

Supporting producer groups and formal producer associations (cooperatives) is closely linked to the marketing of products. In line with the distinctions made in box 5.8, we can distinguish two types of supportive activity:

- supporting the creation of informal farming or handicraft groups, cooperating with buyers
- supporting formal producer associations and cooperative enterprises

In a value chain promotion context, association building has to achieve broad outreach: From a development policy point of view there is little use in supporting only a few producer groups or associations when there is a large number of poor producers in the value chain. In a value chain upgrading strategy, association building should include the great majority of producers at the respective value chain stage: At least 50% of small producers in a particular chain stage should be represented, preferably in one (or a few) associations. A high degree of organization is required in order to reach as many producers as possible and to minimize unfair competition with unorganized producers.

Nevertheless supporting individual producer groups and associations may be justified

- in situations where producers are not yet organized at all. Here, creating *new* producer groups or cooperatives can serve as a pilot case. Promoters come in supporting, documenting and spreading the experience.
- wherever production is highly concentrated or specialized using the same market channels. This is true for niche and specialty products.

In large and dispersed agricultural value chains, efforts to organize small producers village by village take a long time and are not likely to be efficient in the use of development funds. Here, facilitators should rather interfere at the meso level strengthening service provision and contributing to market regulation.

Provided the conditions for a micro-level support are met, the first step is to determine the conditions set out in box 5.9. Support implies determining market opportunities, raising awareness of micro entrepreneurs and farmers, and training people in group organization, the establishment of business plans, record keeping and other skills. The actual formation of groups should be entirely left to the initiative of producers. In group marketing arrangements the buyer has a central role. Controlling market access and setting the terms of delivery, he provides orientation and the incentive for group coherence. Hence, this approach fostering horizontal collaboration entails activities supporting vertical linkages at the same time, e.g. contract production (see box 5.7 for a Kenyan example). An example is the "Commercial Village Approach" (CVA) used by *Farm Concern International* in Kenya (see box 5.10).

Box 5.10 Case: The Commercial Village Approach, Kenya

The Commercial Village Approach (CVA) – an arrangement linking farmers to markets

This approach is being used by the NGO Farm Concern International (FCI) in Kenya to facilitate the market access of farmes. The starting point is the observation that farmers cannot overcome the bulking and quality problem on their own. By brokering the link with buyers and helping to organize joint production and marketing, villages can acquire (semi-) formal sales agreements. Major steps include

- conducting market research to determine the crops for which target villages have a competitive advantage, and identifying buyers and suitable distribution channels.
- Farmer training on market-oriented production and on self-organization.
- Initiating (but not conducting) a buyer – seller forum between representatives of the village and one (!) buyer at a time
- establishing a "commercial village" as a cluster of various farmer groups, producing for one (or several) buyer, agreeing on production schedules, bulking points and marketing plans, so as to comply with market requirements
- Close follow up and monitoring of the performance

(compare: www.familyconcern.net/inside.php?articleid=8)

There are several producer groups and subcommittees per village. In addition to brokering the sales contract, facilitators link public commercial villages to the extension service. Once the production and marketing system is established, it tends to be copied by others in the community – and thus spreads by itself.

Source: Farm Concern International, Nairobi (also see http://www.familyconcern.net/)

It should be clear that the intervention strategy does not consist in directly creating individual groups but in enabling communities to do that for themselves. In any case, strengthening horizontal cooperation has to go hand in hand with the development of market links.

As producer groups evolve into larger associations, they become less dependent on a single buyer, and get better chances of negotiating terms and taking up value-adding activities themselves. On the other hand, greater freedom of action also entails new challenges: Often, business activities need to be formalized in a separate, association-owned company. Managerial decisions have to be taken quickly and professionally. At the same time, association leaders have to organize the participation of a growing number of members and are held accountable for results.

In terms of the effectiveness of chain promotion the advanced stage of association development is more relevant than informal groups, because formal associations assume a more important role in upgrading. Formal producer organizations are intermediaries between smallholder or micro enterprise groups and buyers. They allow external facilitators to achieve a greater outreach. Nevertheless, promoting associations and cooperative enterprises is risky: Eventually, the success of associations is a matter of their internal stability. Here, another set of criteria becomes relevant concerning the economic and organizational viability of producer associations. The indicators in box 5.11 help to quickly assess whether an existing association is likely to master its own development. If association leaders are unable to respond or make documents available, the risk of failure is high.

Box 5.11 Tool: Questions to assess the viability of formal producer associations

Critical indicators of association performance
• Regular sales or long-term contracts with buyers (or suppliers) • Legal recognition: Availability of statute and objectives • Number of members and positive trend over time • Date of last General Assembly is in line with statute • Actual benefits for members • Own funding sources of the association (member fees and own benefits) • Date of foundation (long standing association)

Source: own concept

As in the case of group marketing, the evolution of producer associations is determined by the downstream contractual arrangements. The business plan and market contacts are the foundation of association development. There is widespread agreement that producer associations have to find and implement a business strategy on their own. Facilitators strengthen market orientation by facilitating links with buyers and providing market information.

Provided that a producer association combines enough supply capacity, it can engage in own marketing and value-adding activities, possibly taking over downstream marketing functions. This entails the professionalization of management. By moving into processing, packaging and marketing, farmers and handicraft producers leave their traditional business and start competing with accustomed companies. Hence, building the entrepreneurial capacity becomes a second important field of action.

One consequence of professionalization is the creation of a separate company. While ownership remains with the association, management and operations can be delegated to hired professionals. The development of an associative company is a major step requiring investment and legal decisions - and increases business risk. Thus, it also implies the organizational development of the membership association as such. Associations may need advice in developing and stabilizing the rules of ownership and collective decision-making. Accordingly, the activities building the capacity of producer associations can be divided into three areas of support, as shown in box 5.12.

Box 5.12 Template: Key activities supporting formal producer associations

Activities in support of…		
market orientation & contractual arrangements	*technical & business performance*	*organizational development & social coherence*
• Facilitation of links with buyers • Assistance with obtaining market information • Development of negotiation skills • Assistance with obtaining certification of own	• Professional training in technical and managerial skills • Facilitating the access to service providers, and to financial services • Assistance in the development of input procurement,	• Legal advice on the formalization of association enterprises • Organizational advice • Assistance with internal rules for membership, communication and decision making

products	logistics (sorting, grading and bulking) and value-adding activities	• Development of services for members

Source: own concept

In any case, associations have to acquire the capacity quickly – any dependence on external support is detrimental to their long-term viability.

Association development has an important place in value chain promotion. GTZ project experience[1] shows some recurring challenges supporting associative organizations. Following are a few major lessons and recommendations:

- Good governance and ownership of an association and legitimate representation of members are crucial. Facilitators have to encourage members to articulate concerns and to build up trust and willingness to cooperate.
- While people commonly agree that horizontal collaboration has advantages, the desire for individual autonomy often prevails. Hence, material benefits have to be demonstrated directly and fast enough. Unless people invest in collaboration, the support by development agencies should be reconsidered.
- Illiteracy is a common problem which has to be addressed adequately.

Beyond the overview provided in box 5.12, there is a large number of individual instruments to be used supporting associations. Further links can be found in the list of references, below.

Promotion of enterprise networks and associations at meso level

In the preceding section, the focus has been on association building to pursue joint business activities at the *micro* level. As value chain operators share the same constraints and interests, they also have an incentive to collaborate at the *meso* level. The purpose of collaborating at the meso level is mutual learning and the joint access to support services, especially information and training. This type of collaboration unites local cooperatives and individual companies at a higher (often national) level and therefore requires other forms of organization (see the right column in the matrix in box 5.8).

In the agriculture and food sector, many examples of sector specific grower associations can be found, especially in Latin America. Examples include the national associations of sugarcane producers (www.procana.org) or citrus growers (www.asocitricos.org.co) in Colombia and the national association of cotton and food crop growers (SYCOV) in Mali, West Africa. They have in common, that they have been built from the bottom up - by local farmer associations and by companies in the respective subsector. Value chain promotion can include assistance to the founding of new associations where they don't exist. One example is the creation of the "Ethiopian Honey and Beeswax Exporters Association (EHBPEA)" and the "Ethiopian Beekeeping Association (EBA)" by the SNV-funded program "Support to Business Organisations and their Access to Markets (BOAM)" in Ethiopia (see http://www.business-ethiopia.com/index.html).

Outside agriculture, cooperation at the meso level can be organized in the framework of the chambers of trade and industry which provide an ideal platform for sector-specific business networking.

A case in point is the "nucleus approach" for small enterprise cooperation that originates in Brazil and is now being applied in a growing number of countries. Box 5.13 presents the approach and experiences with applying it in Sri Lanka. There is a certain similarity between the forms of horizontal cooperation at meso level and the cooperation of enterprises for the purpose of organizing joint upgrading. Meso level cooperation such as in the nucleus

[1] For an overview of GTZ projects see: Matthess (2005)

approach may be compared to the core group concept that is also used in Sri Lanka (see box 4.20 in *ValueLinks* module 4).

Box 5.13 Case: The Nucleus Approach - small enterprise cooperation in Sri Lanka

Background

Upgrading involves change in all enterprises concerned. If medium and small enterprises (SME) are to participate as well, they have to have access to support services. However, most SME are often isolated and not aware of the potential and the needs to develop it. They hardly cooperate distrusting each other, yet do not have the means (nor the attitude) to demand and pay for services improving their businesses. This analysis has led to the idea of initiating networks of SME with similar conditions and problems, so that small entrepreneurs could identify common problems, gradually build trust and start activities to address problems and service needs jointly.

The concept of "nucleus"

A "nucleus" (plural = "nuclei") is a "circle of entrepreneurs" (a working group) "within a chamber or association which is moderated, organised and accompanies by a counsellor employed by the chamber" (Mueller-Glodde / Lehmann, 2006). Nuclei are composed of entrepreneurs in the same value chain or subsector. The approach was developed in Brazil in 1991 and has been spreading quickly in the whole country. In 1995, there were more than 4500 nuclei with 50000 SME participating.

Promoting the Nucleus Approach in Sri Lanka

In Sri Lanka, the approach has been strongly promoted by the Economic Strategy Support Programme (ESSP) in the Central region that is being supported by GTZ. Nuclei presently exist in 27 different subsectors, for example in "cut foliage", "beauty culture", "protected agriculture" and "carpentry". On average, each nucleus has 17 members. The nuclei exchange experience, express demands and organize support. This includes activities such as joint marketing and training.

Source: www.nucleussl.com

Over time, the horizontal cooperation of value chain actors at the meso level has to be institutionalized. In the case of the nucleus approach, the institutional framework is given by the fact that the nuclei belong to the chambers of commerce and industry.

In a subsector or value chain with many operators, organizations are needed that represent the special interest of chain actors and has the capacity to provide support services and exercise political influence. Subsector-specific business organizations exist in all developed value chains. In principle, they are open to all chain operators in the business. Box 5.14 presents the story of the apex body for the bamboo industry in Nepal.

Box 5.14 Case: Creating an apex body for the bamboo subsector in Nepal

Background

The market for bamboo product is not well developed in Nepal except for traditional uses. The starting point for upgrading the industry was a bamboo "munch" (i.e. an informal gathering) of bamboo entrepreneurs, researchers, interested parties, as well as NGOs. GTZ acted as a facilitator. Various rounds of bamboo munch meetings were held in which an upgrading strategy gradually emerged – the development of commercial bamboo products for the domestic market, mainly furniture. Participants felt that an organization would be needed as a more permanent form of cooperating. The "bamboo munch" should be converted and registered as a formal structure with a legitimate mandate.

Creating the apex body

Instead of founding an entirely new association, the bamboo munch decided to use the existing scientific NGO “Bamboo and Rattan Society of Nepal”, although it did not have any business role. The society was transformed into an apex body and formal business association at a founding workshop in 2005 of participants from the private sector. Official representation of the Ministry of forest and soil conservation and concerned donors were invited as well. The workshop took 2½ days and officially constituted the Bamboo and Rattan Society of Nepal as a coordinator of investment in the bamboo sector. A new constitution expanded the board of directors from 7 to 11 members incorporating 4 entrepreneurs from 4 different regions of Nepal into the board. The move created a lot of enthusiasm: Within one year, more than 2500 entrepreneurs joined the society. The 4 founding entrepreneurs now are regional coordinators.

In its first year of existence, the apex body has conducted trainings in bamboo cultivation funded by the Nepal office of “Save the Children”. The society also supported a group of bamboo entrepreneurs to present their products in a California Gift Show 2006. It was the first time that Nepalese bamboo products were exhibited under the label “friendly products” (www.friendlyproducts.com). Another activity is the drafting of a national bamboo policy of Nepal. The Society organized an international conference on “Bamboo for sustainable development” to discuss subsector issues and the proposed policy. After having been formalized, the Society is attracting funds and will soon be able to hire staff.

GTZ´s facilitation role

GTZ had an important role as facilitator by calling meetings, organizing workshops, gathering entrepreneurs from different regions and helping make contacts with funders.

Source: GTZ PSP RUFIN programme, Nepal

(Task 5.3)
Business matchmaking

In broad markets with a large number of competing operators and many parallel marketing channels and, generally, in weakly organized spot markets, the interventions cannot be limited to the micro level. Here, upgrading means addressing business linkages at a large scale, changing the conditions under which business contacts are made. Solutions need to benefit the market at large. This means that the interventions of facilitators have to refer to the meso level of market institutions and public support services in the first place, while the collaboration with individual companies is restricted to pilot investments and public-private partnerships (see module 6 on this point).

Improving the efficiency of fragmented agricultural markets - the typical spot (or "wet") markets - includes measures such as improving infrastructure, building collection points, constructing wholesale market places and supporting their management, introducing product grades and standard packaging material and organizing producers into associations. In the specific case of agricultural markets a wide range of references is available and FAO is among the best sources of know-how (see link list at the end). The promotion of agricultural markets is a well documented field of development, because of its importance for the majority of the poor in low-income countries, and because it can be easily structured due to the relatively simple linear structure of agricultural value chains.

An example of a project promoting the marketing of fresh horticultural products through micro and meso level operations is presented in box 5.15.

Box 5.15 Case: Mix of interventions promoting horticulture marketing in Albania

Major components of the "Regional Economic Development Project in underdeveloped areas of Northern Albania" (supported by GTZ):

- Improving market infrastructure in association between local traders and the wholesale market society
- Supporting the creation of producer groups and of a regional umbrella organization
- Connecting producer groups to wholesale markets and to traders in the region and in the EU
- Introducing standard packaging material and labels
- Establishing a market information system providing daily farm gate and wholesale market price information
- Publications related to production and marketing
- Provision of training and technology services

Source: S.Giehncke: "General view on value chain development experience-an example from Albania"

Apart from the approach developing agricultural market institutions, for great variation in the structure of value chains and networks in different manufacturing subsectors calls for generic approaches to promoting business linkages at the meso level. Box 5.13 presents major business matchmaking instruments to create new vertical business linkages in general. These interventions are supposed to involve several, if not all firms operating in a value chain. The objective is to support the growth of the value chain at large.

Box 5.16 Major instruments of business matchmaking

- *Facilitating participation in trade fairs and organizing exhibitions*
  Exhibitions are organized to assemble operators and stakeholders active in a particular market
- *Organizing business delegations to importing countries*
  These business delegations are normally held to build up new business contacts with previously identified concrete buyers in the importing country.

- *Organizing buyer/seller meetings*
  Meetings between buyers and sellers can be organized as workshops to exchange experiences
- *Creating business directories (yellow pages)*
  business directories such as yellow pages open up a search path for both potential buyers and sellers
- *Operating electronic B2B platforms (also see box 5.16, below)*
  The aim of these internet tools is similar to the previous directories but normally offers more detailed information. Normally users can fill in a concrete search request and partners are listed according to specific criteria such as country, sector, type of partner.

Source: own concept

The activities listed in box 5.15 may be performed by a value chain facilitator. It is preferable though, if they become regular support services taken over by export agencies, sector-specific marketing agencies, chambers or private companies. Therefore, facilitators should either leave matchmaking to these institutions or conduct the respective activities in partnership with them.

Box 5.17 Tool: Questions to assess before setting up a matching service

- Are similar services available for the target group?
- If similar services exist, can we contact the initiative in order to profit form their experience or to establish commercial links with them?
- Can we identify a sample of potential users that can be surveyed in order to determine whether they would take advantage of a matching system?
- Is there a need for a matching service? → survey of potential users
- Are there enough potential users to justify setting up such a service?
- Otherwise individual support might be more suitable (see Task 5.1 and 5.2)•
- Is the internet an appropriate technology? If several of the potential users lack access to the Internet.

Lessons learned: Developing economies often tend to tailor their services to the exporters. Though, it can be suitable to focus on domestic market agents and importers.

Source: Own concept – adapted from Giovannucci (n.D.)

Boxes 5.18, 5.19 and 5.20 provide three different cases of business matchmaking.

Box 5.18 Case: "Rueda de Negocios" ("business wheel") in Honduras

Background

In the framework of the programme for income and employment promotion in Honduras, GTZ is promoting new mechanisms serving market transparency and market integration. A platform called *Rueda de Negocios (RdN)* ("business wheel") for business matchmaking has been created in 1999. This is an instrument of trade promotion providing personal contacts and fostering alliances between enterprises to share and exchange contacts, information and technology. So far, business contracts in the total value of 5.000.000 US$ have been concluded.

The business wheel consists in a personal and a virtual component:

(a) Personal component:

Similar to a trade fair, the RdN organizes meetings of business people. Before the meeting, an agenda is drafted based on the objectives and wishes of the participating enterprises. The objective is to find complementary business interests that can translate into new contracts. To generate the right matches, a special method systematizing the search process has been developed and documented in a self-explanatory manual. In addition, software is made available that allows generating agendas for business meetings. The system is accessible in the internet to allow updating and modifications from all over the world.

(b) Virtual component:

This component consists of a website (http://ruedadenegocios.info/) that operates like a virtual market place for supply and demand. The website offers the services of an online chat room before, during and after meetings that can be used to find new contacts and to stay in touch.

Source: http://ruedadenegocios.info

Box 5.19 Case: Nepalese handmade paper products at the "Paperworld" Fair

The vision and strategy for upgrading handmade paper products from Nepal

Nepal exports handmade paper products made of Lokta, the bark of a natural shrub growing in the Himalaya. In order to boost exports, the Nepalese paper product makers (exclusively small and medium enterprises) cooperate to

- develop new designs and products,
- establish a common brand (Nepalokta),
- present products internationally and thus
- create new business links.

An important element of the strategy is international marketing. In January 2007, Nepalese paper products were shown for the first time at a joint presentation of Nepalese products at the international paper trade fair "Paperworld" in Frankfurt, Germany.

Concept and preparation

The objective of the trade fair participation was to launch the new Nepalese trademark for design products in the special innovation section at the fair. Therefore, thorough preparation was necessary including a design contest, the production of prototypes and promotional materials, training of entrepreneurs on product pricing, and a marketing concept.

Organization and funding of the exhibition

The organizer of the activity was HANDPASS, the Nepalese handpaper maker association with active support by GTZ. Most of the funding came from the EU Asia Invest project. The cost of fair space, advertising, construction of the booth, transport of products, website and the production of a CD–Rom was around 63.000 €. The travel cost of 24.000 € had to be paid for by enterprises. Other cost included the design competition, the production of prototypes, training, and a market study by an international consultant. The total cost of the matchmaking initiative was around 140.000 €.

In total, 27 enterprises applied for participation of which 14 were selected by a committee comprising HANDPASS and GTZ. Criteria for participation included the number of years in operation, current export value, export potential, number of employees, formal registration as a company, the capacity to innovate and the contribution to Handpass activities in the past. Enterprises also had to sign the code of conduct of the industry and agree to observe rules, such as not discouraging competitor's products, and linking to others.

Results

The companies receives sample orders worth 10.000 € on the spot. 320 international buyers made enquiries.

Lessons learnt so far

- Prepare well and take time
- Have a marketing concept ready (product, pricing, branding).
- Set transparent criteria for participation and communicate them well
- Process of agreeing on a Code of Conduct can be sped up by joint marketing initiatives
- The collaboration of enterprises is strengthened by travelling and working together
- Costs need to be shared equally

Source: GTZ PSP-RUFIN programme, Nepal

Box 5.20 Case: The regional agricultural commodity exchange in Ouagadougou

The regional agricultural commodity exchange in Ouagadougou
- A project supported by USAID, IFDC, AFRICA VERTE, CILSS.

The Regional Agricultural Commodity exchange was held on March 20, 2006 in Ouagadougou. On the whole, 335 offers to buy and sell were recorded, representing more than 170.000 tons of crops: cereals, nuts, oil crops, pulses, fruits, meat, milk products, technical crops etc. on the one hand, and on the other hand, nearly 90.000 heads of various species of cattle. The promoted sales system supports the cross border value chain of agricultural commodities and is installed to increase sales volumes, sending price signals and to focus the fragmented supply and demand. The concept of facilitating regional value chains via a commodity exchange is new to the region

Source:

A new instrument that has become more and more important in recent years is the mediation between businesses over the internet. Internet-based platforms for business matchmaking (business-to-business or B2B platforms) have the advantage that they are accessible to a large number of users. The main advantage of the databanks and platforms is the reduction of search costs and the facilitation of access to information that is especially valuable in regions where SMEs have limited sources of information. A collection of examples of B2B platforms is presented in Box 5.20.

Box 5.21 Practical hints: electronic B2B platforms on the internet

(1) http://www.e-trade-center.com
This American platform offers worldwide business contacts. It allows clients to post, view and respond to announce.
(2) http://www.us-asean.org/bizmatch/index.asp
US-ASEAN offers business contacts in South East Asia. Contacts can be only selected by sectors. Detailed information is available for product, type of business contact sought-after and special interests
(3) http://www.businessmatchmaking.com/
Is a platform with the purpose to match small businesses with government agencies, large buyers. It offers training and consulting, in regional workshop and online networks.
(4) http://www.africantrade.com/
This internet based trading system is designed to facilitate trade for importers, exporters and manufacturers worldwide. It allows to identify trade opportunities, receive trade alerts and showcase products and services
(5) http://www.ibf.com/bo/ibbo.htm
The site provides information about international business opportunities. It informs about business opportunities and includes a business directory.
(6) http://www.africacncl.org
This website includes two programs, the West & South Africa Business Linkage programs. The platform aims to help matching African and American companies in different sectors.
(7) http://www.wtca.org
The World Trade Centers Association (WTCA) is an organization of World Trade Centers in almost 100 different countries. The website provides trade information and the possibility for posting and reviewing trade opportunities.
(8) http://exporthelp.europa.eu
The European Commission's Export Helpdesk is an online service which aims to facilitate market access for developing countries to the EU. It provides market information about the EU and a market place where exporters in developing countries can establish contacts with importers from the EU.
(9) http://de.kompass.com/
Worldwide business purchasing and marketing directory.
(10) http://www.agroproductores.net/
An example of a platform for supply and demand of agricultural products from Colombia (in Spanish language)

Source: own compilation

All efforts to supporting market development may be futile in situations of severe market failures, such as extremely low contract security, generalized lack of trust, or dispersed, thin markets, in which only temporary business is possible. In such situations indirect action improving the general business environment may be a more effective way forward. Ways to improve the legal and institutional business environment are the subject of *ValueLinks* module 10.

Reference and Weblinks

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FAO (Food and Agricultural Organisation of the United Nations) Marketing website: http://www.fao.org/ag/agS/subjects/en/agmarket/agmarket.html

Sustainable Agricultural Initiative: SAI Platform, http://www.saiplatform.org/index.htm

ValueLinks Module 6



Engaging in Public-Private Partnerships

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ValueLinks Manual - The Methodology of Value Chain Promotion

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***ValueLinks* Module 6**

Engaging in Public-Private Partnerships

What this Module is about

The collaboration between public agencies and the private sector is a basic principle in value chain promotion. Value chains are made up of private enterprises, and it is through their decisions and investment that upgrading is achieved. Therefore, any value chain promoting activity has to address private operators, either directly or indirectly. Private enterprises collaborate in upgrading the value chain they are in because the improved business linkages and overall performance of the whole chain serve their individual commercial interest. As operators coordinate investment, a net benefit from cooperation is created, whereby the interest of individual enterprises coincides with the collective interest of the business community.

Beyond their collaboration in an upgrading project where they have direct business transactions, some private companies or associations contribute to upgrading that directly benefits the value chain community as a whole, for example when a private investment generates positive side effects (externalities) for other businesses. Investment in new technology or product development may provide solutions for the industry at large; staff training can enhance access to qualified staff for other enterprises; standards will be taken over by other producers; and new export linkages may open up opportunities for other firms following this example.

When private companies explicitly acknowledge their corporate social responsibility (CSR), the relationship between private interests and public objectives becomes self-evident. In fact, international companies operating in poor countries should be interested in improving the economic, social and environmental conditions of their host country, as this has a positive impact on the overall business and investment climate.

This module looks into the possibilities of taking advantage of the direct or indirect contributions to development made by private businesses. It also imparts knowledge on how actively to involve private firms in development work, and which are the most suitable areas of cooperation.

Tasks developing the cooperation with private firms

This module treats the implementation of alliances between public actors – in their role as facilitators of chain promotion – and private enterprises. Following is a review of the conditions and principles for attracting the interest of companies to contribute to development objectives. Two different levels of cooperation are presented:

- (6.1) Engaging private partners in development work
- (6.2) Concluding public-private partnership (PPP) agreements

The first section reviews areas of cooperation. The task is to explore common ground between the public and private sectors in value chain promotion, and find ways how to approach and involve companies in development work.

The second task is to determine the right form of collaboration (formal or informal). Wherever formal contracts are made, the partners should observe a series of rules and recommendations.

Basic considerations on public-private collaboration

Private companies as leaders of value chain upgrading

In the process of value chain upgrading, *all* private enterprises have to improve and adjust their own production, marketing and other managerial operations. Depending on the type of value chain (or, more precisely, the form of "chain governance"), big companies often play a key role in leading and coordinating value chain upgrading (see module 5). This is the case, when the value chain is dominated by one or few important buyers, exporters or processing companies who engage in regular contracting with their suppliers. To the extent that such companies specify and impose requirements in terms of product quality and supply conditions on their suppliers, they become *lead firms* in the value chain. Chain leadership may go as far as imposing a specific production technology. On the other hand, they open up new markets and invest in processing and marketing capacity.

Another lead role of private enterprises is that of a market leader or business leader. *Market leaders* are advanced enterprises engaging in product innovation. Such companies take over the investment cost and risk of pioneering new business models, products or technologies. They do this to improve their own competitiveness but at the same time set an example that others in the business can copy. Many lead firms are market leaders at the same time. Especially in niche markets such as organic food, small companies often play the role as pioneer, developing product innovations and bringing them to the market. Both types of chain leaders operate at the micro level.

At *meso level*, associations of companies take over a lead role as change agents by advocating public support and raising funds for joint investments in the interest of the business community.

Box 6.1 Concept: Leadership roles of private companies in chain development

Lead firms in a chain	coordinate production and logistics of their suppliers thus improving overall competitiveness.
Market (business) leaders	pioneer products and processes providing new business models for others to copy.
Subsector business associations	organize a platform for cooperation and joint investment of chain operators.

Source: own compilation

Converging interests of private and public actors

Lead firms and business leaders act in their own interest in the first place. However, by doing so, they address common issues at the same time. For example, they open up

new markets, resolve a technological problem of relevance to the whole industry, or come up with innovative ideas. In their constant strive to maintain or achieve competitive advantage, private companies strengthen the competitiveness of the value chain. Hence, there is an area of common interest between public agencies and the private sector. Public chain facilitators can greatly benefit from incorporating private leaders as change agents in value chain development initiatives.

Box 6.2 summarizes the contributions that private enterprises can make to economic and social development.

Box 6.2 Concept: Contributions of private companies to chain development

Private business leaders can provide benefits for development because they

- …are close to the market and thus capable of assessing business opportunities and market requirements, often sharing this knowledge with their suppliers
- …generate product and process innovations
- …contribute to professionalizing the business of other chain operators by engaging in supplier qualification programs
- …accelerate economic development by investing own resources
- …help to channel public assistance, thus contributing to a greater legitimacy and credibility of government interventions
- …help to enhance a general learning process
- …implement continuous improvement processes that benefit the whole sector

Source: own compilation

Some of these public benefits simply constitute a side effect of private investment. However, they can be greatly enhanced by a conscious and targeted government intervention, and joint initiatives.

(Task 6.1)
Engaging private partners in development work

Fields of public-private cooperation in value chain promotion

The cooperation between public agencies and private companies makes sense wherever a broader development impact can be achieved by joining forces. The impact of cooperation should go beyond the core business of the private partner, contributing to structural changes in the value chain at large. Unless there is a benefit for other private companies and/or stakeholders as well, the public contribution constitutes a mere subsidy for the private partner, which would be unjustified. Private business activities that generate a public benefit (see box 6.2) can be supported under the condition that the activities would not be undertaken otherwise or that they can be made substantially more effective by public support.

Typical fields in which *private* business activities merit support by government and development agencies include

- the development of supply chains, especially through supplier qualification programs
- the development and application of standards and codes of conduct
- the qualification of service providers in quality control, technology transfer and training

The following sections review these fields of collaboration. The list can be complemented by *public* activities. Improving the investment climate is a political rather than business task. Nevertheless, it is in the private interest as well. Hence public-private cooperation also extends to policy issues: Companies and business associations can make a substantial contribution by contributing to the formulation of laws and regulations (see *ValueLinks* module 10 on this point).

Supply chain development and supplier qualification

Private-public collaboration on supplier qualification programmes intends to strengthen the competitiveness of small local suppliers by adding value to their products or by improving their productivity and overall management capacities. Developing supplier capacity is a key element in upgrading. Innovating products and linking SME to new market outlets can only be successful, if suppliers are able to fulfil buyer requirements regarding, among other things, product quality, production efficiency and the observation of environmental standards. The typical private partner is a large local or a foreign buyer with important capital investments. Upgrading suppliers benefits the buyer by enhancing the reliability and quality of local supply. There is huge potential in attracting partners for this particular field of cooperation.

On the other side, the public interest is served because additional investment is mobilized. More importantly, domestic small businesses receive new know-how. It is preferable if the know-how transfer to the local suppliers is done in an embedded service arrangement including a third party service provider. Involving an independent commercial service provider in the qualification program allows creating additional service capacities expanding the service market. The additional service offers are likely to benefit other value chain operators later on and thus contribute to a much broader based know-how transfer. As a consequence, the public benefit is not limited to the supplier qualification alone. A good example of private development partners qualifying suppliers is the coconut sector in Sri Lanka.

Box 6.3 Qualifying suppliers of coir (coconut fibre) products, Sri Lanka

Background

Coir (coconut fibre) is an important export product of Sri Lanka and employs a high number of farmers and small enterprises. However, there is little value addition in the country itself. Coir is exported in its raw form, although it can be processed into a wide variety of consumer products. More value can be generated by improving coir quality and by "functional upgrading", that is by realizing more processing steps in Sri Lanka.

Qualifying specialists and multipliers of know-how serving local suppliers

Three public-private partnerships have been realized to address the issue, involving the German Government (GTZ) on one side and different German companies producing coir and coco products (mattresses from ecological rubberized coir, geotextiles for erosion prevention, and activated carbon). Two thirds of the funding has been provided by the private partners; one third is the public contribution. In all cases, the joint venture invested into the qualification of technical and management personnel and into the training of know-how multipliers. In the case of activated carbon, the private partner also invested in research and technology development and a laboratory for quality control. The know-how is spread via the Industrial Development Board and the Coconut Development Board to other interested enterprises in the industry at large.

Development results

The project strengthened the competitiveness of local companies by enhancing the supply of qualified staff (also for enterprises that were not directly involved). New technology has become available leading to the upgrading of the industry. Hence, value added increases and new jobs are created.

Source: based on reports of GTZ, PPP Office

This type pf cooperation is widespread. Another example of private companies supporting suppliers includes the development of the organic cat fish (pangasius) value chain in An Giang, Vietnam. The "Cotton made in Africa" initiative is a case of a PPP involving a whole group of international companies (Bertenbreiter, 2007).

Development and application of standards and codes of conduct

The integration of local producers into international value chains depends more and more on the compliance with internationally recognized standards. This is particularly true in the case of product safety, environmental and social standards that are gradually penetrating global markets. The introduction of standards as a field of intervention for value chain upgrading is covered in detail in *ValueLinks* module 9.

From the perspective of the private partners, the observation of standards is a precondition for developing the business (or, at times, avoiding losing it). The lucrative business opportunities in organic production can only be developed by if products and production systems are formally certified. International buyers need to rely on the implementation of standards from which they are sourcing. Both primary producers and traders gain if standards are agreed and applied throughout the supply chain.

The public side is motivated by the potential pro-poor growth effect. At the same time, ecological standards have a positive impact on the environment, thus contributing to sustainable development.

The development and implementation of standards is always a joint public-private effort, because the standard has to be widely accepted. Hence, standards are a natural field of public-private partnerships. This is particularly true for sector-specific standards. Lead firms have every interest in securing the quality required by the market. The following box presents examples of the coffee industry.

Box 6.4 PPP promoting coffee quality standards (Peru, Ecuador, Vietnam, 4C)

Background

In a time of dropping coffee prices and high quality demands of consumers, the competitiveness and sustainability of the coffee chain can only be maintained by improving product quality and production processes. Since the 1990´s, a series of different PPP projects have been implemented involving GTZ and international coffee companies (Neumann coffee group (NKG) in Vietnam and Uganda, and Kraft Foods in Peru and Ethiopia), all focusing on coffee quality. Three PPP projects took on to formulate and introduce special coffee standards

Introduction of coffee standards at national level

- *Peru*: From 2000 to 2002, Kraft Foods invested into the formulation of a national quality norm NTP 209.027 together with the national Coffee Chamber of Peru (CPC). The project aimed at avoiding frequent price reduction and marketing problems on the global market. A follow-up project is devoted to the implementation of the standard.
- *Vietnam*: With the help of another coffee company, a national standard for export of green coffee was formulated in 2002, together with a national partner, the Tan Lam Pepper Company and the national coffee organisation VICOFA.
- *Ecuador*: The PROCAP farmer cooperative produces internationally certified organic coffee. However, the undersized beans cannot be exported. The French Societé Coopérative Échange Équitable invests into formulating a standard by which a special fair trade organic coffee can be introduced into the domestic (!) market.

Each time, the PPP communicates intensively with national public and coffee organizations and engages in public relations. The approach always implies technical training of coffee farmers and of technicians in processing, storage and transport, the strengthening of coffee organizations and the introduction of quality control measures and certification procedures.

Impact and Follow-up

The impact can be see in better prices for coffee and and therefore a greater value addition. Over time, the different standards initiatives have been brought together to feed into a broad-based international effort to develop the international “common code for the coffee community (4C)” New PPP projects and pilots now refer to the 4C initiative, e.g. in El Salvador (Neumann group) and Brazil (EDE coffee) (see *ValueLinks* module 9, box 9.11). Further Public-private coffee initiatives include the promotion of organic robusta coffee in Uganda, and of the Arabica forest coffee of Ethiopia.

Source: based on reports of GTZ, PPP Office

An important field of PPP in the area of quality standards is the implementation of organic standards and regulations. As a public partner in a series of different PPP projects, GTZ has been involved in certifying associations of producers of organic cat fish, shrimps, bananas and other fruits, herbs, spices, coffee, cocoa, coconuts and other food products.

Qualification of service providers

Almost all PPP projects include business service activities in fields such as quality control, technology transfer and, most of all, training and qualification.

Private companies need improved service provision for themselves, their suppliers and other business partners. Although companies may take over service functions in embedded service arrangements for local suppliers, outsourcing to local BDS providers is often more efficient. Hence, public-private partnerships often extend to local training and consulting companies and certification bodies. Private firms benefit from the improved service and performance of suppliers.

Building business service providers is in the public interest as well, because it helps fostering the service market enhancing the availability of technology, trained staff and technical support to all enterprises.

The following cases focus on training and qualification services in the furniture industry. In contrast to the PPP in supplier qualification presented in box 6.3, this model relies on collaboration with companies operating "upstream" in the value chain. Not the buyers of final products but the suppliers of equipment and technology take the lead.

Box 6.5 Case: Services for the furniture industry (Indonesia, India, Croatia)

Background

The wood processing industry is a traditional sector of great importance in countries disposing of the adequate resource base. Making furniture is labour intensive. For example, in Indonesia the industry employs 1.2 million people. The development potential is in expanding exports and intensifying value addition in the country. In a dynamic world market this presupposes high quality and, therefore, continuous upgrading of equipment and of the technicians operating it.

Creating and strengthening support service providers

Indonesia: The wood processing group within the German association of engineering industries (VDMA) has contributed to setting up a qualification program at the industrial training institute PIKA (Pendikan Industri Kayu Atas), together with GTZ. The target group is machine operators and maintenance staff of medium-size private wood processing companies exporting wood products.

India: A German mechanical engineering company producing wood processing equipment worldwide has invested into modernizing the equipment of the „Common Service Facility Centre" of the Rajastan Small Industries Corporation" (RSIC). Technical training courses for machine operators have been worked out serving enterprises of the furniture cluster in Jodhpur.

Croatia: Here, the private partner is a service provider himself providing marketing assistance. The PPP is about creating an Academy for Furniture Trade attended by trainees of several South-East European countries.

Expected impact

The immediate result of the PPP projects is the improvement of service offers and the qualification of the workforce available to enterprises. This contributes decisively to the competitiveness of the furniture industry in each country.

Source: based on reports of GTZ, PPP Office

The last case in box 6.5 (Croatia) is a public-private collaboration with an international service company. In order to be able to expand their own business, service companies need partners. The growth of their clients enhances their own business opportunities. A case in point is the cooperation with technology companies providing equipment. In order to make their products and services known in the local market, they often depend on cooperating with local institutions or experts that need to be qualified to operate. Sometimes they adapt the technology to local circumstances. Similarly, they often engage in pilot projects where the benefit of the technology is being demonstrated to the operators in the value chain. In any case, partnership with technological leaders is often the only possibility of promoting innovation and is of great public interest.

The example in box 6.6 is about the collaboration with a domestic service enterprise.

Box 6.6 Case: Introducing export services for Cocoa cooperatives, Ecuador

Situation of the value chain

Associations of small-scale cocoa producers in Ecuador have established new and direct market linkages with international buyers of high-value cocoa. However, they the associations do not have the knowledge and experience in exporting their products. In some cases, they are too small too hire own staff to follow up on export formalities. Despite concrete export market opportunities, the respective competence and services are lacking.

Engaging in a public-private partnership

COFINA is an Ecuadorian enterprise specializing in buying and exporting specialty cocoa. The company has a trustful relationship with groups of small producers all over the country. In its role as facilitator of the cocoa value chain in Ecuador GTZ and COFINA have concluded and implemented a partnership to develop a new specialist export service for associations of small producers. The arrangement is that the associations export their product themselves and hire logistic and administrative services from COFINA to do so. The consultancy service constitutes a new business model for COFINA. At the same time it helps closing a service gap for small producers.

Source: GTZ Namares programme, Ecuador

Besides the three areas of public-private collaboration mentioned so far, there is another field of PPP - the formulation of policies in the subsector at stake. Private companies can be good partners for public agencies when it comes to improving the overall business and investment climate. Public Private Dialogue and other consultation mechanisms are covered in module 10 (section 10.2). However, formal PPP contracts can also be used. The PPP between Metro Cash & Carry Vietnam, the Ministry of Trade and GTZ provides a case in point (see box 10.3).

Identifying private partners and initiating collaboration

Even if the chain upgrading strategy offers good opportunities for public-private collaboration, a partnership does not emerge by itself - it has to be actively promoted. However, initiating partnerships may be hampered by the different cultures and behaviour of public agencies and private companies. Most of the time, it is the public side who has to take the initiative. In order to be successful with realizing the cooperation potential, public facilitators should observe certain guidelines for approaching and engaging private companies in development cooperation.

The first issue is the identification of potential private partners. This means screening the companies operating in the subsector. Innovative firms and lead buying companies are the obvious candidates for collaboration but private business membership organizations are more easily accessible and often have a broader perspective on the development of the subsector. As it stands, innovative and open-minded entrepreneurs often are leading members of business associations and chambers at the same time. Hence, business associations are probably the best starting point for finding a partner.

Establishing the contact with potential private partners, public development agencies have to take an entirely pragmatic approach, trying to clearly understand and anticipate the private interests. The development benefit of cooperating with private firms arises from the interest of companies in favourable conditions for their own business in the first place. Although others (and even society at large) benefit from these improvements as well, the primary motive of a company to engage in PPP is a direct benefit for itself - at the company level. Therefore, it is very important to take the business perspective on value chain upgrading and understand how both sides can achieve a positive impact creating a win-win situation for the public and private interests alike. A concrete advantage has to be visible - in line with regular business objectives and operations. Therefore, development facilitators should start by referring to these business needs and get to the public interest only later on.

Specifying the development interest in PPP and justifying it vis-à-vis public funders clearly is the task of the development agency. It cannot be delegated to a private firm. However, involving companies can also build on the idea of “corporate citizenship”. Especially in the case of big, multinational players, it is possible to allude to the social obligations often enough expressed in their vision and mission statements.

Another important point in initiating partnerships is to build trust. The relationship builds up gradually. It makes sense starting with informal agreements that do not require contracting and carry few obligations and little risk for both sides. Informal cooperation prepares the ground for more intensive partnerships at a later stage. Trust is a key concern in all phases of a collaboration project. This includes communicating regularly and verifying that the alliance partner sees his interest served. Decisions on objectives, mutual obligations and major activities have to be taken jointly.

Finally, the public side has to show its competence in dealing with the relevant business issues. To qualify as a partner for joint projects, development agencies have to build a reputation within the value chain business community. This includes defining the own service offers. Often, the facilitation, mediation and international networking competence of development agencies make them attractive for private companies. They are considered as a neutral broker, balancing the interest of the different stakeholders. Experience shows that public-private partnerships become easier over time, as both sides gain experience and understand how they can benefit from each other.

Preconditions for long-term success of public-private collaboration

A lasting and successful public-private partnership relies on a series of conditions. The most important precondition is the shared interest of both sides in the issues at stake. The following box summarizes some important lessons of public-private development partnerships in value chain promotion.

Box 6.7 Tool: A checklist to verify preconditions for successful partnership

Important preconditions / success factors for public-private partnerships

- Both sides share a common interest.
- The private company has a long-term commercial interest in the value chain and be present locally.
- Both sides are willing and capable of investing into the project.
- There has to be a net benefit from cooperating for both sides (win-win situation)
- Third parties, especially small-scale suppliers should be able to participate in, and benefit from the collaboration.
- The collaboration is based on trust, open and flexible.

Source: adapted from GTZ / Gesoren 2006 and personal communication

(Task 6.2)
Concluding private-public partnership (PPP) agreements

The initial task of value chain facilitators is to identify areas in which private companies would be able to invest into chain upgrading. This includes discovering areas in which public and private interests overlap. Once potential private partners are identified and a common understanding exists of the shared interest, the public and private organizations discuss the objectives of cooperation to arrive at a common understanding of the project. It is advisable to raise potential conflicts of interest at the beginning, so that they may be dealt with in a transparent and open way throughout the partnership. This is especially important where different cultures and values meet.

Depending on the complexity of the overlapping interests and the activities to be carried out, both formal and informal types of agreements can be used. The difference between a formal and an informal arrangement is the time frame, the cost, and the complexity of the venture.

An e-mail or even a handshake can be sufficient for one-time activities such as resolving individual technical problems, providing short-term advice, publishing a document and organizing meetings.

More ambitious objectives and complex projects call for a formal cooperation agreement. Formal public-private partnerships contracts are necessary when both sides engage in medium-term cooperation (one year and longer), commit considerable amounts of money and take risks. Contracts specify objectives, planned activities and the financial and other obligations on both sides. Generally, formal contracts are concluded for a period of two (or three) years. Box 6.8 shows types of formal as well as informal public-private collaboration.

Box 6.8 Template: Types of cooperation of public agencies with private firms

Informal cooperation

- Inviting voluntary contributions and sponsorship of companies for activities of common interest
- Short-term cooperation in studies, conferences and business delegations

Formal public private partnerships (PPP)

- PPP contracts in which both public agencies and private enterprises invest significantly into the same project side by side, yet without any financial flows between them
- PPP contracts in which the public side pays a private partner promoting the chain and generating a public benefit (not for making upgrading investment in the own interest of the company!)

Source: own compilation based on documents of GTZ PPP Office

The German Government has created a specific development policy instrument to encourage the establishment of partnerships with the business community, the “PPP facility”. Setting up a formal public-private partnership in the framework of this particular development instrument is bound to a series of principles.

- Compatibility with priority areas of German development policy in the country
- Complementarity between the public and private contributions

- Subsidiarity: A public contribution is only made if the company does not take the measure anyway, even without public support
- Fair competition: The private partner shall not gain a competitive advantage over competitors. The cooperation is public and open to others.
- Substantial contribution of the private company (at least 50% in cash or in kind)

The specific type of contract varies depending on money transfers between the public and private parties (see box 6.9).

Box 6.9 Template: Types of formal contracts

Three contractual arrangements for public-private partnerships

a) Consulting contract: Private partner operating as consultant for a public agency

Here, the project is mainly implemented by the private partner receiving funds for part of the activities at cost price, i.e. does not make a financial profit. The company also invests own resources into complementary activities. The company needs to account for public funds it receives and reports on the progress and impact achieved

b) Co-operation agreement (contract): Both partners invest side by side

This form of contracting is easier as there are no financial flows between the partners. However, a written agreement on the joint objectives and the respective commitment and in cash or in kind contributions by both sides is required.

c) Grant agreement: Public development agency acts on behalf of a company

Here, the project is implemented by the development agency. The company reimburses the public partner for its expenses. The private contribution to the partnership project is financial, often matched by public funds.

Source: GTZ, PPP Office

All partnerships are different as the situation differs from case to case. Creating the awareness and building trust takes time. Hence, developing PPP requires a flexible process approach in the set-up phase.

Once the process reaches the negotiation phase of formal PPP contracts, the existing rules for spending public funds have to be observed. The following box resumes the experience gained in negotiating PPP into a series of general recommendations.

Box 6.10 Template: Points to observe in negotiating PPP contracts

Recommendations, mainly for public agencies:

- Negotiations should be with the competent decision makers on both sides.
- The public partner takes leadership in preparing the contract but may cede the leadership position to the company during implementation.
- Negotiations start by finding common ground and building a relationship.
- After reaching a general agreement on a common objective, both sides should lay their offers, interests and expectations open. Facilitators should use the language of business and take a concrete, pragmatic outlook.
- Objectives have to be translated into concrete activities, results and milestones. The contributions of each partner should be complementary, based in the respective strengths. However, the public side does not fund regular commercial activities that the company has to undertake anyway (!).
- The public partner has to make sure that the cooperation actually provides a development benefit to society.

- Depending on the type of agreement, different levels of leadership materialize: In a consulting contract (model 1 in box 6.9), the private company leads the implementation of the project, in the cooperation agreement (model 2) both sides share leadership, and in the grant agreement (model 3) the public development agency is in charge for implementation.
- In order to keep the project manageable not more than three partners should be included in the agreement. The duration should not exceed three years.
- While the relationship and contract should be transparent to the partners, discretion is required. Partners should agree on the information that may be given to third parties.

Source: GTZ PPP Office

Summing up, public-private collaboration is highly important as an instrument of development cooperation in promoting value chains. Given the primarily private interest in upgrading, value chains are a natural context for identifying private partner and involving them into development work.

Conversely, a review of GTZ PPP experience shows that a great majority of PPP ventures can be easily related to particular value chains and subsectors. Hence, a PPP idea could as well become the starting point for a more comprehensive value chain promotion project.

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ValueLinks Module 7

Strengthening Services in Value Chains

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ValueLinks **Module 7**

Strengthening services in value chains

What this module is about

The development of a vision and strategy of chain development (*ValueLinks* Module 3) typically reveals constraints in the quality and access to operational and support services. In most cases, service improvement will have been identified as important element of upgrading and a field of action for the future.

There are two types of service-related problems: For one, chain operators may have difficulties finding adequate offers in terms of quantity, quality and price for essential services such as input delivery, maintenance, transport or advertising. Market failure problems prevent these production and marketing functions from being outsourced, thus crucially limiting economic and technical efficiency.

Secondly, upgrading requires additional information, improved technology, better skills, better logistics, and many other process and product innovations. All these improvements reach the operators through specialised service providers. Acting alone, enterprises will rarely be able to improve their competitiveness quickly enough. In fact, as economic development advances, better and more differentiated services are required. Service costs are contributing to an increasingly large share of final revenue.

This module provides guidelines on how to strengthen existing and future services for operators in order to improve chain efficiency. The task of external facilitators is to advise on the most appropriate service arrangements, work on service market failures and build the capacity of service providers without distorting service markets.

Tasks in strengthening chain services

Value chain upgrading regularly implies better access to services. The first step in upgrading service supply is to identify the operational and support services that need to be improved or added in order to reduce production costs, lower transaction costs, and/or improve product quality. Based on the service analysis, development support refers to strengthening service delivery in its different forms. We distinguish private operational services, the provision of (mostly public) support services and the temporary delivery of “substitute services”, i.e. contributions by development programmes replacing currently unavailable operational or support services. Accordingly, we can distinguish the following tasks:

- (Task 7.1) Assessing service needs in view of the upgrading objectives
- (Task 7.2) Strengthening private service markets and arrangements
- (Task 7.3) Improving the responsiveness of public service providers
- (Task 7.4) Strategic use of temporary external services

Intervention strategies make use of the concept of a three-pronged “service system”: interventions can address the supply side (service provider), the demand side (clients), the rules ruling supply and demand (service arrangement) or all three elements at the same time. The basic understanding of a service system is explained in the first section.

Basic considerations on service provision in value chains

A functioning service relationship can be conceptualized as the interrelation of three elements:

- (a) *Service clients* demanding and receiving services. Service clients are the chain operators (farmers, craftsmen, companies etc.) receiving services, either individually, as groups of enterprises (e.g.: farmers associations) or as the entire community of actors in a particular value chain.
- (b) *Service providers* delivering the service products. The service providers include private enterprises as well as public service agencies.
- (c) *Service arrangements*, the rules governing the relationship between service demand and supply, i.e. the form of organizing service delivery. The main types of service arrangements are the private service market, services embedded in the value chain, and public support services delivered in the interest of operators or in the public interest. These arrangements can include third parties funding, regulating or supervising service provision.

Box 7.1 presents these elements in graphic form.

Box 7.1 Conceptual model of a service system



Source: own concept

It is important to note, that the elements are closely interlinked. For example, private service providers will not expand their capacity until and unless customers express their demand effectively. Conversely, weak chain operators will not pay for private services, unless service providers adjust their offers to their purchasing power. Similar considerations apply to the public services: Often, there is no satisfying relationship between supply and demand of public services, because public service agencies do not adequately recognize demands of clients. On the other hand, clients have no influence on the allocation of budgets.

Box 7.2 Concept: Different categories of services in value chains

Operational Services	Production and marketing functions sourced out by value chain operators (micro level)
Support services	´Collective good´ services benefiting the chain community as a whole, often required for chain upgrading (meso level)
Generic business services	independent of the value chain, used by a broad range of clients operating in different final markets
Chain-specific services	specialised service functions only relevant for the value chain in question
Private service providers	deliver operational and/or support services against payment, either individual enterprises or business associations
Public service providers	Government or public agencies providing support services in the interest of the business community and the public
Service arrangement	the roles of the parties involved in a service system, viz. demand, delivery, payment, supervision (see next section)

Source: own definitions (also see the *ValueLinks* glossary)

The support of value chain services addresses the three elements of service systems. In each case the most adequate service arrangement has to be selected given the service market situation. Interventions refer to the demand or supply side or two the facilitation of the arrangement as such (see task 7.1 on upgrading options).

(Task 7.1) Assessing service needs and service markets

Improving and developing services requires information about the current status of service provision in the value chain. Service needs can be derived from the value chain analysis and the development of a chain upgrading vision and strategy (see module 3). These needs refer to the operational (micro level) and support (meso level) services likewise.

Analyzing the provision of operational services

At the micro level, the first issue is the provision of operational services required for efficient production and marketing. Box 7.3 provides an overview of the categories of operational services. The financial services are treated in module 8.

Box 7.3 Concept: Categories of operational services

Value chain specific operational services:

- Specific technical, market and business advice
- Specific technical training
- Input procurement
- Technical services (engineering, maintenance, equipment lending, packaging, lab testing of safety parameters etc)
- Mechanized (agricultural) operations against payment
- Provision of returnable packaging material (in fresh produce chains)
- Product and process certification to fulfil market requirements

Generic business services:

- Transport, shipment and handling
- IT Services (telecommunication, information services)
- Insurance
- Management consultancy (business development, accounting and legal advice)
- Advertising and marketing

Source: own compilation

Technical training can be classified as an operational service if it is specific for the production and marketing functions of enterprises. Vocational training and generic farmer or micro-entrepreneur training is considered to be a support service (see further below).

The question is whether operators have access to these services, at affordable prices and in the right quality. Often times, service markets fail to supply the services, especially to small enterprises. Whether there is a problem of market failure, can be found out in a service market analysis. The procedure is to go through the value chain stages and specify those services already in demand and those for which outsourcing could make economic sense. The characterization of the services in terms of volume and frequency of demand, and the ability of operators to pay indicate reasons for an incompatibility of service demand and supply (see the structure of the analytical table in box 7.4).

Box 7.4 Tool: Table characterizing demand for operational services

Groups of chain operators along the value chain	*Service needs of the groups of operators*	*Characterization of the services needed*	*Ability of operators to pay for services*
- Farmers - Traders / collectors - etc.	to be specified	to be specified	to be specified

Source: own concept

On the supply side, the question is which services are actually provided – and by whom. This shows to what extent demand is satisfied – and whether public service providers take over the function (box 7.5).

Box 7.5 Tool: Table characterizing supply of operational services

Service needs, specifying effective demand	*Services (public as well as private) currently provided to satisfy the needs*	*Private service providers with offers covering the demand*	*Service gaps (no offers made by private providers)*
(taken over from the table in box 7.4)	to be specified	to be specified	to be specified

Source: own concept

Service gaps are those service needs for which there are no equivalent private or public offers.

The second issue in the analysis of services at the micro level is the demand for *new* operational services that are needed to satisfy the upgrading requirements. Chain upgrading regularly means introducing new technology, improving and managing product quality, and engaging in new business linkages and distribution channels. These changes can only be achieved, if operators can rely on services for assistance. Some of the services can be adjusted to the new needs, but in many cases new service content (skills and information) and even entirely new types of services (quality certification) may be required. Here, the question is, which set of coordinated operational and support services is needed in order to upgrade processes and diversify into higher value products. Box 7.6 shows how service requirements may be derived from upgrading objectives.

Box 7.6 Template: Chain upgrading and related operational and support service needs

Upgrading strategy	*Services required*
Identification of new markets	- Market intelligence, business matchmaking - Management consultancy - Information and communication (ICT services)
Product innovation	- Research and technology development - Supply of technical inputs and equipment - Technical advice and training - Technical services
Process innovation to enhance reduce cost and/or improve quality	
Quality management and assurance	- Advice on quality management systems - Product and process certification
Expansion of productive capacity	- Financial services: New credit lines
Organization of producers	- Organizational development advice

Source: own compilation

The different upgrading strategies refer to the discussion in *ValueLinks* module 3 (task 3.1). It should be clear that they are often interlinked. Box 7.7 has a few illustrative cases showing the relevance of new services in the context of chain upgrading.

Box 7.7 Cases: New services introduced as part of chain upgrading

Logistic services
The supply of fresh pineapples from Ghana to supermarkets in the Netherlands and Great Britain relies on well timed and consistent series of packaging, labelling, transport and storage services, at the farm level and at the port facilitates in Tema, Ghana.

ICT services
Information and Communication Technologies (ICT) have provoked the most radical change in trading agricultural commodities. Traders in remote African regions now engage in sales negotiations using mobile phones. Internet services of specialist companies tracing consignments from the farm to retail outlet, are the basis for the future development of commodity markets.

Quality management services
After experiencing an EU import ban for two years, the fishermen cooperatives at Lake Victoria had to apply the HACCP concept. Through endless direct contacts with importers they became aware of them being suppliers into a sophisticated value chain applying ever rising quality standards (on this issue, also see module 9).

Source: on compilation

Problems of market failure delivering operational services

The basic arrangement for the delivery of operational services is the private service market, in which services are contracted and paid for by the operators. In functioning service markets there is no need to care about the access to services. Depending on market incentives, they will become available as economic development advances.

However, under the conditions of value chains with many weak operators and little capital private service provision frequently fails. In many developing countries the range of contracted services on offer is fairly narrow and hardly differentiated enough to support value chain upgrading. Analysing the question at the outset of the constraint analysis (box 3.7: "What are the reasons for the value chain to stagnate?"), delivers several factors responsible for the failure of service markets, namely:

- *Weakness and fragmentation of demand*: The delivery of services for scattered rural producers and processors is expensive. Unless there is a critical mass of clients, services have to be offered at prohibitively high commercial rates. Generally, poor producers do not have enough cash income to pay for services.
- *Low market transparency*: Often, operators are not aware that the required service exists in their neighbourhood. Even if they know, the potential benefits may not be directly visible to them.
- *Market distorting practices of public agencies*: As public agencies or donor-funded programmes subsidize services or offer them for free, many poor producers are not used to the idea of paying for services. Rural areas often lack a commercial service culture.
- *High start-up cost of services*: Some services e.g. quality certification, need to be internationally recognized. This involves start-up costs and high entry barriers for newcomers.

The consequence of service market failure is that enterprises are not able to outsource production and marketing functions and hence lose efficiency.

Analyzing the provision of support services

The second category of services to be analyzed is the support services delivered by providers at the meso level. Support services benefit chain operators collectively who together share the interest in a thriving industry. As distinct from the operational services

support services do not directly contribute to performing production and marketing functions and therefore are not contracted individually. Box 7.8 enumerates typical support services

Box 7.8 Concept: Categories of support services

Support services include:
- Sector-specific vocational training and university education
- Applied research and technology development
- Publication of market and price data and other sector-specific general information
- Services of shared technical facilities, e.g. reference laboratories
- Organization of fairs, exhibitions and meetings
- Public relations and joint marketing of products
- Export promotion (e.g. business delegations)
- Advocacy for common interests of the value chain business community

Technically speaking, most of these services are ´club goods´, providing advantages from which no participant in the value chain can be excluded: Trained staff can change jobs in the industry, technical solutions will be copied, and every operator benefits from the establishment of a regional trademark. As these benefits are all private, they should be paid for by the chain community (the "club") that is benefiting. Most of the support services listed in the box is highly relevant for chain upgrading. In fact, they are efforts to enhance the competitiveness of the value chain they seek to support and can be seen as services to facilitate upgrading. The clients of support services are groups of operators or the chain "community" as a whole. They can be provided by private or public service providers alike.

The regulatory interventions of government, such as the setting of grades and standards or fixing market prices are not included here. They will be treated as part of sector policies (see module 10). However, technical inspections in the interest of consumer protection, e.g. meat inspection, can be considered support services for government, and indirectly for the industry as well. Public reference laboratories are supporters of value chains as they provide the basis of a functioning quality management for all entrepreneurs.

The first issue in the assessment of support services is to check on the need for support services and their current availability. Boxes 7.4 and 7.5 (see above) can be used as tools to identify support services required for upgrading, and the support service providers. In general, these will be private business associations and technology institutes of an industry - or government agencies and NGOs. Service gaps are the starting point for upgrading action.

Problems with private funding and provision of support services

Although support services benefit value chain operators, they are not always able or willing to pay for them. Strong value chain communities with large revenue will pay for support services themselves and work with private agencies while weak chains depend on public money and government or NGO provision. Typical problems of private support service provision include:

- *Low degree of value chain organization*: Producers and enterprises in traditional markets, especially in agriculture and other natural resource products are rarely organized to demand, let alone pay for support services. Income often is too low to support collective action.
- *Free riding:* Often, individual enterprises have no interest to invest in collaboration - everyone is waiting for others to move ahead.

The problem of client and demand orientation in public service agencies

As a consequence, we find that support services regularly are funded and provided by government. In any case, there are strong arguments for the public funding of support services, not least because of the public benefit in terms of jobs and a broader tax base. However, the public funding of support services has the disadvantage that operators are not in full control of the service provision. In a situation where the client of a service is not paying, the service arrangement includes at least three (if not more) parties – the service clients,

service providers, and the (public) funders of the service. This ´service gap´ implies a series of problems typical of public support service provision:

- *Little accountability towards operators*: Public providers of support services are primarily accountable to their public financiers and much less to their private clients. Public administrations or research institutes do not easily understand business needs and keep distance to private companies. The result is a marked supply-side orientation.
- *Inconsistent support policies*: Public agencies (as well as donor-funded programmes) often apply inconsistent subsidy policies. Service offers and modes of delivery follow political conditions rather than needs.
- *Limited capacity of service providers*: There is a general undersupply of support services for small producers as public agencies find it difficult responding to weaker market partners. In weak subsectors and marginal locations often hardly any public service agencies are active. As a consequence, support service provision is rather dominated by international aid programmes and NGOs which may involve a problem of sustainable funding.
- *Low image of government*: Justified or not, public service providers often suffer from an image of low efficiency.

Hence, the problem of support services is not just their availability, but also rests in their adequacy for the upgrading strategy at stake and for weak market partners in particular.

From analysis to action: Arrangements for service provision

The leading principle in strengthening value chain services is the perspective on the service systems as a whole. In order to contribute to upgrading, the service arrangement has to specify the demand clearly, provide incentives to service providers and assure the sustainable financing of service supply. Focusing only on the supply side of the service system is not enough.

The first step in strengthening chain services is to determine the most appropriate service arrangement for the service in question – considering the problems spelled out above. Box 7.9 summarizes viable service arrangements in value chains according to the categories of services in demand and the type of service provider.

Box 7.9 Tool: Selecting service arrangements in value chain upgrading

Overview of service arrangements (see following sections for explanations)

	Private providers	**Public providers**
Operational services	***- Contracting / Service Market*** ***- Embedded service*** ***- Business member-ship organization***	***- Fees for service*** ***- (substitute service)***
Support services	***- Business Associa-tion (membership fees)***	***- funded through taxes or levies*** ***- mixed funding***

source: own compilation

Providing operational services is a private task. The upper left quadrant in the graph names private contracting, i.e. the service market, as the basic service arrangement. The other two arrangements (embedded and association-based services) involve more or less elaborate organizational solutions addressing the funding problem. Public agencies are not supposed to provide operational services. The only exception is the ´fees for service´ arrangement with private paying clients and a public agency as provider (upper right quadrant). Support services are provided by private business associations (lower left quadrant) or by public agencies (lower right quadrant). In the latter case, arrangements mainly differ in terms of funding mechanisms – from conventional budget to mixed funding.

To support a particular service arrangement, the parties concerned have to make a coordinated effort to formulate demand, organize and agree on the arrangement and adjust service supply. In the following, action to upgrade services is always structured into three fields:

- Articulating service demand,
- organizing service arrangement and
- strengthening service supply

The task of facilitators is to mediate and advise on appropriate service arrangement. The following sections present arrangements for the provision of operational service by private providers (upper left quadrant in box 7.9) and the arrangements for support service provided by public providers (lower right quadrant). A treatment of substitute services (upper right quadrant) follows.

(Task 7.2) Strengthening private service markets and arrangements

Operational services can be made available in three ways: They can be purchased (contracted) from private firms or agencies, be made available as (embedded) part of existing business linkages between value chain operators, or the can be provided by associations of operators. Accordingly, there are three types of private service arrangements in value chains:

- Markets for contracted operational services
- Embedded service arrangements (part of vertical business linkages)
- Services provided by business associations to their members

Services improvement as part of value chain upgrading is achieved by developing one or several of these service arrangements. The basic principle in any private service arrangement is that the service is fully paid by the operators. Therefore, the total volume of service delivery is limited by the chain revenue. Only if the market for the final product grows covering additional service costs, the private market for operational services can grow as well. This is true for all three arrangements. Following are some guiding principles and examples for the development of private service arrangements. They mostly apply to micro, small and medium enterprises as service clients.

Creating and supporting markets for contracted operational services

The market for contracted services involves a ´closed relationship´ (see Huppert and Urban, 1998, p.24) between just two parties, the client and the service provider. The clients, i.e. the operators in the value chain, demand, consume and pay for the services delivered in cash. The coordination of demand and supply is regulated by market prices. This is the most common form of business services delivery. Promoting the service market becomes necessary if chain upgrading implies an expansion of service demand or the creation of entirely new services. Another reason is the withdrawal of the state from service provision.

Conditions for the functioning of service markets: An obvious and pretty basic condition for private service markets to work is a sufficient demand volume and purchasing power of clients. Operators need to be integrated into the market and receive cash income to pay for services – a condition that is often missing in weak markets. The service in question must be crucial for operators and not easily available from other than private sources.

Action to articulate service demand: In the case of small producers, the formation of associations can lower the barriers to service access for clients. As bulking of produce and joint marketing is a strategy to improve business linkages, forming groups is a way forward to foster private services (see module 5 for horizontal collaboration).

Action to create or strengthen the service arrangement: The development of a value chain opens new business opportunities for service providers. The process can be sped up by assisting the foundation of new service enterprises in the context of the upgrading project. There are two options: One is to develop a new service business idea to satisfy the service needs emerging as in the upgrading project. Facilitators actively involve interested service enterprises linking them to the growing market in the value chain. An important new type of private service is quality certification (see module 9). The second possibility for strengthening the arrangement is the privatization of hitherto public services, handing over business responsibility to the newly founded agency, and supporting its start-up phase.

Action to upgrade service supply: This includes the creation of new service enterprises and/or the support to existing ones in line with the evolving service market. Typical support measures include strengthening the service providers with business training courses, on the job training and the mentoring of start-up service enterprises. Since service providers depend on successful survival in the market, the support measures should be directed at all private providers avoiding market distortion.

Box 7.10 provides a case the case of promoting a private service market in Mongolia.

Box 7.10 Case: Privatizing veterinary services in Mongolia

Point of departure: The privatization of animal husbandry in Mongolia

Mongolia is a livestock country with a socialist past. In 1993, the collectively managed herds were privatised and 90% of the rural population became private livestock owners again. About 187.000 nomadic families are herding 175 animals, on average. The herds are composed of 20% large stock and 80% small ruminants as a rule. In a second move to privatization in 1998, the public veterinary and livestock breeding stations and services followed and were privatised (auctioned) as well. Before 1998, all veterinary services were offered to the collective holdings by the public Mongolian Veterinary Service free of charge. As a result of privatization, 500 veterinarians lost their public employment. The privatization left a void, aggravated by the complicated nomadic way of life, seasonal production and service demand, large distances and little cash income.

Strategy and contributions of the project „Privatisation of Veterinary Services"

In its first phase (1998-2002) the project pursued the objective to promote reforms and assure the supply of (mostly private) veterinary services in the most important sector of the Mongolian economy. Besides the support to private veterinarians, other private actors were supposed to take over service functions as well, especially the veterinary association and the veterinary co-operatives of nomads themselves. The project took a ´systemic approach´ co-operating with actors at all levels.

Strengthening of private veterinary service providers (individuals and cooperatives)

The most important activity was training in "management of private veterinary practice" and in "veterinary economy". Another was the introduction of management tools for private veterinary practices such as commercialisation and marketing of services. 340 formerly public vets were able to purchase private veterinary stations (practices). Complementing private cash income, the project helped to develop varying modes of payment and cost recovery, such as establishing revolving funds for inputs in veterinary co-operatives. Some services are indirectly funded from public sources, e.g. training courses for nomads.

Enabling nomads to make own contributions to the veterinary service system

Important activities include the promotion of nomad groups (internal organisation, empowerment) so that they become able to organize their demand vis-à-vis service providers. Part of the services is provided locally by assistants guided by veterinarians.

Building the capacity of the Mongolian Veterinary Association

This is a professional organization and a private actor as well. The project advised the association on organisational development and helped to develop a country-wide training programme for private veterinarians and vet assistants.

Adjusting the tasks of public organizations to private service delivery arrangements

Complementing the activities with the private sector, the project also helped to prepare and adapt the respective laws and regulations. This included the definition of new tasks of the remaining public agencies and the exchange of information and experiences related to the development of the new veterinary system.

Source: G. Kleemann: "Privatization of veterinary services in Mongolia", mimeo, Eschborn, 2000

Facilitating embedded service arrangements

In an embedded service arrangement operational services are delivered in combination with a basic business transaction (the sale of products or a loan) by one operator to another. Operational services are coupled with (embedded in) business transactions, e.g. information coupled with the sale of inputs or technical advice coupled with the purchasing of raw produce by processing industries. The decisive point is that the embedded service is funded

as part (mark-up) of the underlying business transaction thus relieving the cash needs of clients. A classical example is the technical service provided by dairy plants to their supplying milk producers. Embedded service arrangements have the advantage that they use the existing linkages between service providers and clients.

Combining sales of equipment with maintenance services is a standard form of service embedding. More important forms of embedded arrangements for chain upgrading include complete service packages, e.g. supplier training, lab services or organizational support. These embedded arrangements are more complex and often include professional service providers as additional partners. They include three or even more parties. From the perspective of clients, services can be embedded into three types of business links as shown in box 7.11.

Box 7.11 Concept: Types of embedded service arrangements

Embedded services according to the basic transaction / business link they are linked to:

(a) Sourcing of inputs and equipment (backward business link)

- Services provided by input dealers to farmers or small enterprises

(b) Sales of products (forward business link)

- Services supplied by professional providers to farmers or small enterprises, and paid for by the buyers of products
- Financial services (inventory credit) based on warehouse receipts (box 7.12)
- Services supplied by buyers as part of contract farming, contract production or outgrowing contracts (see module 5)

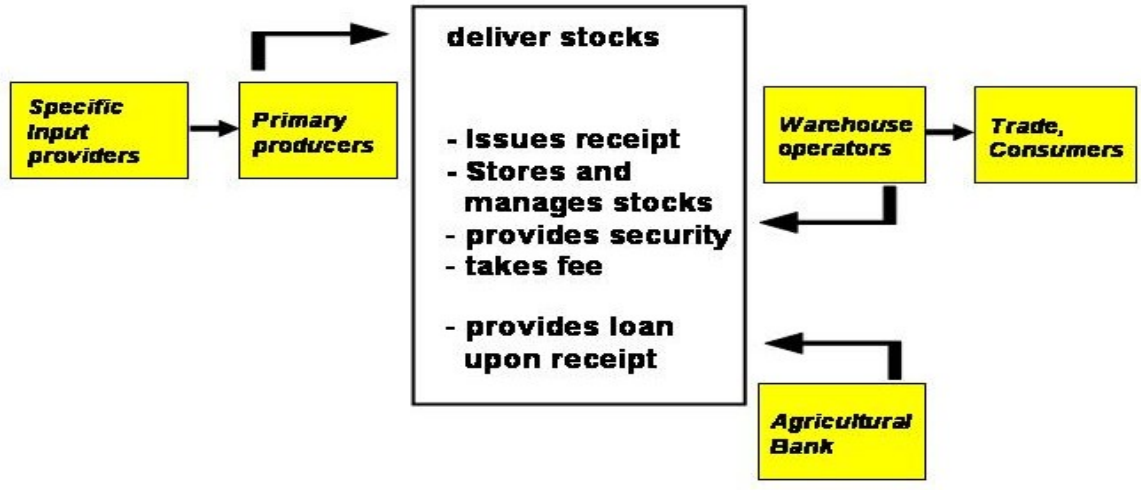
(c) Loans

- Services supplied by professional providers and funded as part of a loan (interlinked financial arrangement, also see module 8)

source: own compilation

One example is the ´warehouse receipt system´ that involves three partners, i.e. primary (agricultural) producers as service clients, warehouse operators and a financial service provider, such as an agricultural bank. Warehouse operators provide secure storage of products financed by fees that are deducted from the sales price. The agricultural bank provides inventory credit with the produce as collateral.

Box 7.12 Concept: The warehouse receipt system



source: own concept

Conditions for embedded service arrangements to work: Embedded services are closely tied up to important firms of the chain, especially input providers, banks, processors or traders who have the interest, capacity and funds to set up a service for their smaller

business partners and suppliers in the chain. Unless such firms exist, there are little chances of using this arrangement. The main incentive for firms to become engaged is the need to secure their own supply or sales. For this to be the case, market integration has to be strong.

Action to articulate service demand: As in the other private service arrangements, organizing service clients into associations often is an important aspect. Client organizations lower costs and enhance the possibilities to set up embedded services.

Action to create or strengthen embedded service arrangements: The main type of support action is the facilitation of the service arrangement, explaining advantages to partners, providing solutions and lowering the risk on both sides. Frequently, third parties have to be brought in. It is advisable to keep the primary business relationship and the service provision aspect apart, so that the division of tasks and the funding mechanism are transparent. As embedded services are tied up with companies, an important external intervention is the cooperation with the lead firm, e.g. as part of a public-private partnership.

Action to upgrade service supply: The most important action is the training of the operators who take up a new service function. An example is training of input dealers so that they become able to provide advice on the use of the input they sell (e.g. knowledge about the application of agrochemicals or the use of seed varieties). In the case of industrial buyers providing services or paying for them, action involves delivering the service know-how. Facilitators can support service provision with information and advisory materials.

Box 7.13 Case: Training in quality management for fish traders in Papua New Guinea

Point of departure: Trade in fresh fish in Morobe Province, Papua New Guinea

Fish trade in Papua New Guinea is usually done through middlemen, due to the small quantities traded by scattered villages. The buyers in the provincial capital Lae used to assess fish according to personal criteria, such as size, visual appearance, and market situation. No generally recognized quality criteria existed, on which pricing would be based. Supply was erratic. There was not enough ice for cooling and the potential of internal markets was not tapped. As buyers in Lae wanted to open new markets in the north of the country they needed fresh, high quality fish plus a reliable supply. However, it was difficult both for fishermen and intermediate traders to meet buyers´ demands in terms of quality and steady supply.

Embedded qualification services improving the marketing of fresh fish

The project “Promotion of Coastal Fisheries in Morobe province” builds private market infrastructure and services (supply of ice), supports the organization of fishermen and develops quality standards for fresh fish. Building the foundation of a transparent trading system, the project facilitated the development of a quality assessment system. With the help of specialists, traders and fishermen developed basic visual quality criteria for fish and agreed on a shared common criteria catalogue. Prices were categorized accordingly.

In order to introduce the new market regulation, practically all local traders had to be informed and trained. This service is made available in an embedded arrangement, linking service provision to the fish trade: Provincial buyers received an initial training and now act as service providers to local traders who, in turn, pass on the know-how to fishermen. In the first step, buyers train their suppliers in assessing the quality standards for fresh fish and provide information on production and transport requirements. On their part, traders give training to fishermen in improved practices according to the rules specified before and enable them to evaluate the quality and price of the fish right in the village. This arrangement is much cheaper than the organization of trainings for many scattered fishermen by an extension service. What´s more, the project contributes to a common understanding of quality, a higher level of transparency between traders, middlemen and fishing groups, efficient private input logistics, a steady supply of fish and above all, access to a new market – without building parallel structures. The transparent pricing agreement also helps to build trust between local traders and fishermen.

Source: Peter Jarchau, GTZ

Box 7.14 Case: Farm extension embedded in seed trade in West Africa

Inefficient input use is one of the bottlenecks in the production of small farmers in Western Ghana. Government extension coverage has always been insufficient and is decreasing further. No private extension for small-scale market-oriented farmers exists. Agricultural input dealers are one of the few sources for extension and market information left to farmers.

The project "Promotion of seed production and marketing in West Africa" worked on embedded production advice in cooperation with the International Fertilizer Development Cooperation (IFDC), an international NGO with links to the fertilizer industry. The objective was to build up a viable seed network in West African countries to improve quality seed production and marketing. At present twelve West African countries are members of the seed network. The project selected about 450 seed dealers, roughly half of all registered input dealers in the region. Together with the IFDC they were trained in business development, marketing, organisational development, product quality management, seed production and in how to give technical advice to their customers. The participants of the courses received a certificate of participation; compliance to determined criteria is inspected and if necessary the certificate is removed. Basic training was free of charge, whereas advanced courses have to be partially financed by the participants. The technical information provided, such as seed rate, sowing date, fertiliser and proper pesticide use, are standard national research recommendations. The combination of business development with embedded extension services for customers of agricultural inputs is rather unique: It helps input dealers to become more professional, to develop and maintain high quality products (seeds) and to increase their competitiveness compared to non-organised dealers.

Participating farmers get relevant extension information at the time of sale. They can choose the maize variety with a good yield level, get to know the main production and storage practices, and receive whom to sell it afterwards. With this embedded service, the seed dealer forges linkages with his/her clients, secures the market for certified seeds and knows more about the expectations of the clients. However, the standard recommendations of dealers may not always be optimal for the agro-climatic conditions of specific locations and dealers´ recommendations can be biased.

Source: Wolfgang Bertenbreiter, GTZ

Supporting service provision of business associations to their members

Organizing demand and supply of operational services within a producer association is a classical arrangement in the agricultural, rural and handicrafts subsectors with many small farmers and enterprises. In its simplest form, members of groups organize services in the form of mutual self-help. In a more formal sense, service provision means hiring specialized staff. In rural associations this often involves the formation of second-tier associations (federations of producer groups). Service are either paid for by membership fees and/or the proceeds of own business operations of the association, such as joint marketing or processing.

Conditions for association-based service arrangements: An obious condition is the existence of associations and business membership organizations within the chain, e.g. marketing cooperatives. Whether or not these associations are able to take over service functions depends on their size and the type of service. Market information can be provided more easily than technical support. Nevertheless, several hundred paying members are necessary to render service supply by associations economical.

Action to articulate service demand: Most producer associations are created for the very purpose of serving their members. Either service provision has already been the motive behind creating the association or the demand for services is latent and can easily be made transparent.

Action to create or strengthen the service arrangement: Supporting and facilitating the development of a service function for members implies the organizational development of the

association to provide services, clarifying financial and staff management issues. The support needed for association building as such is an issue in module 5 (see task 1).

Action to upgrade service supply: This is the key intervention area because the capacity of many producer associations to actually render services is trailing behind needs. Hence, facilitators invest into the qualification and training of association staff. The following box 7.15 provides an example that is representative for other associations as well.

Box 7.15 Case: Services of the sheep and goat breeders association in Morocco

The ´Association Nationale Ovine et Caprine´ of Morocco (ANOC)

ANOC is a private non profit organisation with 2500 members, most of them medium size sheep farmers. ANOC members are organised in 32 local groups and a total of six regional associations. A small central office is located in the capital, Rabat. ANOC members own 650,000 sheep equivalent to 4% of the national sheep herd. (All data refer to the year 2000.)

ANOC offers a comprehensive package of services to its members including vaccination and parasite treatment, selection and performance testing of animals, supply of animal feed and technical advice. The association has two categories of staff, (a) the honorary staff, elected by the members and (b) the 66 professional staff members recruited on the labour market and receiving a salary. Services are provided by the professional staff, of which eight work at the central level (ANOC head office), six are regional co-ordinators, and 52 are field staff. Each local group has their own field agents. Funding is provided by the own income of the association (63%), allocations by government and fees for services of local groups. Each group has its own bank account and pays a part of the field agents´ costs.

Service improvement approach of the GTZ/DLG Agriservice project "Strengthening the National Sheep and Goat Breeders Association":

The GTZ/DLG project contributed to the service provision capacity of ANOC at all levels: Capacity building at local (group) level included the clarification of the role and responsibilities of staff, the introduction of cost controlling and the self-organization of groups. Professional staff received training in the fields of communication and didactics, development planning and monitoring, as well as in technical subjects. At regional level, the support project introduced activity planning and performance indicators, established an electronic data base of members and field staff activities and set up a regional co-ordination committee. At central level, the project undertook an organisational review, contributed to the development of commercial activities (feed supply, organisation of animal shows, marketing etc.) and reviewed staff management instruments (performance bonus and social security).

Source: J. Heinkele: "Strengthening a breeders association in Morrocco" (mimeo, Eschborn, 2000)

(Task 7.3)
Improving the responsiveness of public service providers

In the course of value chain development, support services (box 7.8) need to be developed and adjusted to the upgrading needs. Many sector-specific support services can be funded by private contributions and fees - at least partially. However, under conditions of poverty and weak markets, government agencies and other public organizations are often the only providers. Even in well developed economies public service provision continues to be important.

Strengthening public services has always been a focal point for international technical assistance. Given the problems of capacity and accountability discussed earlier (see section 7.1) the task is to orientate public support service providers to the needs of the business community. There are two principal ways towards making public support services more responsive to the requirements of value chain upgrading:

- Introducing mixed funding and outsourcing of public services
- improving the capacity of service providers in public core functions

Mixed funding arrangements and outsourcing of public support services

Wherever services are directly related to the needs of the business community, support services should be provided by business associations or by privately funded technology and training institutes. Private providers are best placed to respond to the demands, especially if they are governed by value chain operators. A general observation is that business associations tend to provide both operational services for their members as well as support services for the wider community. Frequently, they can also count on public funding to perform this function, as in the case of ANOC (box 7.15). Hence, association-building is an important option developing support service provision.

However, many value chains are not organized into associations and have no common support organisations. If at all, support services are funded by government and provided by government-owned public service agencies. The classical example for this arrangement is the public agricultural extension service. The question is how the existing public support service providers can be strengthened and their services be directed towards the value chain and its upgrading needs. Moving away from the traditional arrangement of public funding / public provision involves two elements.

- One is to mobilize funds from clients and third parties to pay for the support services. This enhances the overall capacity and gives enterprises a say in the allocation and utilization of funds. Hence the incentives for service providers to perform are improved.
- The second element is transferring the provision of support services from public service organizations to others (private enterprises, associations, NGOs) who provide services on behalf of government and international donors. Privatizing service supply has the advantage that support services are publicly contracted and can be supervised closely.

Mixed funding and outsourcing of public services also are aspects of public sector reform policies. In many countries, budget allocations for public service providers are reduced and money is made available through competitive funds instead. There is increasing pressure on public service providers to develop new sources of funding. Changing public service provision can become part of economic development policy (see module 10).

There are different forms of funding and outsourcing arrangements. The mix of public and private elements depends on the type of support service, the possibilities of raising additional funds and the existence of alternative providers. Developing and introducing a more appropriate arrangement of public support service includes the following activities.

Action to articulate service demand: Enterprises have to understand in which way they are benefiting from the support services. As the joint upgrading vision and strategy evolves, the opportunities for collective action in the value chain increase. Facilitators can help to formulate common needs for support and the self-organisation of operators. Mandated members of the business community may join boards of service agencies to decide on topics and evaluate results. Their lobbying power can also be used to raise additional funds.

Action to create or strengthen the service arrangement: The first step in reforming public support service provision is to characterize the services that are delivered at present. The question is who and how many operators are benefiting and whether they are able to cover part of the cost. The mixed funding mechanism can be designed accordingly: Options for organizing private contributions include export levies, compulsory membership in industry associations, entrance fees at fairs and meetings, or voluntary contributions. Another possible action is to create competitive funds and tender the support services. Except for extremely marginal areas and markets, this will attract alternative service providers and help to expand overall capacity.

Action to upgrade service supply: An obvious intervention is the capacity development of public service providers, especially training of service staff. In a context of public sector reform this includes to change the legal status of agencies and enable them to raise and administer external funds. Generally, service agencies need to understand the value chain context and have to adjust their portfolio to the upgrading needs.

Box 7.16 contains an example for the private provision of publicly funded support services, in this case farmer training.

Box 7.16 Case: Privatizing farmer training in Kenya

The starting point

In the context of Kenyan reform policy, government is reducing the budget allocations to the state-owned Cooperative College of Kenya (COCK, see http://www.cooperative.ac.ke/). Forestalling total privatisation of COCK, a decision was made to privatize one of its main institutes, the Agribusiness Training Centre (ATC) as its commercial branch. ATC has own training facilities but only a small core staff. It works mainly with a pool of experienced trainers from outside the college who can speak the various vernacular languages of Kenya and receive standard rates for conducting courses. Its main products are training courses for market-oriented farmers and farmer groups in business orientation.

Currently, ATC is in the process of being registered as a private company (ATC Services Ltd). The establishment of a private training company required a business plan, a portfolio of attractive products, organizational flexibility to do training in remote places, and, most of all, enough paying customers from the start. The business model states public and development organizations as main clients. Participants may be asked to contribute a fee.

Supporting ATC through training product development

One way of supporting the privatized ATC is by developing training products. Several development agencies including Hanns Seidel Foundation, ACDI/VOCA Kenya and GTZ-PSDA contributed ready-made training products. One example is the 6 day course “Farming as a business” (FaaB), which has been introduced by GTZ and GfA. This course is now attended by about 1200 farmers per year. Contents include, among other things, farm economics, value-adding, group formation, accounting and marketing. The course includes a lesson plan and material for trainers as well as for trainees.

Supporting ATC through market development

The second support activity is the outsourcing of training activities by development agencies, in this case GTZ-PSDA. All associations supported by PSDA have to go through the 6 day FaaB-training thus securing ATC an important market. The presence of other trainees (extension staff) at the trainings enhances the outreach and makes follow-up easier.

Source: M. Braun and PSDA Kenya, GTZ, and ATC Kenya website, http://www.atc.co.ke/.

Strengthening service capacity in core functions of government

Most public support services offer a potential for mixed funding and outsourcing, especially when revenues are growing as a result of chain upgrading. However, some key support services have the character of common goods that are relevant for society at large, especially product safety testing and the supervision of environmental and workplace safety. Other services, such as technology development and export promotion are closely related to the general public interest in economic advancement. Although there is no clear demarcation between the different service categories, it is clear that a number of core functions will stay in the domain of government. As in the case of the other service categories, these core services need to be focused towards the development of value chains. The minimum requirement is a service attitude of public agencies and the appropriate equipment, procedures and staff qualification to perform the function.

Action to articulate service demand: In this case, the demand for services is as much political as it is private. Decision makers will come to realize the importance of the service if they understand its connection with economic progress. The main activity is to raise awareness and explain.

Action to create or strengthen the service arrangement: An important element is to define the core functions of government in the provision of support services. This is most easily achieved in a context of public sector reform and transformation which would also have to include securing sufficient budget allocations.

Action to upgrade service supply: Once the institutional set-up is clarified, external facilitators have a key role in building the capacity of the public agency concerned. Capacity and quality of service can be built by

- twinning the agency with similar institutes from advanced countries
- providing staff training (long-term and on-the-job training)
- financing the equipment of public laboratory capacities.
- Facilitation of technology transfer

The following box provides the example of an approach to build government service capacity in Central Asia. It stands for similar activities in other transformation economies.

Box 7.17 Case: Building quality testing capacity for export certificates, Central Asia

Point of departure

Value chain promotion in several Central Asian countries (Azerbaijan, Kyrgyz Republic, Tajikistan) is facing the problem of missing recognition of national export certificates. The missing link is the outdated laboratory capacity for conformity and residual testing. For example, before export honey to the European Union, samples of each consignment have to be sent to Moscow or to accredited Western European laboratories - a very time consuming and costly procedure. Another example is the absence of meat inspection services in some transformation countries such as the Kyrgyz Republic which not only causes a threat for urban consumers but also blocks fresh meat exports.

Developing public service capacity

Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan are currently building the Central Asian initiative „Cooperation on Meteorology, Accreditation, Standardization and Quality" (CAC-MAS-Q), a regional system for quality certification. In this context, the governments concerned are exploring the possibility of setting up a regional laboratory for conformity testing. The agreement includes activities to create reference laboratories at regional level, establish links between the quality and standards authorities of the four countries, and exchange know-how and technology between national laboratories in each country. Since this initiative is new, practical results are not yet available.

Source: Wilhelm Elfring

(Task 7.4) Strategic use of temporary support services

The improvement of value chain services in a poverty context often faces the general problem of an extended “service vacuum”. After governments have withdrawn from service provision, there are simply not enough offers around to even think of building on the existing service providers and agencies to support chain upgrading.

In the absence of public and/or private service providers, external facilitators of chain development (international development programmes in particular) often decide to fund and even provide services themselves. Services are being offered at reduced market rates or even for free to chain operators substituting a missing function in the value chain. Substitute services can easily get into conflict with the definition of roles in economic development discussed in module 3 (point 3.1). The critical risk is obvious and well known to every development practitioner: Substituting the genuine functions of enterprises, business associations or government

- is inefficient, as money is being spent on services that might as well be funded otherwise
- distorts market relations crowding out private service providers and private investment
- creates an impression of economic progress (“white elephants”) whilst the success may simply be the result of external subsidies
- is not economically viable.

Strategic use and phasing out of external services

Nevertheless, by their very nature external facilitators are service providers as well. Hence, it may not always be clear how best to differentiate between temporary external services on one side - and the permanent operational and support (!) services required for the long-term functioning of the value chain. The point can only be clarified by making the criteria transparent with which external facilitators justify the provision of services to value chain actors. External services that are not considered to be substitute services would have to fulfil one or several of the following criteria. Services should

- be designed as temporary facilitation (such as confidence building via round table meetings)
- have the characteristics of a public investment into economic development jump-starting value chain upgrading, e.g. technology development, export intelligence and promotion, or assistance in association building
- be of a pilot nature, e.g. demonstrating new technologies and business models

It is clear that these services should benefit all chain operators alike so as to avoid market distortion. The only exception to this rule may be the investment into the grouping of small producers, the quality certification of small producer groups, and the facilitation of linkages with lead firms. These activities may be regarded as public investment into equal opportunities and pro-poor aspects of economic growth.

As it stands, the criteria describe some of the support service categories listed in box 7.8. The difference is that the long-term economic development of chains also needs permanent support services, while the external promotion always has a limited time horizon. Form this follows the principle that any external service provision needs a clear exit strategy. There has to be a practical scenario of the situation at the end of external programme funding anticipating and preparing the chain supporters who are to take over the support service function.

Strictly, external service providers do NOT provide operational services of any kind. The cost of operational services along the chain is part of the production cost and definitely has to be covered by the revenue generated.

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Weblinks

Donor Committee on enterprise development: www.bdsknowledge.org

Springfield Centre, Durham, GB, focusing on BDS market development: www.springfieldcentre.com

Annex

Relevant tools in www.gtz.de/agriservice:

- **Actor/Function Grid**: Clarification of roles and functions of various service providers in the public and/or private sectors.
- **Defining the role of the State in public service provision** Checklist for inventorising the public sector as well as approaches to improvement and delivery of public services.
- **Service Interaction Analysis (SIA)**: Clarification of service delivery interactions and problem analysis of complex service delivery networks.
- **Power and Interest Analysis (PIA):** Analysis of institutional arrangements in relation to distribution of power and interests, e.g. to determine the chances of achieving goals
- **Analysis of service organisations**: Analysis of service organisations, with special attention given to the management of organisations in the service delivery sector.
- **Systemic Integration Management (SIM)**: Holistic system development and implementation, with the dimensions of the actors, communication, culture and vision.
- **Assessing the costs and benefits of transforming advisory service delivery:** Analytical tool, yields economic parameters concerning economy of service provision, investments to be undertaken, arrangements for cost sharing, determining models of cost recovery, defining appropriate role for the government actors in service delivery.
- **Benchmarking in Service Provision**: Identification of deficits in the quality of service delivery and possible solutions by comparison with other organisations or enterprises.
- **Governance Mechanisms in Service Provision**: Analysis of the institutional arrangements of service providers.
- **Rapid Result Approach**: Help for people in leadership positions to head and motivate teams. Achievement of the aim is constantly accompanied by a learning process.
- **Scenario Technique:** Strategic planning by scenario development.
- **Characteristics of customer-driven organisations (self-test)**
  Self-evaluation of client orientation in the context of change processes in organisations and societies.
- **Determining Training Requirements for Upgrading Production Chains**:
  Systematic development of training modules and standards in Good Agricultural Practices and Good Processing Practices.
- **Charging Users for Public Service Provision**:
  Checklist for identifying the 11 key areas for delivering services. These should be considered before a payment system is introduced.

ValueLinks Module 9



Introducing Social, Ecological and Product Quality Standards

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ValueLinks Module 9

Introducing Social, Ecological and Product Quality Standards

What this module is about

Improving final product and process quality is one of the most important strategic objectives in value chain upgrading (see *ValueLinks* Module 3, Task 3.1). Its importance is driven by rising demand for high-value products and growing concern for the environmental and social impacts of production and trade. In the context of economic globalisation, quality is increasingly defined in a holistic manner, comprising not only the intrinsic quality attributes of a product (e.g. its size, shape, colour or taste and the absence of damage), but also its characteristics related to the production process. International sourcing, growing urbanisation and changing consumer behaviour are all inducing changes in developing countries' markets as well.

This has implications for value chain development in low-income countries as well as in emerging and transition economies. A key challenge is compliance with current legal, trade and industry standards in the US, Europe and some emerging markets. Unless exporting countries are able to adopt and implement the required standards effectively, their export opportunities will be increasingly diminished. Often, the challenge is to integrate small-scale farmers and micro-entrepreneurs into global value chains as competitive and reliable partners.

At the same time, quality improvement and certification can be actively used to achieve a competitive edge. Markets reward high-quality products with better market access and higher prices. Hence, quality improvement is part of a strategy of product differentiation.

Another important aspect is the fact that promoting environmental and social standards has become a development strategy which is itself shaping the course of globalisation. The facilitation of standards initiatives represents a powerful instrument that can foster environmentally and socially acceptable (i.e. pro-poor) growth.

As in the preceding *ValueLinks* modules treating implementation aspects, the focus here is on how to promote value chain upgrading, in this case by developing and implementing standards, and by building quality assurance schemes as well as verification systems and mechanisms.

Tasks introducing standards

Based on an overview on the world of standards, this module provides know-how on the action required to upgrade quality systems in value chains. This includes interventions at the macro and meso levels in the first place, i.e. the agreement between operators, public interest groups and government on standards and legal regulations. Once a standard has been defined, the second task is to implement it. Production and product quality will only improve if chain operators and service providers are able to actually apply the necessary technology and procedures. Therefore, upgrading is required in the fields of enterprise capacity, quality infrastructure, quality-related services, and the collaboration along the value chain. Finally, it has to be made sure that *all* parties play by the rules. This is achieved by a standard verification system. Accordingly, the main tasks of value chain facilitators relate to

- (Task 9.1) Facilitating the development of social, ecological and product quality standards and the adaptation of product (especially food) safety standards
- (Task 9.2) Accompanying the implementation of standards and building the capacity of quality management in value chains

- (Task 9.3) Developing the capacity for the verification of standards, i.e. institutions for quality control, certification and accreditation

In the following, “introducing standards” will be used as a general term comprising standard development, standard implementation and the building of verification systems.

Basic considerations: The world of standards

The quality of a product has two basic dimensions: One is its intrinsic attributes, i.e. aspects that become apparent by examining a product sample. The other dimension is its non-material, ethical value which refers to the origin of the product and the conditions under which it was made and traded (see the table in box 9.1).

From a development policy point of view, the ethical aspects of production are particularly important. There is a growing public consensus that production technology should not harm the environment or destroy resources, that labourers be treated fairly and children kept out of commercial business. While ethical aspects are clearly in the public interest, the safety for consumption of a product is in both the public and the private interest.

While the practical value of a product can be assessed by consumers, the non-material and safety characteristics of a product often are invisible. Substantiating them requires process supervision, laboratory testing and social and environmental management systems. Hence, visible attributes can be regulated through quality grades, while safety and ethical aspects need specific and far more demanding standards. Box 9.1 classifies important categories of product quality and relates them three basic types of standards (see below).

Box 9.1 Concept: Overview of terms related to product quality and standards

<table>
<tr><th colspan="4">Aspects characterizing standards</th></tr>
<tr><td>Type of product quality</td><td colspan="2">Material (extrinsic and intrinsic) quality</td><td>Non-material quality</td></tr>
<tr><td>Public or private interest in product quality</td><td>private interest</td><td>private and public interest</td><td>public interest</td></tr>
<tr><td>Type of quality concern</td><td>Practical value, transparency</td><td>Safety for consumption</td><td>Ethical aspects</td></tr>
<tr><td>Type of standards</td><td>Quality grades enhancing market transparency</td><td>Safety standards</td><td>Ecological and social standards</td></tr>
<tr><td rowspan="2">Reference to the process or to the product</td><td colspan="2">------ Product standards ------</td><td></td></tr>
<tr><td></td><td colspan="2">------ Process standards ------</td></tr>
</table>

Source: own compilation. Also see the *ValueLinks* glossary

The table in box 9.1 classifies three main types of standards (the shaded row) in terms of four aspects characterizing them. Standards may be material or immaterial, serve the interest of private operators or the public, refer to different technical or ethical concerns, or refer to products or the process of making it.

Standards are a means of defining and regulating product quality by specifying the characteristics which a product or the process of making it must have. This regards intrinsic as well as ethical attributes.

Process or production standards specify the characteristics of the production process. Product standards specify the characteristics of the product. Social and Ecological standards are process standards whereas food safety standards are a combination of process and product standards. Another distinction of standards (mandatory / voluntary) is given in box 9.2.

Box 9.2 Concept: Definition of different types of standards

- *Mandatory standards* are set by governments in the form of regulations, including technical requirements such as testing, certification, labelling etc.; enforced by liability rules in case of non-compliance. In the case of mandatory standards, only standardized products are allowed to circulate in the market, whereas in the case of voluntary standards even those products not meeting the standard can be supplied
- *Voluntary standards* are set through formal coordinated approaches of key stakeholders in the value chain (e.g. business associations, companies, NGO). Such standard initiatives most often foresee an independent third party verification. Sometimes standards or codes of conducts are developed and their conformity assessed by individual companies.

Source: World Development Report 2005

A separate category of standards are the generic management standards, which are applicable independent of the respective product or process, e.g. Quality Assurance Systems like ISO 9000, Environmental Management Systems like ISO 14000 or SA 8000 of Social Accountability International (SAI). [1]

Standards play an important role in the transaction of goods on their way from the producer to the final consumer. With many products, buyers suffer from “information asymmetry”, which means that the producers know more about the product than traders, and traders more than consumers. If duly implemented, standards resolve this problem providing everyone with reliable information on the product characteristics. They reduce costs of buyers and consumers by delegating quality control to specialized verification agencies. Vertical contracting between business partners becomes easier if both sides can refer to - and rely on - commonly accepted grades and standards.

The introduction of standards provides an incentive for more sustainable production and consumption patterns on a worldwide scale. However, the growing concern for product quality and social and environmental issues has led to an ever expanding and sometimes confusing list of standards and regulations. Box 9.3 tries to organize the multitude of standards according to the major types of standards, and the levels at which they are set. This table concentrates on the food sector (albeit not exclusively) as this industry has the greatest number of individual standards.

At the highest level are rules for standard setting at the multilateral level. The World Trade Organization (WTO) established the “Agreement on Technical Barriers to Trade” (TBT) and the “Agreement on the Application of Sanitary and Phytosanitary Measures” (SPS), both in view of preventing the misuse of national standards as a means of restricting and controlling international trade. In the food sector, international standards are provided by the Codex Alimentarius Commission (CAC), the World Organsation for Animal Health (OIE) and the International Plant Protection Convention (IPPC). These standards are internationally recognised as benchmarks and thus serve as basis for the development of both public and private standards worldwide, facilitating global trade. In the field of social standards reference is made to the core labour standards and of the International Labour Organisation (ILO)

The next level presents legal regulations of commercial activities set by supranational institutions (EU) level or by national Governments. The classical case is the food legislation reducing the supply of unsafe products. These are mandatory standards binding the food business. Some legal standards are limited to particular markets and only are relevant for

[1] Please find a list of all abbreviations at the end of the document

those enterprises operating in them. The case in point in the food sector is organic production.

Finally, the private sector is an important source of standards, too. Industry standards are developed to comply with regulatory provisions and to respond to public debate and consumer preferences. Therefore, these standards are often developed in collaboration with consumer organizations and NGOs representing public concerns. They help to position enterprises in superior markets, and to defend their collective interest against low-value competitors. Even if the industry standards are not binding from a legislative point of view, they become an obligation for suppliers who want to keep and increase market shares, both in their domestic markets and in supplying to global value chains. Within a particular industry, individual companies come up with their own quality standards and product specifications. Here, the issue is to obtain an advantage over competitors operating in the same markets. Establishing company- and product-specific labels serves to differentiate market segments in the first place, even if they refer to public good issues.

Box 9.3 Overview of different types of standards – illustrated with examples of the agriculture and food sector

Type of market regulation			***Types of standards (examples referring to the food sector)***		
Level of market regulation	**public or private**	**mandatory or voluntary**	**Product quality standards**	**Product safety standards**	**Social and ecological standards**
supranational: WTO guidelines	public / legal	mandatory, for WTO members	Technical Barriers to Trade (TBT) Agreement	Sanitary and Phytosanitary Measures (SPS Agreement)	Core Labour Standards of the ILO International Conventions in the case of environmental standards
supranational: WTO recognized standards	public / legal	mandatory, for WTO members	(CAC, OIE, IPPC)	CAC, OIE, IPPC	
multilateral/ national: Legislation regulating commercial activities	public / legal	mandatory	COM (EU) Marketing Standards (Regulation 2200/96/EC ex 1035/72/EEC)	EU food law (EC 178/2002) and national food laws – principles: traceability, liability, due diligence, GAP, GMP, HACCP	National environmental laws, National labour laws
multilateral/ national: market-specific regulations	public / legal	voluntary, binding for mar-ket participants	EU Council Regulation No 2092/91/EEC of 24 June 1991 on organic production	./.	EU Council Regulation No 2092/91/EEC of 24 June 1991 on organic production
industry (sub)sector: collective regulations of company groups and networks	private	voluntary	./.	GFSI recognized standards: post-farm gate: BRC, Dutch HACCP, IFS, SQF 2000; pre-farm gate: SQF 1000 others: EurepGAP, FPA-SAFE (US), QS (Germany), GAP, GMP, GDP, GRP, ISO 22000	EurepGAP, FSC, MSC,ETI, 4C, FLO Global Compact
company individual regulations	private	voluntary	product specifications	food safety specifications (based on HACCP)	Code of conduct / Policies on corporate social responsibility (CSR)

Source: own concept, for abbreviations see the list at the end of this module

(Task 9.1) Facilitating the development of standards

The first task introducing standards is to develop or adjust a standard. The following text is structured according to the types of standards as classified in boxes 9.1 and 9.3 - product quality standards, food safety standards and, finally, social and ecological standards.

Developing new product quality standards

Developing and implementing a new product quality standard is part of a chain upgrading strategy that aims at penetrating new markets by quality improvement and branding. The product standard provides a guideline (a common code of conduct) for all operators along the value chain. It helps to ensure final product quality, enhances market transparency and provides a new selling point. The effort to establish a common quality standard benefits all operators. It is particularly useful in the case of small agricultural and handicraft producers who can only improve their market position by acting jointly. Box 9.4 presents the example of a product quality standard for "Nepal Orthodox Tea".

Box 9.4 Case: Code of Conduct for Orthodox Tea Producers and Exporters of Nepal

Situation:

With an average of 1,500 tons, Nepali Orthodox Tea (OT) makes up 15% of the total volume of Nepali tea production (10,000 tons p.a.). About 5,600 smallholders account for two thirds of the OT production. As a high quality product, the tea has a good market potential. However, the export marketing channels are extremely weak with large quantities passing through Indian blenders and brokers.

The VC stakeholders share the *vision* to develop a niche for Nepali Orthodox Tea in the international market aimed at obtaining premium prices 30% above average and expanding direct exports from 200 tons to 600 tons p.a. while guaranteeing fair trade conditions for smallholder farmers.

Support measures

- organizational development:
  facilitating association and cooperative building and joint export marketing by producers;
- marketing support:
  developing a brand strategy, facilitating participation in trade fairs, linking with importers;
- quality management:
  introducing a code of conduct and improving production systems,
- accompanying services:
  facilitating microfinance services to foster private investments in smallholder plantations.

Code of Conduct for Orthodox Tea Producers and Exporters of Nepal

An agreement on a joint Code of Conduct (CoC) was reached after Nepali tea exporters understood that they have a common interest with smallholder producers in responding to target market demand. The Code is an initiative of the "Himalayan Tea Producers Cooperative" formed by 13 (out of a total of 15) factories blending Orthodox Tea. The Code regulates production, processing and standards on worker health and safety. GTZ provides technical assistance to the members of the Cooperative to establish embedded services for farmers. The CoC has become the basis for the success of the new trademark "Nepal Tea", which is being used for joint export promotion. To ensure compliance with the Code, only exporters who have signed and are implementing the COC are allowed to use the "Nepal Tea" logo.

Source: PSP-RUFIN project, GTZ Nepal

Standards are useful for joint marketing to the extent that they reflect market preferences. They also need to have the right level of ambition to be applied.

Developing or adapting food safety standards

The importance of food safety standards

Among the different quality aspects listed in box 9.1, the safety for consumption probably has the greatest implications for trade and economic development: Food-related diseases can ensue great human and economic losses. To fend off these hazards both the legislator and private retail trade and industry set standards for food safety. At international level, the WTO provides the legal framework for setting national food safety standards in the "Agreement on Sanitary and Phytosanitary Measures" (SPS agreement). For all technical aspects the SPS Agreement refers to the international food safety norms of the joint FAO/WHO Codex Alimentarius Commission. In the world's leading import markets (USA, EU, Japan) the legal requirements for food safety become more and more demanding.

At the same time, supermarket chains and multinational companies submit suppliers to strict private standards. Their interest is to avoid food hazards jeopardizing their reputation and market shares. Retailers and the food industry have taken on board the lessons learned in numerous food scandals in recent years, such as the BSE crisis. The most important private food safety and quality standard in Europe, EurepGAP, is dominating the market for fresh produce.

Compliance with food laws and private standards, therefore, is crucial for any food producer and exporter. As many pro-poor growth opportunities are in fact in agricultural and horticultural production, compliance with food laws and private safety standards is also an important issue in chain upgrading strategies. It should be noted though, that food safety standards are not specific to particular value chains. However, they include technical guidelines specifying the quality of particular products, e.g. milk or meat.

Food safety means freedom of dangerous residues, microbial pathogens, parasites or adulterants. To avoid contamination, hazards should be prevented at any stage of the value chain, with every operator assuming responsibility. The principles of the new EU Food Law[2] perfectly depict this holistic approach. Many stakeholders see the new European Union (EU) food law as a state-of-the-art model pointing the way ahead in food safety legislation.

Box 9.5 Concept: The European Food Law

The EU food law stipulates that "unsafe food shall not be placed on the market". Its safety concept builds on three pillars:

- self control of the industry;
- risk based public control;
- consumer information.

The principles of the EU food law are as follows:

- *farm to table approach*
  controlling risks and assuring food safety along the entire value chain;
- *self-control systems*
  food operators having primary responsibility for food safety;
- *traceability*
  defining the capacity of the operators to follow the product/ procedures at least one step upstream and one step downstream from their position in the VC;
- *Good Practices*
  including Good Agriculture Practices (GAP), Good Hygiene Practices (GHP), Good Manufacturing Practices (GMP) and Good Distribution Practices (GDP).

Source: Margret Will / Doris Guenther (2007)

[2] Regulation (EC) No. 178/2002 of the European Parliament and of the Council of 28 January 2002 laying down the general principles and requirements of food law, establishing the European Food Safety Authority and laying down procedures in matters of food safety

The EurepGAP standard is a private regulation of food safety. It has been developed by leading European retailers to respond to the crises in consumer confidence following the BSE cow disease and other events. Because of its presence in the retail market for fresh produce, EurepGAP is of great importance to agricultural exporters from outside the EU.

Box 9.6 Concept: The EurepGAP standard

EurepGAP is the abbreviation of the "European Retailer Produce Working Group on Good Agricultural Practices", representing the leading food retailers in Europe (such as Tesco in the UK or Metro in Germany) with a market share of around 60%. Together these retailers have established a (private) process and product standard for fresh fruits, vegetables, potatoes, green coffee, livestock, aquaculture, flowers and ornamentals.

The standard regulates agricultural production ("pre-farm gate"), but not the packing, processing and transport of the products. To this end, members have agreed upon normative documents specifying "Control Points and Compliance Criteria" and "General Regulations" that describe the process of certification and the specific auditor requirements at farm level.

For detailed information on the standard, see www.eurepgap.com

Source: own compilation

Potential interventions to support agricultural producers in complying with the EurepGAP standard are treated in section 9.3 of this module.

Adaptation and application of food safety standards

In the case of food safety, the issue is not so much the development of entirely new standards but the creation or adaptation of national regulations to conform to laws important for international trade. Food products exported to the European Union must comply with relevant requirements of the EU Food Law or equivalent standards in the US and other countries. Not least, food safety also is a concern in the domestic market and certainly not only for commercial reasons. Hence, a performing national food safety system is a prerequisite for any market-oriented agricultural development. However, the legal and institutional framework in many countries is weak with overlapping mandates, insufficient regulations as well as deficiencies in the human and financial capacity of the organizations mandated with legal regulations and enforcement. In the following, "developing" food safety standards is understood as the adaptation of international, especially EU rules and the creation of the appropriate institutions needed in a food safety system.

According to the relevant FAO/WHO publication, establishing a national food safety system should consist of the "building blocks" listed in box 9.7.

Box 9.7 Concept: National food safety system

Building blocks of food safety system (FAO/WHO: "Assuring food safety and quality"):

- Food law and regulations
- Food control management
- Inspection services
- Laboratory services: Food monitoring and epidemiological data
- Information, communication, education and training

Further information and know-how on appropriate institutional solutions can be found on the FAO website

Source: www.fao.int/foodsafety/en

Every country wishing to export food into the EU has to establish so-called ´Competent Authorities´ as the official government agency having jurisdiction over food safety. Competent Authorities are recognised by the EU as responsible for performing the duties arising from food control requirements, such as monitoring, controlling, approving food processing enterprises and issuing health compliance certificates.

A case in point for the strengthening of a national food safety system is the PIAQ programme in Morocco that aims at standardizing and simplifying food safety management and control (box 9.8).

Box 9.8 Case: Integrated Programme for Quality Improvement[3)] (PIAQ) in Morocco

In a view to strengthening the competitiveness of the Moroccan agro-industrial sector on domestic and export markets, public and private actors joined forces to design and implement an integrated "Programme for Quality Improvement" (PIAQ), based on the ISO 9000 and HACCP principles. The programme was supported by the Federal Ministry for Economic Cooperation and Development (BMZ) and implemented by GTZ and DLG Agriservice.

In the PIAQ program, the Moroccan Ministry of Agriculture, Ministry of Trade, national export quality control laboratories, the agro-industrial business federation and a consumer association agreed on a joint effort to introduce a standardized quality management and control system and promote the own responsibility of food industry companies. This included the following actions:

- elaboration of a *reference manual* to harmonize the approach towards hygiene and quality management in the agro-processing industry;
- submission of the PIAQ reference manual to the national competent authorities for recognition as national reference (national recognition achieved on 25th January 2006);
- analysis and selection of pilot companies according to criteria such as company performance and export potential;
- implementation of trainings/ company advice to introduce the PIAQ scheme (18 to 24 months according to capacities, human resources and commitment of the management);
- assistance to public administration to elaborate a harmonized, streamlined and thus more efficient safety and quality control and advisory system for food;
- elaboration of guidelines for company audits carried out by the agents of different administrative entities;
- coaching of agents carrying out audits in companies implementing PIAQ or equal quality management systems in conformity with PIAQ requirements;
- elaboration of a concept for the replication of the quality management system throughout the food sector in conformity with PIAQ requirements.

Source: adapted from Will/Günther, 2007

Food safety in international trade is subject to WTO rules. Following the introduction of new food laws in import countries, many suppliers in developing countries suddenly face unforeseen and sometimes serious problems. Value chain operators often have difficulties in accessing country specific and/or product specific information and fail to obtain a national compliance certificate. They also lack a forum where they can submit their concerns related to standards. In order to avoid unjustified trade barriers, the WTO obliges its members to communicate both changes in existing legislation and new laws *before* they enter into force.

WTO requires that national Notification Authorities and Enquiry Points (SPS and TBT Enquiry Points) are created, which channel information on changes in food standards affecting trade. When properly operated, these entities provide early information giving the food sector more time to make necessary adjustments. Moreover, an Enquiry Point can help organising stakeholders to engage in the standard setting process in the respective country. If producers or exporters consider the measure in question inadequate, the government can send a comment to the notifying WTO member. It may ask for modifications, for a longer transition period or for technical assistance. As a last resort the government can challenge the measure. Ideally, Enquiry Points are useful not only in facilitating trade but also in their role in strengthening the national food safety system.

[3] Programme Intégré d'Amélioration de la Qualité

However, these public services are often weak or out of reach for most operators in the food chain. Hence, another field of intervention is the building and strengthening of Enquiry Points. Box 9.9 provides and example from Azerbaijan.

Box 9.9 Case: Building an Enquiry Point in Azerbaijan

Situation

The Republic of Azerbaijan submitted an application for membership in the WTO in June 1997. One of its commitments in this context is to bring its system of SPS in compliance with the WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement). An inventory of the legislation relevant to the SPS Agreement and analyses of the level of compliance with the SPS Agreement have been prepared. EU-TACIS (Technical Assistance for the Commonwealth of Independent States) carries out several projects relating to the reform of the legislation of Azerbaijan, including SPS-relevant legislation, as part of the "Support for the implementation of the Partnership and Cooperation Agreement (PCA) between the EU and Azerbaijan".

Support Measures

To supplement the work carried out on reforming legislation, the GTZ, in close collaboration with the German Ministry for Food, Agriculture, and Consumer Protection provides a practical training for Azerbaijani technical staff. The main goal is to make the National Notification Authority and Enquiry Point fully operational, so that they are able to

- evaluate notifications of important trading partners on a regular basis
- procure full texts of notified measures
- provide information on mandatory SPS-requirements to interested parties
- initiate a national dialogue with relevant stakeholders in order to evaluate the effects of the notified measures
- comment on measures they disagree with
- bring trade concerns to the attention of the SPS or TBT committee of the WTO
- look for alliances with other WTO members
- inform about new developments regarding certification to private standards (e.g. EurepGAP, IFS, BRC, etc.)

Source: own compilation

Developing social and ecological standards

Social and ecological standards have an ethical dimension in the first place. Developing and implementing new standards has an impact on the ecological and social conditions of production and trade and therefore are directly relevant for poor producers. Yet, ecological, and, to some extent, social standards can also be of commercial interest by differentiating products and winning new, critical consumers.

From a development policy point of view, the key question is outreach - the market share of a product standard. Hence, developing a new standard requires including as many stakeholders as possible, companies and civil society organizations likewise. Naturally, the higher the demands on social and ecological criteria the fewer chain actors will join in.

The numerous coffee standards provide a case in point: The coffee standards set by the Rainforest Alliance, Utz Kapeh or the Smithsonian Institute (for “bird-friendly” shade grown coffee) are much more restrictive than the 4C standard for sustainable coffee production (see box 9.11 for the 4C coffee initiative). For example, the Smithsonian “bird-friendly” standard specifies particular shade tree species. Although the market for specialty coffee has been growing at impressive rates, labelled shade-grown coffee still has a market share of below 0,1% of the global coffee market, almost exclusively restricted to the USA. Conversely, developing a less strict sustainability standard for the mainstream coffee market has the potential to cover the entire market and may eventually become an international industry

standard. This offers advantages: Entry barriers for small-scale producers and other small scale chain operators tend to be lower compared to more demanding "niche" standards for specialties, such as the "bird-friendly" coffee. As large volumes of trade are affected, the impact is more broad-based.

Box 9.10 lists some selected social and ecological standards. Generally, it can be observed that ambitious standards with a small market share use an end-consumer label promoting sales. They differentiate the final market. Conversely, standards conceived as sustainability standards for the whole industry refrain from labelling. Here, the idea is a business-to-business standard serving the generic industry interests to enhance the supply base - and a common public-private interest in the development of the sector at large.

Besides the product and commodity standards that are directly relevant to value chain upgrading, there are also generic social standards cutting across economic sectors (see the social codes of conduct in the second part of the list in box 9.10). These standards build on the ILO core labour norms and other international conventions. They are set by initiatives of international companies, often in collaboration with NGOs and trade unions – in response to the international debate about the little respect for labour rights and human rights in many supplying countries. Social codes of conduct are business to business (B2B) standards and do not entail labelling. This is because full compliance with the standard along the value chain is often hard to guarantee. Instead, member companies commit themselves to continuously improve labour conditions of their suppliers.

Box 9.10 Examples of social and ecological standard initiatives and labels

Selected standards with end-consumer labels

- *not product specific*: Fair Trade Labels (see www.fairtrade.net)
- *Wood and Furniture*: FSC standard - Forest Stewardship Council (www.fsc.org/en/)
- *Flowers*: Flower label program (www.fairflowers.de/) (in line with the international code of conduct for the production of cut flowers)
- *Cotton apparel*: Cotton Made in Africa Initiative (www.cottonmadeinafrica.org/)
- *Carpets*: Rugmark label – Rugmark Initiative (www.rugmark.de)
- *Organic products* – European and other ecolabels

For information on other product standards, see www.buyerbefair.org or www.label-online.de (in German)

Selected standards without end-consumer labels / business to business initiatives

- 4C Code of Conduct - Common Code for the Coffee Community (www.sustainable-coffee.net)
- Code of Conduct for Responsible Fisheries - FAO http://www.fao.org
- BSCI Code of Conduct - Business Social Compliance Initiative (www.bsci-eu.org)
- ETI Base Code - Ethical Trading Initiative (www.ethicaltrade.org)
- Workplace Code of Conduct - Fair Labour Association (FLA) (www.fairlabour.org)

Source: own compilation

The development of new standards demands close cooperation between all relevant stakeholders. Virtually all important ecological and social standards are developed by companies and business associations together with civil society organisations such as environmental and human rights advocacy groups, and trade unions. The collaboration is not only necessary to negotiate a consensus and obtain legitimacy; it also serves the individual interests of participants. Many transnational and national companies demonstrate their commitment to Corporate Social Responsibility by actively participating in multi-stakeholder fora. Civil society organizations and advocacy groups promote their cause exercising influence on private companies.

Public facilitators of chain upgrading in national government, donor organisations and UN agencies have their role in organizing discussion fora and promoting multi-stakeholder initiatives.

Initiating a self-sustaining process of standards development and introduction should follow three basic principles:

- *using a systems (value chain) perspective*
  encompassing the entire value chain (input suppliers, farmers, traders, processors, exporters, retailers as well as consumer groups);
- *assuring competent representation of civil society actors*
- *following a participatory approach*
  integrating as many actors of the value chain or the sector in question as possible;
- *operating bottom-up and top-down at the same time*
  integrating a critical mass of innovative companies willing and capable of developing a standard (bottom-up) and supporting public awareness creation (top-down).

Box 9.11 provides general information on the ISEAL approach to developing standards, applicable to different types of standards that address social and environmental practices. It constitutes a code of good practice in itself.

Box 9.11 Template: Procedures for developing standards according to ISEAL

The International Social and Environmental Accreditation and Labelling Alliance (ISEAL) has developed a Code of Good Practice for Setting Social and Environmental Standards - with assistance from BMZ/GTZ. The code specifies requirements for the preparation, adoption and revision of standards that promote progressive social and environmental practices. It contains regulations on

- Procedures for the development of standards
- Effectiveness, relevance and international harmonization of standards
- Participation in the standards development process

"Compliance with the code means that the process by which a standard is developed is credible" (ISEAT code of practice, page 2), see www.isealalliance.org

Source: own compilation

Development organisations and public actors can support multi-stakeholder standard initiatives with the following activities:

(a) Facilitating the development of a standard or code of conduct:

This can include

- providing technical inputs and advice on relevant conventions, laws and regulations and providing financial support for meetings and the acquisition of know-how
- obtaining and strengthening the commitment of stakeholders and creating trust
- facilitating the process and the negotiations between participants, in line with the ISEAL code (see box 9.10)
- developing and implementing a communication strategy to inform the public.

(b) *Facilitating the participation of disadvantaged groups in the negotiation phase such as representatives of small-scale producer organisations and civil society representatives*

This includes training weaker stakeholders. An example is the *Forest Stewardship Council* (FSC) that meets every three years in a General Assembly (GA). The GA is the major decision making body of FSC about political issues and about projects and activities. All stakeholders have the possibility to make suggestions and to influence the agenda. For the representatives from developing countries getting their points across often turns out to be difficult. They are often less organized and have lower negotiation skills. GTZ has conducted workshops to impart communication and negotiation skills on the representatives of Latin America. As a consequence, Latin American representatives made more than half of the

motions in the GA 2005. (see information provided under www.gtz.de/de/themen/umwelt-infrastruktur/umweltpolitik/10889.htm).

(c) Assisting national standard initiatives to demonstrate equivalence with international conventions (benchmarking of standard requirements)

Example: The Common Code for the Coffee Community seeks collaboration with other standard initiatives in the coffee sector in order to find out whether 4C can be benchmarked with other standards. The Business Social Compliance Initiative has come to an agreement with Social Accountability International. But benchmarking in the field of social and environmental standards is still in its infant stage and best practises have not been developed yet.

(d) Assisting the clearance of standards developed by multi-stakeholder initiatives with anti-trust authorities

Example: in many standard initiatives competitors work together. In case a given market is dominated by only a few companies antitrust issues come up. Anti trust authorities have to be involved. The Common Code for the Coffee Community had to be approved by anti trust authorities in the EU as well as in the US. 4C can give advice who to go about the process of anti trust clearance.

(e) Facilitating the creation of membership-based standard-setting organization

Every standard initiative starts with a group of interested companies and civil society organizations. As a standard is being developed, the initiative needs to establish an organization and rules for the formulation, diffusion, updating and supervision of the standard. External facilitators can help to formalize the initiative in a standard-setting organization. According to the ISEAL rules, membership has to be transparent and non-discriminatory.

Box 9.12 presents the case of a prominent recent standard development process, the 4C Code of Conduct for the mainstream coffee market.

Box 9.12: Case: The 4C Code of Conduct (Common Code for the Coffee Community)

One of the core elements of the standard initiative “Common Code for the Coffee Community” (4C) is the 4C Code of Conduct. This is a set of practices which are used in the coffee sector guiding farmers and companies on their way towards sustainable production, post-harvest operations, processing and trade of coffee. The 4C Code of Conduct covers 30 social, environmental and economic principles for all actors in the green coffee supply chain, such as coffee farmers, plantations, producer organisations, estates, mills, exporters and traders.

GTZ has supported 4C through a Public Private Partnership Project with the German and the European Coffee Federation (ECF). Initially, the management unit of 4C has been set up with GTZ and EFC staff. In the first phase of the initiative the management unit facilitated the development of the 4C Code of Conduct. Different stakeholders (producer representatives, trade, industry, trade unions and NGOs) discussed and decided on the design of the Code. In the second phase, stakeholders worked on a business code that specifies the commitments of trade and industry. In addition, the management unit facilitated the debate on the appropriate long-term governance of the standard and a verification mechanism. In 2006, the 4C initiative has registered as an association. Two donors have financially supported the building of 4C - BMZ and SECO (Switzerland).

The 4C code does not allow the use of a label or logo on the final product. However, members can claim their membership on the packaging, in company reports or other communication channels. See www.sustainable-coffee.net, also see box 9.13.

source: 4C project, GTZ Office for Social and Ecological Standards

(Task 9.2) Accompanying the implementation of standards

Developing a standard and creating or strengthening the respective organizations is only the first step introducing a standard. In order to become effective, regulations of the standard have to be put into practice and compliance is expected. Implementing a standard means adjusting production and marketing practices to the standard and building the capacity of quality management in value chains.

In fact, chain operators are confronted with a multitude of options. From the perspective of pro-poor value chain upgrading, the key question is if and how small-scale operators can benefit from a product standard or from social and ecological codes of conduct. Box 9.12 presents a series of useful questions, chain facilitators should consider to decide whether the implementation of a standard is likely to generate a pro-poor growth impact.

Box 9.13 Tool: Lead questions to analyze the needs for standard implementation

Assessment of objectives:
If the chain upgrading vision is to move into new markets: does it imply observing standards?
Can small producers expect an economic benefit from adhering to the standards?

Assessment of target market access requirements:
Which are the relevant standards in these markets?
Who sets the standards for the new markets – and how are they enforced?
Does the standard have to be adapted? What is the scope for adjustment?

Assessment of market access capacities:
Can small producers meet the standards of these new markets?
Which capacities need to be strengthened along the chain to meet the standards – and at what cost?
Which institutions or innovative companies are capable of supporting chain operators to implement the standards?

Identification of leverage points and intervention strategies:
Which constraints and opportunities are critical success factors that could impede or enhance necessary changes implementing the standards (leverage points)?
Which technical or financial assistance is necessary to initiate and strengthen the implementation and long-term application of the standards?

Source: adapted from Reardon, 2004, page 80.

Implementing a standard incurs investment costs for assets (e.g. pesticide stores), equipment (e.g. protective clothes) and technical and managerial skills. Operators need to build the capacity and acquire the appropriate technology. Small farmers and enterprises often face serious problems responding to the requirements as the fixed cost of individual investment may be too high given the small scale of their operations. This problem should be resolved by building associations rather than subsidies. Only if the costs of implementing a standard are covered by a price premium or can be made up for by reducing production cost, adherence to the standard is a viable option. Hence, the economic benefits have to be identified prior to implementation and certification of any standard – especially in the case of small producers. The following comments provide know-how on the implementation of standards, beginning with food safety management. A treatment of implementation support for social and ecological standards follows. The implementation of product quality standards, such as the Nepal tea standard presented in box 9.4, is not treated specifically here as it follows the same principles.

Implementing food safety standards

Implementing food safety standards calls for a continuous and comprehensive quality management system. Because of the strict regulations food hazards have to be detected at

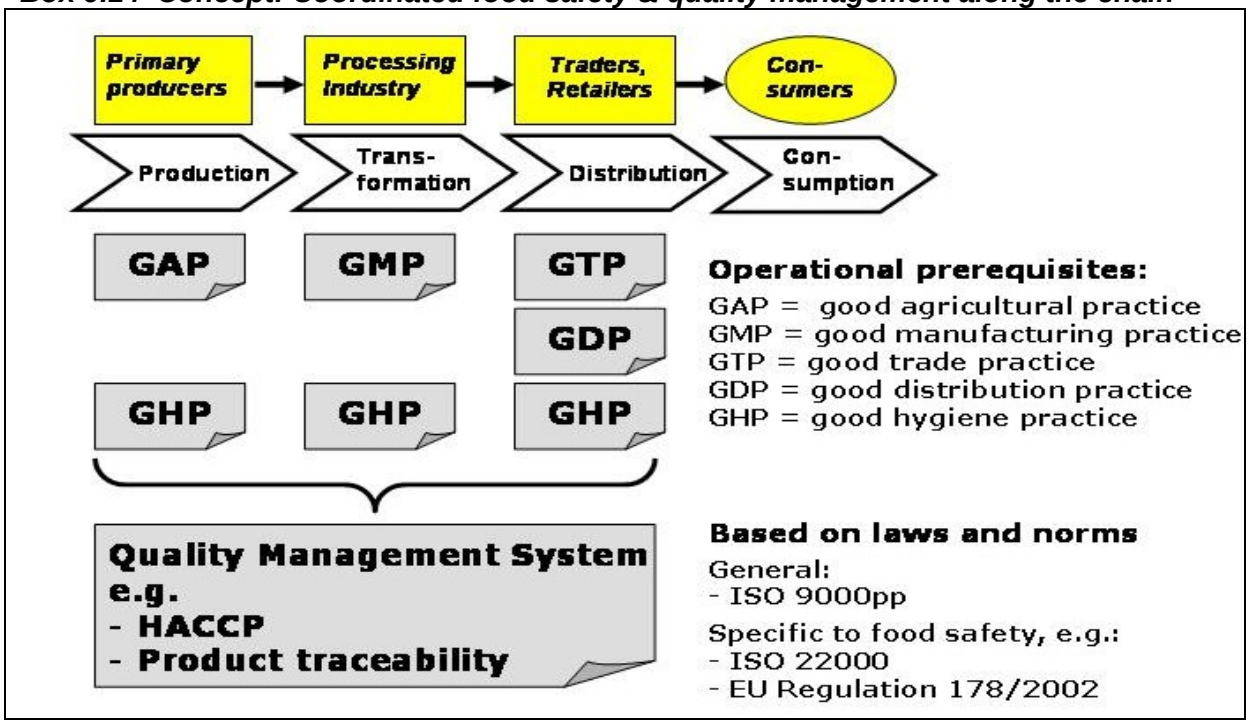
the source. Having to withdraw unsafe food once it has reached the consumer market is not only extremely costly; it also seriously damages business linkages.

Since the safety status of the final product corresponds to the capacity of the weakest link in the value chain, food safety and quality have to be managed at each point along the entire value chain. Every value chain operator, from the supply of inputs to the distribution and shelf-life management in retail trade, has to establish appropriate safety and quality assurance practices. A food safety system along the value chain also has economic benefits for operators, because it

- reduces input costs using integrated crop and pest management technology;
- helps to enhance labour productivity through improved work-flow;
- improves market access by communicating the good practices applied;
- improves long-term supplier-buyer relationship

The general concept of a coordinated food safety management system is visualized in box 9.14.

Box 9.14 Concept: Coordinated food safety & quality management along the chain



source: own concept

The elements of a coordinated food safety management system are given in the concepts of product traceability and the HACCP (Hazard Analysis and Critical Control Point) system. Principles of implementation include risk assessment, an appropriate product and process management (control of produce received, handling and storage), use of HACCP plans, self-control of operators, the documentation of work routines and risk communication. The technical aspects at each stage of the chain are operationalized in a series of "Good Practice" documents (see box 9.13). These principles are based on international (ISO) norms and the food safety norms of the joint FAO/WHO Codex Alimentarius Commission. The responsibility for implementing the system is shared between the operators at different stages. It includes farmers, packhouses and processors, importers, wholesalers and retailers, as well as operational service providers such as forwarding agents subcontracted by operators and food control agents at international boundaries.

Although food safety legislation is not specific to particular products per se, safety assurance programme often are organized by subsectors or value chains. The particular technical characteristics of products call for specific HACCP plans for each category of product (dairy, meat etc.). These plans may also specify requirements for segments of the respective value

chains. Hence, building a food safety management system has a generic dimension at meso and macro levels (legislation, institution building and training) as well as value-chain specific technical and organisational aspects. Typical promotion activities of government agencies, often in cooperation with development agencies, are:

(a) Organisational development of food safety institutions (macro and meso levels)

Facilitators help by assessing the current institutional structure in food safety assurance and derive measures to promote change. This includes the definition of responsibilities, (see box 9.7 for an example from Morocco) and sharing the respective know-how. An efficient way of achieving this are twinning agreements between public organizations in Germany and other EU countries on one side, and countries in Eastern Europe, North Africa and Central Asia on the other. Administrative twinning is now financed in the context of the new "European Neighbourhood and Partnership Instrument (ENPI)" which replaces earlier twinning programs, such as TACIS (see http://ec.europa.eu/world/enp). Twinning programs operate through the national contact points for institution building in EU countries. In Germany, it is hosted by the Federal Ministry of Economics and Technology (BMWi).

(b) Training of trainers and coaching

This includes developing concepts, curricula and organizations for vocational training programmes in food safety assurance and quality management. One example is the GTZ support to the planned food safety training centre in Georgia.

(c) Advisory services supporting quality management systems

This field of intervention is closely linked to the arrangements for agricultural service provision in general (see module 7). Here, the focus is on the "Good Agricultural Practices" (GAP). Facilitators can promote smallholder integration into an embedded service system, in which the downstream buyer (a large outgrower scheme, industrial processor or exporter) transfers the know-how and technology for quality management to the supplying farms.

Implementing social and ecological standards

As in national food safety systems, development cooperation has an important role to play implementing social and ecological standards. The challenge is to assist building the capacity of operators to comply with the standard. Farmers and small enterprises need special guidance on what to change und how to benefit from social and ecological standards. Typical tasks supporting the implementation of standards comprise:

(a) Informing chain operators

This includes organizing and facilitating round tables to engage a discussion on the respective standard and start pilot activities and advising producers on the content of a given standard. Facilitators also promote the use of media reaching small-scale producers to raise awareness on standards

(b) Supporting checks on current practices

In order to prepare investment into the implementation of corrective measures and into the training of service providers and certifying agents, the current situation with regard to the standard criteria has to be established. Facilitators can facilitate the investment thus accelerating the process.

(c) Training of trainers and business service providers

The transfer of know-how and technology to improve on quality and standard compliance is taken over by specialized service providers. GTZ has developed a training program called "Profitable Social Management" (PSM) used to train service providers and multipliers (see www.gtz.de/social-ecological-standards). Another example is the implementation of the 4C Code of Conduct for sustainable coffee production (www.sustainable-coffee.net). Important

buyers can deliver similar services in the context of supplier qualification programs or through embedded services (see modules 5 and 7 on the respective arrangements).Boxes 9.16 and 9.17 present cases of comprehensive programmes implement standards.

Box 9.16 Case: The PPP project of GTZ with the German Foreign Trade Association

Between 2003 and 2007 GTZ has implemented a public-private partnership project with the Foreign Trade Association of the German retail sector (AVE, see *www.ave-koeln.de*). AVE had developed a standard with its members and linked up with Social Accountability International (SA 8000). The task of the PPP project was to implement this standard in eleven countries in Asia and Eastern Europe including China, India and Bulgaria. The implementation consisted in four steps:

- The first step was to conduct workshops with producers to inform about the content of the standard and the whole process of conformity assessment.
- In a second step producers asked audit companies to make a compliance check.
- Depending on any critical results of the audit, the suppliers had to implement a corrective action plan in a certain period of time (third step).
- Finally, another audit took place (fourth step).

Parallel to the implementation of the standard, GTZ set up round tables on social standards (see *www.social-standards.info*) in every participating country. The round tables accompanied the process of standard implementation and enabled participants from the private sector, government and civil society to discuss the related issues. Thus, multi-stakeholder fora were established that have the capacity to develop and apply the AVE standard in their countries.
(for further information, please see *www.gtz.de/social-ecological-standards*)

Source: GTZ Office for Social and Ecological Standards

Box 9.17 Implementing the 4C Code of Conduct

The criteria and principles of the Common Code of the Coffee Community are based on existing national legislation in the coffee producing countries, UN conventions as well as good agricultural practices. Specific regional or national features related to production systems and the different types of green coffee will be reflected in special indicators. Criteria inapplicable to smallholder production are not taken into account when smallholders' compliance is verified.

Small producers need to become part of an organized unit in order to join 4C. Under the umbrella of a "4C Association", access to training and capacity-building activities will be coordinated for producer groups in coordination with the existing structures in the coffee producing countries and with development agencies. Based on a self assessment of producers, the 4C Associations and other local service providers assist producers (large and small scale alike) in production technology. The idea is a continuous improvement reducing production cost through effective management practices, such as minimized use of pesticides and fertilizers, and better trained workers. In a separate business code, trade and industry members of 4C have committed themselves to purchase increasing amounts of 4C-compliant coffee over time and to contribute to training and capacity building activities.

Activities to support the implementation since 2005

- In 2005 and 2006, the 4C Code has been tested on the field. The feedback supports the development of the specific indicators and further tools for the adaptation of 4C.
- Developing the future set-up and governance system of the initiative: At the end of 2006, the initiative has been institutionalized as independent membership association.
- Finalizing the operational aspects of the 4C system, such as registration of members, verification system and reporting.
- Spread and decentralize the 4C code by organising consultation workshops and trainings worldwide and by establishing National 4C forums.

source: 4C project, GTZ Office for Social and Ecological Standards, *www.sustainable-coffee.net*

(Task 9.3) Developing the capacity for the verification of standards

The third element in any quality management system along the value chain is an effective mechanism verifying whether a standard is actually applied. Managing quality in compliance with standards requires checks on processes and products and the certification of complying producers. This task is performed by "certification bodies" - service enterprises conducting quality control and certifying producers. Certifiers have to have the necessary know-how and capacity and need to be certified (accredited) themselves, by accreditation agencies. Standard-setting, quality management, certification and accreditation together constitute a system in which different functions and services interlock:

- Chain operators have to manage quality in line with the respective standard.
- Certification bodies (certifiers) conduct regular checks on the compliance with standards and issue certificates to those operators fulfilling the criteria.
- Accreditation bodies control the competence of certifiers.

Box 9.18 presents the relevant definitions.

Box 9.18 Concept: Definition and scope of accreditation and certification

Certification is a procedure by which a third party (the certifier) gives written assurance that a product, process or service conforms to specified requirements. Certification is an asset and an advantage for producers and consumers. It gives an incontestable added value to the product or service bearing its label, valorises the goods and thus opens up markets and simplifies business. Finally, it reassures the user since the product or production process meets defined characteristics.

The task of certification bodies is to audit operators along the value chain by monitoring their compliance with standards. Certification encourages chain operators to adhere to standards and also continuously improve the performance.

Labelling: Certain standard initiatives (Fair Trade, organic farming, FSC, MSC, Rainforest Alliance) operate with a label. The label informs the end consumer that a product conforms to the content of the standard. Labels are a marketing tool in the first place.

Accreditation is the procedure by which an authoritative body gives formal recognition that a certifier is competent to carry out the specific tasks. Accreditation can be granted to a certification body for recognition of its competency in the following fields (examples):

- Product or service and quality management systems accreditation (ISO/EC 65)
- inspection certification (ISO/ IEC17020);
- laboratories certification (ISO/ IEC 17025);

Principles of credible and effective accreditation systems include:

- foundation on clear mandates, roles and responsibilities of organizations involved;
- development of procedures and guidelines for compliance checks;
- specification of criteria for the recognition of a certification scheme;
- development of a procedure for regular assessment of the national auditing/ certification system.

Source: own compilation

Most standards specify the verification procedures as well. A problem arises wherever the local capacity to actually verify standard compliance and issue certificates is weak or where the certification procedure puts operators to great expense. The cost of certification adds to the implementation cost. Taken together, they may exceed the benefit from adhering to the standard. Therefore, creating locally available verification and certification systems and strengthening the respective service providers is a key field of chain upgrading. Two intervention possibilities to lower costs for small-scale producers exist - the creation of local certification bodies, and the promotion of group certification schemes.

The first option, creating local certification bodies, has the advantage that it generates additional economic activities and employment and thus helps to realize part of the local growth impact of upgrading. At the same time, any support to certifiers has to take account of the fact that they need to survive as private service enterprises in the long term. Due attention has to be paid to the financial viability of local certification bodies. A classical example is the creation of AfriCert, the first East and Central African certifier for agricultural and horticultural products (see box 9.19).

Box 9.19 Case: Introducing a local certification body - AfriCert, Kenya

Background

Before the foundation of AfriCert as the first accredited local body in Kenya, European service providers provided certification services in East Africa. Prohibitive costs (airfares, first class accommodation, daily fees ranging from EUR 400 to 800) resulted in the exclusion of small-scale producers from certification, hence from access to foreign markets.

In 2001, GTZ and ICIPE (International Centre of Insect Physiology and Ecology) started a project to create a regional certification body for organic products in East Africa aimed at facilitating small-scale farmer's access to internationally recognized certification services at affordable prices. According to a feasibility study local organic certification alone could not sustain a private certification body. Hence, it was agreed to additionally embark on EurepGAP certification. Later, other standards were added.

Support measures:

- development of the quality management documentation as requested for accreditation by AfriCert in cooperation with a German sub-contractor of GTZ;
- accreditation of AfriCert under ISO/ IEC Guide 65 EN 45011 for certification services for food quality and safety, agricultural production system audits and quality systems development (December 2004);
- registration with EurepGAP in 2003 and accreditation in 2004 (accreditation costs: approximately EUR 45,000);
- accreditation as a regional certification body for two further international quality label programmes, the Flower Label Programme (FLP) and the Utz Kapeh Green Coffee Standard with support from other donors;
- Accreditation as a regional certification body for organic production as a public-private partnership project between GTZ and AfriCert; the accreditation costs of roughly EUR 18,000 are shared equally.

Lessons learnt: More attention needs to be paid to:

- building managerial skills of the certification body as a self-sustainable private service provider (marketing, service provision, financial management);
- setting up private-sector oriented structures with local, perhaps regional shareholders (Tanzania, Uganda) to facilitate market development across borders;
- Providing sufficient seed money to support the certification body up to a stage of economic viability where local investors become interested to buy in shares.

(see www.africert.co.ke/)

Source: adapted from Guenther, 2005, p. 52

The second option strengthening local verification and certification systems is the support of group certification. For many smallholders, taking part in a group certification is the only possibility to benefit from the lucrative export opportunities offered by the EU markets. Compared with individual certification under EurepGAP Option 1, a farmer group certification under EurepGAP Option 2 has some advantages, namely: auditing costs are shared among smallholders in the same group and it is easier for a farmer group to exchange information, jointly invest into infrastructure and bargain with customers.

Group certification of a farmer group or cooperative presupposes a common Internal Control System (ICS) and joint investments into capacity building, equipment and infrastructure.

Box 9.20 presents the example of a project that has developed guidelines for group certification for EurepGAP (see box 9.6) to be used both by producer associations as well as certification bodies. The guidelines are documented as a generic handbook. It explains the EurepGAP scheme and details the certification process under the so-called option 2 (group certification for EurepGAP). Its core part consists of a template including standard operating procedures and forms for a fictional farmer group. It also discusses critical aspects in group certification to avoid failures. Not to be understood as a "one-size-fits-all" solution, the manual can be taken by farmer groups as a starting point to create their own quality management system. Farmer groups can make adjustments to the manual according to the situation of their group members and specific circumstances within their groups. The project is a public-private partnership with the EurepGAP consortium. The smallholder manual was developed by BMZ/ GTZ as the public partner. The European Retailer Working Group 'fruit and vegetables' has approved the manual. It can also be used in other countries.

Box 9.20 Case: Smallholder Group Certification under EurepGAP Option 2
Description of the Public-Private Partnership project between GTZ and EurepGAP to develop a Smallholder Manual for EurepGAP certification

Goal	Enabling small farmer groups in developing countries to acquire cost-effective EurepGAP certification as a prerequisite for their integration into global value chains
Objective	Development and pilot-testing of a GTZ/ EurepGAP Smallholder Manual to assist small farmers to acquire EurepGAP certification under EurepGAP Option 2.
Tasks / activities	Establishing a group Quality Management System (QMS) allows certification of an entire group rather than of each group member. The GTZ/ EurepGAP Smallholder Manual serves as a practical guidance on how to develop and implement such an ISO-type QMS and internal control procedures without extensive support. The Manual assists smallholders to establish and document their QMS (which is an Internal Control System) as the basis for a group certification Technical assistance by GTZ: • local adaptation of the internal control system as described in the GTZ/ EurepGAP Smallholder Manual • implementation of a series of pilot projects in Africa, Asia, Latin America and South East Europe between 2005 and 2007 • completion/ improvement and final editing of the QMS manual to be made available as simple local public shareware ready for adoption by small-scale farmer/ outgrower groups • collaboration with interested parties working with smallholder farmer groups • liaising with EurepGAP with a view to making the group certification option feasible for smallholder farmers

Source: Guenther, Doris (2005): The EurepGAP Smallholder Manual – Building up an Internal Control System for Certification to EurepGAP Option 2 in the Horticultural Sector, http://www.eurep.org/documents/webdocs/E-book-Globalreport.pdf

List of important abbreviations

BRC	British Retail Consortium
BSCI	Business Social Compliance Initiative
CAC	Codex Alimentarius Commission
4C	Common Code for the Coffee Community
COM	Common Market Organization
EU	European Union
ETI	Ethical Trading Initiative
EurepGAP	European Retailer Produce Working Group - Good Agricultural Practices
FLA	Fair Labour Association
FLO	Fair Trade Labelling Organizations International
FPA-SAFE	Food Product Association
FSC	Forest Stewardship Council
GAP	Good Agricultural Practices
GDP	Good Distribution Practices
GFSI	Global Food Safety Initiative
GMP	Good Manufacturing Practices
GRP	Good Retail Practices
GFSI	Global Food Safety Initiative
HACCP	Hazard Analysis Critical Control Point
IFOAM	International Federation of Organic Agriculture Movements
IFS	International Food Standard
ILO	International Labour Organization
IPPC	International Plant Protection Convention
ISO	International Organisation for Standardisation
MSC	Marine Stewardship Council
OIE	Office Internationale des Epizooties (World Organisation for Animal Health)
QS	Qualität und Sicherheit (Quality and Safety)
SAI	Social Accountability International
SPS	Sanitary and Phytosanitary Measures
SQF	Safe Quality Food
TBT	Technical Barriers to Trade
WTO	World Trade Organisation

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ValueLinks Module 10

Improving the Business Environment of Chains

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ValueLinks Module 10

Improving the business environment of value chains

What this Module is about

Whether or not enterprises are able to realise their market potential depends to a large extent on the general conditions of doing business in a particular value chain and in the economy as a whole. The business environment of the value chain comprises the macro-level conditions that affect all value chain actors. These include a wide range of issues such as public policy and administrative governance, laws and regulations, market regulation through grades and quality standards, the capacity and quality of infrastructure and utilities, and the availability of public services. A list of the typical macro-level conditions in value chains is presented in Box 10.1 below.

Identifying these issues is part of the value chain analysis (*ValueLinks* Module 2). In fact, macro-level constraints affect value chains everywhere and often are the major reason why there has been little value chain development. Unlike development strategies that promote a conducive business and investment climate in general, chain promotion means working on the specific business environment of the value chain in question. All companies in a specific sector benefit from a positive business and investment climate.

An important field of intervention is the introduction and enforcement of quality, environmental and social standards, the technical aspects of which are treated separately in Module 9. However, more topics need to be addressed, and this module concerns the ways in which influence can be exerted on the responsible government institutions and other involved stakeholders.

Broadly, two possibilities exist. The first approach is issues-based and builds on the needs and initiatives of the business community. Interested private companies, enterprise groups or government take the lead in advocating solutions to common, specific problems that the subsector is facing. The intention is to remove obstacles, lower transaction costs, take advantage of certain opportunities or improve very specific legislative and regulatory framework conditions of the sector.

The second approach is more comprehensive. Here, the government takes the initiative in setting up mechanisms through which broader sectoral issues can be worked out – in a multistakeholder approach and in partnership with a strong business association or a lead firm. Ideally, this should lead to a coherent subsector development policy. Both approaches imply an intensive public-private dialogue (PPD).

Tasks in supporting sectoral policies and market regulation

External facilitators and chain promotion projects have to perform different tasks depending on the policy approach taken.

- (Task 10.1) One is supporting private initiatives addressing specific macro level constraints.
- (Task 10.2) The second option is fostering a more comprehensive value chain development policy addressing all chain-related aspects of the business environment in a coherent manner.

The approaches address the policy and business environment of a value chain differently. Development agencies require different procedures. The first approach often evolves out of a value chain promotion initiative and is driven by the business community. The second

approach mostly starts at government level. In both cases, procedural support is required along with technical inputs from external development advisors.

Basic considerations on the business environment of value chains

Value chain analyses often bring out problems regarding the general conditions of doing business in the country, the “macro level”. Box 10.1 lists factors that typically present constraints to the economic progress of a value chain. Reviewing the problems, analysts should distinguish between the sector-specific business environment and the general conditions of doing business.The general investment climate cuts across many value chains affecting the economy as a whole. A typical general condition is competition policy. Fostering competition has a positive impact on the competitiveness of the sector as a whole. Economic theory as well as experience has shown that companies benefit from being exposed to competitors, as it forces them to improve productivity and become innovative.

Box 10.1 Concept: Critical factors in the business environment of value chains

General conditions of the business environment in the country (investment climate):

- Macro-economic policies and conditions (monetary policy, interest rates, costums duties on imports of intermediate goods, taxation etc.)
- Laws and regulations for business registration and licensing, employment, associations and cooperatives
- Contract security and enforcement
- Extension and quality of road and rail network and port infrastructure
- availability and cost of utilities (energy and water)
- and other factors

Sector-specific framework conditions for doing business in the subsector / VC in question:

- Existence (or absence) of grades and standards regulating the market of the product
- any subsector-specific legal and administrative regulation, such as land and water rights in agriculture, food laws, sector-specific trade policy or product-specific taxes and levies
- Existence (or absence) of specific support services funded by government, such as specialized research, technology and education institutions
- problems of market failure within the value chain,such as a lack of coordination, information asymmetry, opportunistic behaviour and mistrust
- and other factors

source: own compilation

The relevance of the business environment for chain development is exemplified in the case of the value chain for improved aromatic rice (Somali variety) in Cambodia. The respective chain analysis of World Bank revealed that high fees by customs inspectors damaged the export of improved rice to specialty shops in Europe. Since profit margins in rice trade are fairly low, informal payments at border crossings put the entire business at risk.

The improvement of the investment climate ar large constitutes a development approach in itself that may or may not be combined with value chain promotion. Here, the focus is on the second set of variables in box 10.1

(Task 10.1)
Supporting private initiatives addressing macro-level constraints

In many countries, governments pursue an active economic development policy strengthening the competitiveness of particular industries, value chains or clusters (see below, section 10.2). Independent of the question whether a sectoral development strategy is well thought through or not, many policy issues can only be discovered by the enterprises concerned. Those who are closest to the business practice have the best knowledge of the macro-level constraints affecting them.

Hence, successfully addressing macro-level constraints always depends on the ability of businesses to communicate the issue and take action. The specific interest needs an organized ´voice´ to become effective.

Three forms of business organisation can be distinguished:

- Horizontal associations of enterprises in one stage of the chain: This includes Business Member Organizations and farmer associations. Building on a shared commercial interest, producer associations can evolve exercising their “voice” over public issues as well (see *ValueLinks* module 5 on the commercial forms of horizontal association).
- Subsector-wide (horizontal plus vertical) committees or organisations representing the value chain as a whole (e.g. “core groups” or the “interprofession” described in box 10.8), and
- Institutions representing business interests in general, such as the chambers of commerce and industry.

All types of business organizations can address macro-level problems. Whether they do it by promoting individual issues or by participating in the formulation of a new policy or law, the decisive point is their capacity of analysis and communication. The potential for mobilizing chain operators to address a policy matter depends on the size of enterprises, the number of operators concerned, and the urgency and importance of the issue.

External development agencies have an important role in strengthening the organization of the business community and improving the performance of business interest groups. Facilitators also create awareness outside the business community and may facilitate a broader debate in which common problems can be raised publicly and solutions found.

Organizing a public-private dialogue (PPD)

Public Private Dialogue can take place at different levels, and for different purposes. The initiative to organize them may stem from the private side or from the public side. To be effective, issues of common concern have to be raised with the relevant political entities, where the decision power over the issue is located (local, regional or national). The institutional set-up for promoting the public-private dialogue differs according to the dialogue partner on the public side. When a PPD is initiated by the private sector, it often takes the form of

- lobby meetings with the responsible minister/secretary or the competent government authorities
- subsector or value chain conferences and workshops to discuss sector strategies and specific sectoral topics to which government representatives and public agencies are invited.

When government invites the PPD, be it regional or national, it typically takes the form of

- consultation workshops with the business community to get the feed back of companies on sector specific new laws, regulations and policies
- a regular dialogue forum (not necessarily sector specific) such as a local economic development committee.

Donor projects can play a crucial role in bringing together the two sides and facilitating the dialogue. Boxes 10.2 and 10.3 present examples of successful private-public dialogue initiatives. The first concerns sector-specific issues of the business environment that have been addressed by private sector initiatives. The underlying concept of value chain core groups is described in *ValueLinks* module 4 (box 4.20).

Box 10.2 Case: VC core groups promoting sector-specific economic policy, Sri Lanka

Background

The value chain component of the ´Vocational Training and Private Sector Promotion Programme´ (VCPC) in Sri Lanka engages in the promotion of 7 different value chains. At several occasions, critical policy issues emerged at value chain mapping workshops. Representatives of the private sector organize in "core groups" to advocate and promote solutions.

Value chain for canned organic products – The issue of import duties on imported cans

During a chain mapping workshop in 2004, food processing firms reported an acute shortage of cans for export due to problems of the local manufacturer whose production had almost come to a standstill. Cans had to be imported from India at 28% duty instead. The VCPC facilitated talks between food exporters and the Ministry of Industrial Development that led to a reduction of duties to 12% from 2005 onwards. Further incentives followed - making imports easier and preventing the breakdown of the industry.

Cinnamon value chain – The issue of a public technical training centre

Although Sri Lanka is the world market leader for cinnamon, production is running far below capacity. This is due to a shortage of skilled ´cinnamon peelers´ at the processing stage, a problem that was intensively discussed at value chain workshops. VCPC facilitated a coordinated private-public effort to create the ´Cinnamon Training Academy of Sri Lanka´.

Tourism Sector – The issue of a quality certification standard

Another example is an initiative taken by the value chain core group on alternative tourism that aims at promoting Sr Lanka as a high-profile destination. Here, the policy issue is the introduction of the ´Green Isle´ standard specifying quality requirements for small and medium enteprises serving individual tourists. The issue is taken forward by the Tourism Board.

Source: Peter Richter, 2006

In the second case, the policy issue – business laws - cuts across different subsectors. Nevertheless, value chain-specific interests were at stake.

Box 10.3 Case Public-private consultation on business laws in Vietnam

Role of business laws for the development of fresh produce value chains

Developing the fruit and vegetable sector in Vietnam has to deal with issues of food market regulation and economic policy. One concern is the control of product quality; other issues have to do with the enterprise and investment laws affecting the distribution and retail sector. Improving the framework conditions at the macro level is seen as complementary to improving the efficiency of the value chains in pilot projects at the micro level and to strengthening support service provision at the meso level. During the implementation phase of the SME development programme, a new enterprise law (EL) and investment law (IL) was in the process of being drafted that is of great significance for further investment into fresh produce retailing. The sector support strategy needs to increase the competitiveness of the local distribution sector, especially in view of Vietnam´s accession to the WTO and in a situation where the economy is opening up to foreign competitors.

Organizing a private-public consultation process

In the run-up to the passing and ratification of the new law, the SME programme provided direct support organizing policy dialogue meetings between government agencies, the

drafting committee of the EL, and the private sector – for instance with foreign business associations such as Eurocham and with local business associations under the umbrella of Vietnamese Chamber of Commerc and Industry. At the same time, both GTZ and the international retail company *Metro Cash&Carry* provided the Ministry of Trade with expertise through comissioned studies, study tours, legislative and regulatory expertise on specific topics. The support was organized as a Public Private Partnership (PPP) project.

Even after the law has been passed in 2006, the consultation process must go on. Both the public and private sides should assure that subordinate regulations of the law are as well consulted with affected companies as the law-making itself. Otherwise, the reforms introduced by the law may not produce the desired effects. Therefore, continuing efforts by GTZ and others are required to maintaining the dialogue.

Source: SME promotion project Vietnam

In organizing PPD, external value chain facilitators should establish the link between the upgrading strategy and the economic framework conditions clearly. The starting point is the identification of constraints in the business environment during the value chain analyses. The third case (box 10.4) presents the case of potatoes in Kenya, a large, traditional value chain. It shows that the solution of a value chain problem calls for a combination of interventions concerning legal regulations at national level, organization of producers, and the mobilization of local government at the same time.

Box 10.4 Case: Standardizing the bag size in the potato value chain, Kenya

Background: Potato marketing in Kenya

As one of its activities, the Kenya-German PSDA programme is promoting the potato value chain in Kenya. This is a highly fragmented chain that embraces around 500.000 small-scale producers, and a large number of formal and informal rural assembly buyers and village brokers. Potatoes are usually sold fresh and largely undifferentiated on urban spot markets. The market channel is organized informally. Market participants trade in bags of produce and do not use any standards or weighing scales.

Among other problems of the potato value chain (e.g. seed and input availability and production technology), initial analyses and participatory chain mapping reveal market inefficiencies as major problems in the marketing system. One is the use of “extended bags” instead of the standard-size “flat bags”. The weight of extended bags varies. Buyers tend to increase bag size by weaving an extension onto the bag bringing the weight up to 130 kg but keep the price steady all the same. This tendency is reinforced by the fact that local government charges road cesses per bag of produce transported.

Facilitating a policy process introducing a standard bag size

The PSDA programme organized a value chain stakeholder workshop to discuss the problems. Local and national government authorities were invited to participate. Following the workshop several task forces were constitutes addressing the market constraints. The Ministry of Agriculture established a staff working group including the horticulture division and the agricultural policy unit. At the same time, the “Kenya National Potato Farmers Association” was formed organizing the interest of primary producers. Another team included representatives of local government. The initiatives led to an agreement on a standard potato bag size corresponding to 110 kg. In 2005, the Minister of Agriculture signed a potato industry regulation to that effect.

The new market regulation has been introduced and is well accepted. Nevertheless, the formulation of policy is not the end of the story. The widespread application and implementation of the policy has to be assured by the newly founded farmer associations and by local government.

Source: Höffler, H. and Maingi, G. (2005), GTZ PSDA Programme, Kenya

Initially, the quality of the dialogue is often poor. External moderators can use facilitation techniques to make meetings livelier and more productive, raise awareness and interest of

participants, and help to achieve political commitment. External facilitators take the role to rally private sector representatives to make a consistent request to the government. The following box summarizes important tenets for organizing successful PPD in regard to law and policy making processes.

Box 10.4 Practical Hints: Key success factors in organizing private-public dialogues

Recommendations for development projects initiating PPD in value chain promotion

a) Identify the right dialogue partners – both from the public and the private sector side.
b) Emphasize the ownership of the chain actors who have to be the drivers of the process.
c) Operate issue-based and demand-driven making the private businesses fully aware of the benefits of participating in the policy dialogue with government.
d) Build trust between the private and the public sector. There is a higher chance of success if the dialogue is carried out in an atmosphere of trust.
e) Promote a positive attitude among participants instead of just complaining.
f) Suggest solutions and options. This is where agencies such as GTZ can give technical advice and support to work out a number of possible policy options.
g) Keep the participants informed about how their proposals and requests have been taken up by government.
h) Use the press and other media contributing to an atmosphere that is favorable to market reforms. The media are indispensable partners in any policy dialogue.

Source: Based on experience documented by the SME development programme, Vietnam

Besides government and the value chain community, there are important groups outside the value chain, that development agencies can work with. Mobilizing and promoting civil society alliances or consumer pressure in combination with press work and other public relations measures can have a direct influence on the behaviour of stakeholders in the value chain, making them improve their current behaviour and performance. This is particularly important when it comes to topics like social and environmental standards, where civil society and consumers are important political players exercising considerabe influence on businesses. Involving the press can also produce wider impact influencing policy and law makers to take a more business-friendly and reform-oriented stance.

An issue-based approach requires companies to team up each time addressing the business issue collectively. Sometimes it may be easier to work on regulatory problems that can be resolved in the short term. However, if the policy perspective is long-term, the private-public dialogue has to be institutionalized in some way. Fostering a coherent value chain policy implies an institutional role of the private sector.

(Task 10.2) Fostering a coherent value chain promotion policy

The second option for intervening at the macro level of the value chain is to collaborate with government in formulating and implementing subsector- or value chain specific policies. Government policy aims at formulating comprehensive strategies, rather than just addressing individual issues. The task of government (and its advisors) is to clarify the public good interests in private sector development in particular industries, and engage in a policy process with the respective private actors and competent agencies. The policy process concludes in a subsector / value chain development strategy and action plan. Usually, plans are implemented by several government agencies and by value chain actors at the meso level. Value chain policy can be undertaken by national or by regional government. An active value chain development policy

- formulates objectives and a coherent set of policy measures integrating the different fields of value chain development
- defines public and private roles clearly, and
- provides an institutional mechanism organizing the collaboration of actors within a value chain or subsector, e.g. through associations or committees.

Typical elements functions constituting a value chain development policy are listed in box 10.6. It can be noted that a value chain policy comes close to a value chain promotion project at national level. Policy instruments partially correspond to the elements of the *ValueLinks* framework and the fields of intervention treated in modules 5 to 9 of this manual.

Box 10.6 Concept: Elements of public subsector and value chain policy

Subsector-specific public policy fields include:

- Export promotion and business matchmaking (see module 5)
- Funding and strengthening public support service providers (see module 7)
- Provision of public-good type information
- Research and technology
- Vocational training
- Investment promotion - public financial support to private investment (see module 8)
- Introduction of quality standards and grades (see module 9)
- Introduction and enforcement of sector-specific legal regulations including contract security
- Institutional strengthening and coordination
- Provision of infrastructure and facilities
- Land use planning (in the case of sensitive crops)

Source: own compilation

The question is how development agencies can support the formulation and implementation of a coherent value chain policy. In the political reality, many constraints to formulating and implementing a coherent subsector policy exist: Political decision centers are highly fragmented with competences spread over different line ministries and between national, regional and local administration. Often, the room for manouevre of government is limited because of insufficient budget to fund tax incentives or provide the financial resources needed to actively support investment. At the same time, contradicting interests and conflicts have to be handled.

Given these conditions and following the principle of subsidiarity, policy makers have to build on the resources and active engagement of business, associations and international agencies. However, value chain policy is not just about shaping the conditions of the business environment. Essentially, it means promoting the interaction between private firms, associations and public agencies. This idea is at the basis of the two models of value chain policy making that are presented in the following. The first model is the “competitiveness agreement” (“acuerdo nacional de competitividad”) used in Latin America (see box 10.7). The second is West African concept of the “interprofession”.

Box 10.7 Case: Supporting value chain policy in Latin America (Peru & Ecuador)

Competitiveness Agreements for value chain development in Latin America

In many Latin American countries, subsector policy uses the format of a "national competitiveness agreement". A competitiveness agreement (or competitiveness plan) is a national policy to promote the integration of private companies in the national and world market and improve the competitiveness rating of the country in World Bank reviews. Policy fields include, among other things, institutional strengthening, innovation and infrastructure. At present competitiveness agreements exist in eight Latin American countries. Institutionally, the policy follows the levels of administrative hierarchy: The Minister of Economic Development presides a national competitiveness committee (or competitiveness council) integrating the representatives of private sector organizations.

At a lower level, stakeholders in a particular industry (the terminology varying between ´value chain´ and ´cluster´) or in a particular region constitute roundtables initiating a multi-stakeholder policy process under the competitiveness agreement. The policy process leads from a joint diagnosis of the competitiveness situation in the respective chain / region, to the formulation of a strategy and the agreement on an action plan agreed between private and public stakeholders. Roundtables also coordinate the implementation of the action plans. International funding is acquired to realize individual projects.

The Case of Peru: National Competitiveness Agreement in the Maize & Poultry value chain

The Peruvian government created a National Competitiveness Council in 2002. After lengthy political consultations, a National Competitiveness Plan was passed in July 2005.
In parallel, The Peru-German programme for sustainable rural development (PDRS) supported the process of creating a competitiveness agreement in the maize and poultry value chain, along with another donor, IICA. The process was initiated by the Ministry of Agriculture and took one year. The agreement has the format of a public-private contract signed by all participating companies, associations and public agencies. It specifies 5 areas of value chain development, i.e. crop and animal health, infrastructure, improvement of vertical linkages between primary production and marketing, maize productivity, and strengthening of farmer organizations. The principal achievement is that, for the first time, operators at different stages of the value chain have come together and started joint pilot projects.

Experience shows that it takes at least one year to arrive at the agreement. To large extent, analytical and facilitation methods can be taken from the toolbox of value chain promotion.

Source: GTZ / PDRS Newsletters, personal communication of Manuel Rojas, and Govt. of Peru, 2006

In francophone Africa another model of value chain policy is in use. It builds on the "*interprofession*" (a French term as the concept originates in France). Interprofessions are value-chain specific private formal associations uniting and organizing all enterprises and business associations operating in the chain. They have the function to establish rules and standards for the business, create market transparency, promote the product on domestic and export markets, and collectively address problems affecting the value chain as a whole.

Box 10.8 Case: Interprofessions in Senegal

Competitiveness Agreements for value chain development in West Africa

In Senegal, Mali and other African countries interprofessions are officially recognized by law and formally part of the institutional set-up of national value chain policies. Only one private interprofession per value chain is allowed. It takes the lead in regulating the market and suggests development measures. In the case of Senegal, the legal framework provides that the agreements reached by the interprofession are compulsory for all chain operators as long as the decisions are taken unanimously. Hence, the interprofession constitutes a sort of "value chain parliament". At present, there are 7 interprofessions and interprofessional organizations in Senegal covering fish, cereals, industrial tomatos, rice, milk, groundnuts and horticulture.

Source: A. Robast / Peche, D. 2005, also see the website www.inter-reseaux.org

To perform their functions, the different groups of operators and stages in the respective value chain have to be equally represented in the interprofession. This model is particularly relevant for export-oriented commodity chains. Examples include the CNIA in Senegal (National Interprofessional Committee on Groundnuts) and the AIC in Benin (Interprofessional Association for Cotton). So far, the capacity of the interprofessions to actually perform their role in value chain governance is still limited. However, interprofessions are highly valuable as a framework for initiating value chain promotion projects and providing policy advice.

Supporting value chain policy formulation, external facilitators should take care to feed into the policy model given. Some principles initiating and supporting a process of value chain policy making are presented in the following.

- External value chain facilitators should make sure that the policy builds on business interests and follows a ´bottom-up´ process rather than a ´top-down´prescription.
- Value chain promotion projects strengthen the self-organization of the business community counterbalancing any tendency of government to dominate the upgrading.
- Policy advisors should stress the difference between regular (core) functions to be performed by government, and tasks that should be left to the private sector and its organisations. This includes defining criteria for subsidy policies.
- Policy decision makers should be given support that is directly useful for developing solutions and implementing them in practice.
- The interprofession, chain committees and other formats organizing the private role in chain-specific policies can evolve out of chain promotion projects. Section 4 in *ValueLinks* module 4 (“Institutionalizing collective action of chain actors”) provides know-how that may also be useful here. After all, facilitating value chain upgrading also has the objective to transfer and institutionalize the facilitation function itself.
- Finally, the policy process has to be shaped in such way as to foster mutual learning and communication

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Donor Committee on enterprise development: www.businessenvironment.org

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ValueLinks Module 11



Monitoring and Managing Impact

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ValueLinks **Module 11**

Monitoring and Managing Impact

What this Module is about

Public chain promotion projects use tax funds to create new jobs, increase the income of poor producers and stimulate further economic growth. Because their expected development impact is the only justification for spending tax money, value chain projects have to make sure they achieve these results to the greatest extent possible. Impact monitoring is the management tool which makes sure that a project stays on course.

Given the dynamic evolution of markets and of the overall business environment, the activities needed to facilitate chain upgrading have to be continuously assessed. Impact monitoring asks whether the public investment is still likely to yield the expected benefit. Typical questions include: Are the promotion activities used and supported by the value chain actors? Is upgrading actually taking place? Is the upgrading vision still realistic, or should the money better be invested in another value chain? The answers to these questions guide project implementation. The main function is to facilitate the upgrading effort. Therefore, impact monitoring is not a function at project end; rather, it should start at the beginning of any value chain project – i.e. when the product and chain to be promoted are selected.

At the same time, projects have to account for the money entrusted to them. Impact monitoring generates the necessary data for reports and allows a case to be constructed for continuing (or stopping) public investment in chain development. It also provides the data for final project evaluations.

This module presents the main principles of monitoring in value chain promotion. It concludes the cycle of modules addressing the tasks of facilitators, so that from selecting a value chain for promotion (Module 1) to facilitating the process (Module 4), we finally arrive at results monitoring. An important step in creating the basis for impact monitoring is the formulation of the upgrading vision and strategy (see Module 3). In fact, the upgrading strategy implicitly contains the major impact hypotheses and provides the core element of the chain promotion monitoring system.

Whether or not the value chain actors are able to realise their market potential depends to a large extent on the general business conditions in a particular value chain as well as in the economy as a whole. Monitoring also has to cover the business environment to provide guidance on the possibility of achieving significant results with the least interventions.

Tasks in monitoring the impact of value chain promotion projects

Monitoring the impact of value chain promotion projects includes a whole series of tasks. In the following, the steps in an impact monitoring system are structured into three major tasks.

- (Task 11.1) Formulating impact hypotheses of value chain promotion
- (Task 11.2) Verifying the impact hypotheses
- (Task 11.3) Managing for development results

The first two tasks are to formulate, operationalize and assess an impact model of the value chain promotion project. They include the methodological issues of how to create a picture of the ongoing process of chain promotion and upgrading. The third section concentrates on the impact monitoring as a management task. Monitoring information is used to serve the very purpose of a project – to enhance the prospects for achieving impact.

Basic considerations on monitoring chain promotion impact

Monitoring is a management function that can refer to different tasks of project management. This module concentrates on impact and outcome monitoring. The approach can be classified as a tool for ´results-based management´ (RBM), a concept that focuses on the output, outcome and achievements of a project rather than the inputs and activities. Hence, financial and activity monitoring are left aside in the following.

The point of departure in designing *any* impact monitoring system is the utilization of the information it generates. Generally, impact monitoring performs two functions: One is project steering which needs a management information system to prepare decisions. Monitoring data guide project implementation and allow adjusting the strategy if necessary. The second function is to account for the use of funds vis-a-vis the funding institution by showing to what extent the project is achieving its objectives and contributes to the Millenium Development Goals (MDG), especiall the MDG 1 and 2 that are relevant for chain promotion. The monitoring information is used to prepare reports and provide the foundation for project evaluations.

Box 11.1 summarizes the main elements of a typical impact monitoring system.

Box 11.1 Template: Generic elements of an impact monitoring system

The impact monitoring system of GTZ includes six steps:

1. Defininig system boundaries and impact model / results framework
2. Clarifying interests and expectations concerning the monitoring system
3. Determining important fields of observation
4. Formulating indicators and operationalising indicators
5. Data collection and interpretation of data
6. Presentation of results, reporting und use of data

Source: GTZ

The impact monitoring system constitutes a management cycle that start with the planned results (planned output and expected outcomes and impact). Planned results are systematized in a “results framework” or “impact model”. The latter term is used in the following. Monitoring compares planned results with actual results. Depending on the assessment, managers get back to reviewing the initial targets. After completing each cycle is starts over again, either at step 1 or 2 by revising the impact model, expectations and indicators, or at step 5 by entering a new round of (annual) data collection. This model is fairly general. It applies to *any* kind of development project.

The following sections aim at substantiating the general monitoring system by applying it to the *ValueLinks* framework and know-how. The basic principles of impact monitoring are not specific to value chain promotion projects and will not be repeated here. What makes a monitoring system specific is the formulation of the impact model of a particular project, the indicators and specific data sources.

(Task 11.1)
Formulating impact hypotheses of value chain promotion

Impact monitoring starts by anticipating the economic and social change a value chain promotion project is supposed to generate. In our case, the anticipated change is pro-poor growth: One dimension of pro-poor growth is the increase in the total value generated by the value chain, i.e. the turnover at the final sales point (sales prices * final sales volume). The other is the creation of additional jobs and income for poor people. As has been discussed earlier (in *ValueLinks* module 1), at least part of the additional value added should stay with poor people, i.e. the producers and/or employees being integrated into the chain. Therefore, the public promotion of value chains does not pursue just any kind of growth but only growth in those value chains where poor people have a chance to participate. Under the condition that poor people capture part of the value added, increased value addition is the decisive change sought after.

Impact monitoring has the task to verify whether that change actually happens and whether the activities of a support programme contribute to it. In order to achieve this task, project managers have to understand the process that eventually leads to value addition and higher income of the poor. Conventionally, results are structured into a sequence proceeding from ´project outputs´ to ´outcome´ and on to direct and indirect ´impacts´. The sequence entails causal linkages (´if-then relationships´).

Applying this terminology to value chain promotion delivers a very general impact model as shown in box 11.2. The sequence also includes an intermediary step (´use of output´) that is used in the monitoring format of GTZ. The impact model should be read from the bottom up: Facilitation activities (project output) are supposed to induce a change in the behaviour of chain actors (use of output), who, in turn, work to improve the functions of the chain (technology and business operations), the capacity and organization of chain operators, their relations, and the final market outlets. This outcome is tantamount to a greater competitiveness of the value chain as a whole and will translate into an increased value addition and higher overall income – the final impact. Depending on the number of poor and their participation in the value chain, part of the additional income will go to the poor. The income increase is a contribution to poverty alleviation. At the start, this logic is entirely hypothetical.

Box 11.2 Template: Levels of an impact model for value chain promotion

Stages	***Levels of impact in VC promotion***
Indirect impact	• Poverty alleviation
Impact	• additional income for poor operators and employees • increased value added
Outcome	• greater competitiveness of the VC • upgrading of technology, linkages, horizontal cooperation, standards, service arrangements etc. • more producers integrated
Use of Output	• Chain operators (micro), chain supporters (meso), and policy makers (macro) take action to improve the VC
Output	• Facilitation and support activities of VC promotion projects

Source: own concept

The generic impact model in box 11.2 summarizes the major steps explaining how interventions may lead to pro-poor growth in principle. For the purpose of practical monitoring this model has to be applied and adjusted to fit the particular case of the value chain in question. Every case of value chain promotion requires a particular impact model.

The point of departure formulating the impact model for any concrete case of value chain promotion is the vision and upgrading strategy agreed earlier in the project (see module 3).

Ideally, the upgrading strategy is derived from a vision of chain development and contains implicit assumptions about the expected impact. Therefore, constructing an impact model uses the upgrading strategy as a reference. In fact, impact monitoring is closely related to visioning and strategy building. It can be understood as updating the information that provided the basis for the formulation of the strategy in the first place.

Project managers can build the impact model by reversing the upgrading strategy. While the forumulation of an upgrading strategy starts from the vision to arrive at specific aspects of the value chain to be transformed, e.g. technical improvements or new market outlets, the impact model follows the opposite logic. Project outputs are supposed to lead to technical improvements that in turn result in reduced cost or improved products. In formulating the impact model, the implicit assumptions of the upgrading strategy have to be made explicit. This is a relatively easy task provided chain actors have a clear vision of the future. If this is not the case, establishing an impact model can help to clarify and inform the upgrading strategy. The following box provides an idea of how to operationalize the generic impact model. The first task is to identify the parameters describing the expected change. Typical parameters are given in the third column of box 11.3.

A second task may be to differentiate the main stages into intermediate steps, i.e. two or three impact or outcome levels. This helps to describe the advancement more precisely. Conventionally, the project objective is to generate impact and not just outcomes. Differentiating these levels is a way of precisely determining the level at which project objectives shall be located. In fact, there is a certain amount of flexibility in defining a particular level as either outcome or impact. Box 11.4 shows that projects objectives vary with regard to what is specified as the impact (=objective) level.

Box 11.3 Template: Impact model for value chain promotion – parameters of change

Stages	***Levels of impact in VC promotion***	***Key parameters of change***
Indirect impact	• Poverty alleviation	• Wealth / poverty status of producers and employees and their families • Economic & social conditions in the environment
Impact	• Additional income for poor operators and employees	• Number of new jobs in the value chain • Number of new jobs of external service providers • Income of poor operators
Impact / Outcome 2	• Increased value added	• Value chain turnover (prices, volume) in previously existing market channels and in new market channels / outlets
Impact / Outcome 1	• Realization of chain upgrading solutions	• Productivity parameters (production per ha, per labour day, unit cost) • Product quality / product innovation • Production capacity per day or per year
		• Types and number of vertical business linkages • Use of improved production technology • Existence of a standard regulating product quality and actual compliance with the standard • Types and numbers of operators integrated into the value chain
Use of Output	• Chain actors take action to improve the VC	• Behaviour change of chain actors (investment rates, participation in events, self organization) • Services provided and received • Funding of services • Policy formulation
Output	• Facilitation and support activities of value chain promotion projects	Activities and support services such as • Information and studies, facilitation of events • Investment aid, PPP

Source: own concept

Another way of differentiating the impact model further is by splitting outputs, use of outputs and some of the outcomes according to the fields of action (e.g. services or business linkages) or according to partners (e.g. at micro or meso levels). A generic impact model that follows this logic is presented in *ValueLinks* module 3 (see box 3.14). A concrete example can be found in box 11.6.

It is important to note that the parameters in box 11.3 are purely illustrative in nature. The major strategic orientations of chain upgrading such as product quality improvement or cost reduction do not provide blueprints of change. In reality, the pathways towards growth vary considerably. Hence, for every product and final market, the technology, services, volume of investment and time horizon need to be specified further. Do not copy the templates but construct a specific model for every value chain project at stake!

The following box 11.4 provides an overview of the objective level of 16 selected projects supported by GTZ in the year 2007, each promoting several value chains. The left column presents keywords that appear in the formulation of objectives and objective indicators. They have been clustered into groups of similar concepts. The keyword that represents the highest level of expected impact is used to classify development programmes in the second column. It can be seen that the typical objective level corresponds to increased income, higher profits of small and medium enterprises and farms, and the creation of additional employment.

Box 11.4 Cases: Objective levels in chain promotion projects supported by GTZ

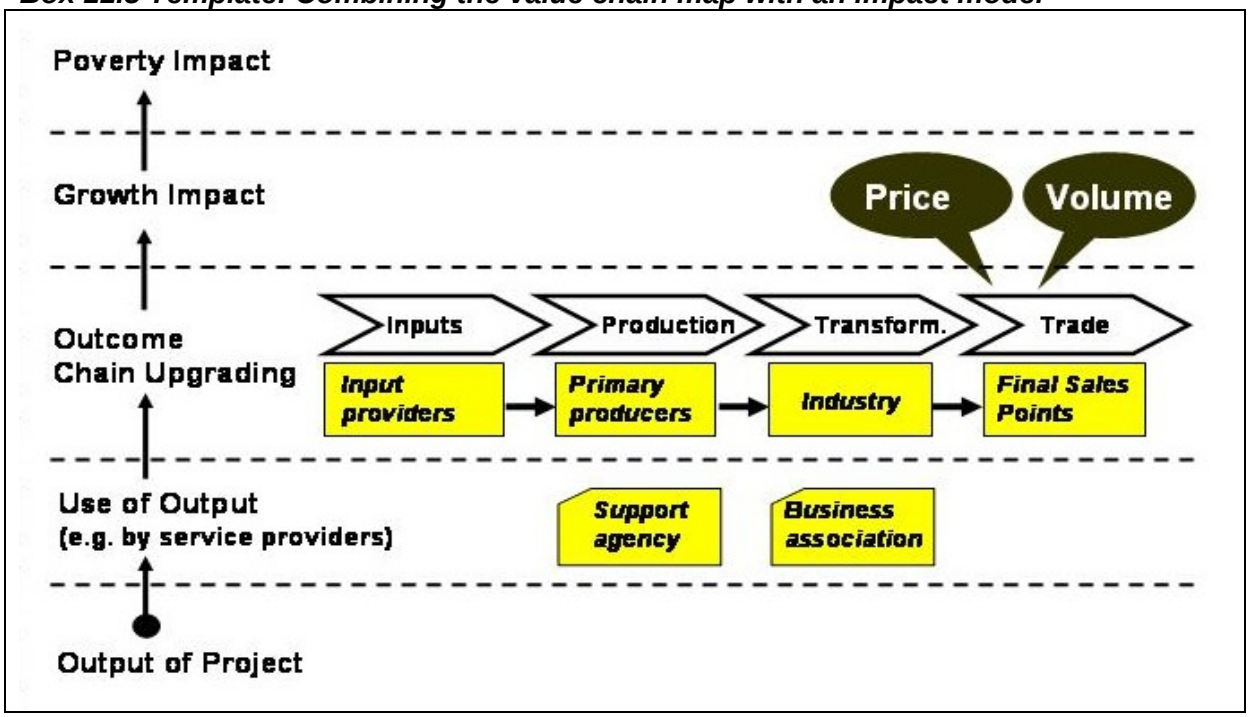
Keywords used in the formulation of objectives and objective indicators	*number of programmes targeting the respective impact level*
• reduced share of poor households	1
• higher income, higher profit of SME, additional employment, improved food subsistence level	9
• higher turnover, trade and export volume, • higher production output, greater market shares	4
• better productivity, lower cost of production, reduced energy consumption • additional investment • better management qualification • improved technology and production processes • existence of product standards • Improved sector policies and support initiatives	1
• better access to improved services • functioning private service market • better services of chambers and business organizations • vocational training offered	1

Source: own compilation

The outcome and impact levels shown in box 11.3 can be related to the value chain map and analyses. Box 11.5 shows the relationship between the value chain and the impact model in graphical form. Some parameters of change can be directly derived from value chain mapping. Hence, value chain analyses provide a good basis for impact monitoring.

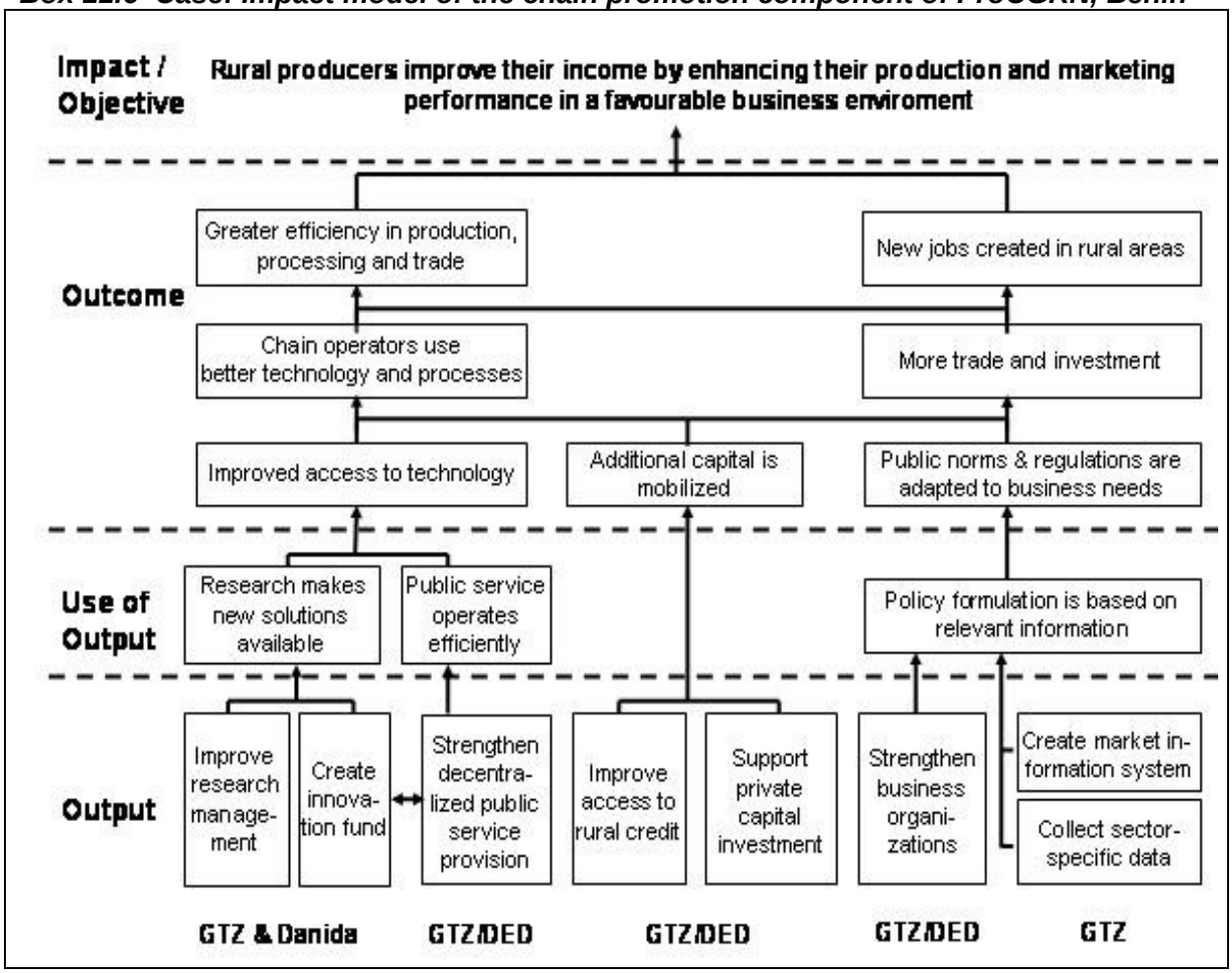
The impact model of each value chain promotion project has to be constructed anew. The following box 11.6 presents the example of an impact model designed for the second component of the “Programme for the Protection and Management of Natural Resources” (ProCGRN) in Bénin. The component has the title “agricultural sector policy and agricultural value chains“. It pursues the objective to increase the productivity and value added of selected agricultural value chains (rice and cashew nuts).

Box 11.5 Template: Combining the value chain map with an impact model



Source: own concept

Box 11.6 Case: Impact model of the chain promotion component of ProCGRN, Bénin



Source: adapted from ProCGRN, Bénin

The impact model of the component is reproduced in box 11.6 in simplified form. The complete version includes two additional outputs which also contribute to the impact. One concerns community investment in land and water management supported by the development bank KfW, the other the regulation of property rights in land use. The impact model shows how different support agencies contribute to the achievement of objectives in parallel.

The change in a value chain can only be regarded as impact, if we assume causal linkages between the different levels of the impact model. Assessing the change at each level is not enough. Impact monitoring also has to produce plausible arguments why and how the change has happened. This is not only an issue in reporting. Project managers have to conduct a chain promotion project with a strategic perspective always keeping the expected final impact in mind. As long as the upgrading goes on, the causal linkages of the impact model remain hypothetical. It is of great importance to make them transparent and to check on impact hypotheses regularly. Monitoring does not only include observing indicators, it also means reviewing the upgrading strategy - and thus the project strategy. This is done by verifying the impact hypotheses. If necessary, impact hypotheses have to be revised as a consequence.

Box 11.7 presents generic impact hypotheses for chain promotion projects that can be used as a starting point for making the project (and upgrading) strategy transparent. The sequence of impact hypotheses tells the anticipated story of the project. It is recommended to take this step consciously and carefully making sure the story is realistic.

Box 11.7 Template: Formulating impact hypotheses

Generic impact hypotheses

Impact hypothesis 1 (Causal link between project output and use of output)
Support activities and interventions of the chain promotion project are actually taken up by value chain actors.

Impact hypothesis 2 (Causal link between use of outputs and upgrading outcome)
The partners and clients of the chain promotion project invest into value chain upgrading, both individually and as a business community achieving improvements in the different fields of chain upgrading.

Impact hypothesis 3 (Causal link between upgrading and value addition / growth)
The upgrading translates into an improvement of value chain competitiveness and leads to greater value addition and a higher overall income of chain operators.

Impact hypothesis 4 (Causal link between between growth and the income of the poor)
Poor producers and employees get a share of the increased overall income and thus become able to move beyond the poverty line.

Source: own concept

While the link between project output and the use of output by partners in the value chain is comparatively strong, the subsequent impact hypotheses are subject to the influence of an increasing number of other factors. Hence, impact hypotheses entail assumptions. It is useful to make the important assumptions transparent, too.

(Task 11.2) Verifying impact hypotheses

Impact monitoring means verifying the impact hypotheses. This includes recognising and measuring change at each level of the impact model and attributing the change to the prior activities of the chain promotion project. Change becomes impact only if it can be attributed to the inital activities of a chain promotion project.

Monitoring and evaluating the impact of value chain promotion faces the same challenges as projects in other fields of social and economic development. One is the dynamics of economic development: It is important to note that neither the chain actors nor any support projects can fully control the evolution of the value chain: Consumer demand changes, new competitors emerge and the conditions of production in agriculture vary from year to year. Because of the dynamic environment it is extremely difficult to distinguish the impact generated by a support project from the change resulting from market forces and the business environment. The higher the level of the impact model the more intervening factors have to be taken into account.

The second challenge is attribution: As the promotion of a particular value chain does not exclude any particular enterprises, it is practically impossible to single out a control group that would not have benefitted from external support action. Chain operators invest at their own risk and hence bear the responsibility for chain upgrading. To this adds the fact that often several agencies support chain development in parallel. Which of them is the most influential is hard to judge.

Given these fundamental constraints to measuring impact, the impact hypotheses should be treated as a flexible guideline. While it is absolutely necessary to establish the project logic managers should be prepared to change the logic over time if necessary. The task is not to produce hard evidence that the chain promotion project is fully responsible for the progress made. Rather, monitoring means observing the ongoing change, delivering information to all chain actors and drawing conclusions for further upgrading. Even if the achievements can not be fully attributed to the promotion project, impact monitoring shows the role of external facilitators. The very fact that external facilitators monitor change, interact with chain operators and adjust their interventions accordingly demonstrates their impact orientation – and enhances their credibility.

In order to verify the different impact hypotheses, they have to be operationalized by defining fields of observation and formulating measurable indicators. For each level, two aspects should be considered. One is the observation of the ongoing change, the answer to the question whether and to what extent change is actually taking place. The second aspect refers to attribution: Can the evolution of the value chain at each level be traced back to earlier changes and, ultimately, to the external support activities? Interpreting the ongoing change as impact is only possible using and verifying the impact hypotheses as well.

The following boxes present generic criteria for the verification of impact hypotheses listed above. They refer to both the observation of change and the attribution question. The criteria are not formulated as complete indicators because the specific indicators differ from value chain to value chain. The major source of information on the criteria is the value chain analysis and the value chain map in particular. In most cases, the value chain analyses provide a baseline for monitoring as well. Even a relatively simple value chain map shows the functions performed, the types of operators and their relations, and the final sales points. Thus, a straightforward possibility of conducting impact monitoring is updating the value chain map.

The detailed specifications of indicators and the respective qualitative and quantitative measures have to be formulated anew in each case – based on the data of the value chain analysis. A few hints on how to formulate indicators follow in section 11.3, below.

Impact hypothesis 1: Usefulness of support activities and interventions

Monitoring starts at the lowest level of the impact model. Unless the outputs of the project – support activities and interventions – are actually used by partners and clients, none of the chain development can eventually be attributed to the project.

Monitoring the impact hypothesis 1 refers to the use that the partners of a chain promotion project (companies, associations and/or meso-level agencies) make of the facilitation and support activities. The fact that chain actors actively pursue upgrading objectives collaborating with external facilitators is an important achievement in itself. It shows that the development project operates demand driven and performs its support functions well. As project managers have a high influence on this first level of results, the monitoring information is directly useful for conducting project activities.

Whether or not operators and support service providers engage in upgrading may be verified by talking to partners at the occasion of meetings and stakeholder workshops. Another possibility is to draw on reports of joint activities, and the own reports of service providers and enterprises.

Box 11.8 Tool: Monitoring the use of project services and interventions

Criteria for observing the ongoing change:

- Operators, service providers and meso-level organizations engage in upgrading activities
- Chain actors collaborate with the chain promotion project in realizing upgrading activities

Criteria for attributing change to chain promotion projects

- Client satisfaction with support services and interventions
- Partners make own efforts to initiate collaboration with the chain promotion project and actively ask for support

Source: own concept

To what extent can the investment behaviour of operators and service providers be attributed to previous interventions of a chain promotion project? This question may be answered by obtaining feed back from participants at stakeholder workshops and meetings organized by the project. The keyword is “client satisfaction” with project services.

Box 11.9 Case: Monitoring use of output and impact in the PEC Program, Thailand

Project objectives and impact model

The Thai-German Program for Enterprise Competitiveness (PEC) supports 7 sub-sectors or value chains (longan fruits, vegetables, Saa paper products, shrimps for export, palmoil, tapioca products and bioplastics). In each value chain the project strategy envisages targeted ´competitiveness enhancing interventions´ (= output) aimed at influencing either the demand, supply or enabling environment of service markets for small and medium enterprises (SME). The output is used by the service providers (public agencies, business membership organi-zations or private service enterprises). It results in improved service arrangements and better access of SME to services. Service providers are expected to continue service for the target group in a sustainable way once the assistance is finished (= outcome). The improved access to services is supposed to result in an enhanced competitiveness of the SME (= direct impact) that will finally lead to greater employment and incomes (= indirect impact).

Monitoring the utility of interventions and their impact on SME competitiveness

The monitoring system is based on the follow-up of the ´competitiveness enhancing interventions´ of which there are around 40-50 in total (up to 14 per value chain). For each intervention, an “intervention report” is prepared using the following monitoring tools:
- a survey to assess changes in the service market: Questions include whether SMEs buying more services than before, whether they are more aware of the services, and whether more services are available now, etc).

- collection of baseline data from the intended target group (SME). This is done through small stratified sample surveys with no more than 30 respondents. Questions include, e.g. whether the service had an impact on your business, whether you would use it again etc.).
- follow up surveys of SME target groups to measure the changes or lack of changes in competitiveness and service markets. The programme measures competitiveness in terms of market performance, productivity, innovation and environmental sustainability of enterprises in the respective sector.

The individual intervention reports are aggregated into ´sub-sector strategy progress reports´ which are used to account to funding agencies and political partners.

Source: Thai-German Programme for Enterprise Competitiveness, Thailand

Impact hypothesis 2: Chain upgrading

The easiest way verifying whether upgrading is actually taking place is by observing the structural change in the value chain. Many changes are “discrete”, that is one-time structural improvements. For example, the introduction of a new product, the opening of a new marketing outlet or the founding of a producer association are all changes that can be easily observed. Only one or few observation data are sufficient to verify whether these changes have actually occurred. Similar elements of chain upgrading include the introduction of standards, a major capital investment or the creation of service enterprises.

Other changes such as a gradual product quality improvement, improved productivity parameters or reduced production cost have to be described in more detail but may still be easy to register by asking typical enterprises who participate in the upgrading effort. In small business communities it should not be too difficult to identify such farms and enterprises.

Box 11.10 Tool: Monitoring chain upgrading

Criteria for observing discrete change

- New outlets for the products exist (e.g. export).
- A new or different technology is in use (in lead companies).
- New or improved products are sold to final costumers.
- Product standard has been agreed upon and is being implemented.
- A new producer association or BMO has been founded.

Criteria for observing gradual change (time series)

- Change in productivity parameters or cost of production in typical enterprises
- Number of producers / enterprises using critical inputs and services
- Percentage of produce sold in different channels of the value chain

Criteria for attributing the change to chain promotion projects

- The upgrading is in line with a strategy that has been agreed upon in the framework of the project.
- The improvements have been realized by firms and associations who either cooperate with the chain promotion project directly, or receive support services from project partners.

Source: own concept

The sources of information to monitor chain upgrading basically are the same as in the initial value chain analyses. Essentially, monitoring is a continuation of previous chain studies. The better the value chain is organized, the easier information can be generated by talking to representative bodies - business associations, meso-level support organizations, core groups and stakeholder meetings.

Observing improvements in large and weakly organized (mostly agricultural) chains with many operators is more challenging. In theory, the technological change and business behaviour of a large number of farmers and small enterprises could be captured by a baseline and follow-up surveys. However, surveys are costly and survey data do not tell the

whole story unless they are combined with an analysis of the structural change in the value chain. A less demanding and more elegant approach to assess the upgrading in large chains relies on indirect information obtained from chain actors holding a critical position in the value chain. These may be

- important chain operators at bottlenecks (such as important producers associations, processing companies, exporters and big traders) who are handling a large share of the product flow,
- providers of critical equipment or improved inputs selling to a large number of operators
- providers of critical services, e.g. technical advice, and
- financial institutions serving a large number of clients.

Box 11.11 presents an example, in which producer associations included in PPP agreements realize upgrading activities and monitor the progress themselves.

Box 11.11 Case: Monitoring upgrading outcome at PAC, Ecuador

Project objectives and impact model

The PAC programme has the objective to increase the income of poor cocoa and coffee farmers in Ecuador. This presupposes higher product prices and a bigger volume of coffee and cocoa exports (impact). In order to achieve this, the following variables of both the cocoa and the coffee value chains have to be improved: a) production costs; b) product quality and certification; c) production volume; d) new products and e) new markets (outcome).

Indicators operationalizing upgrading outcome

The variables are operationalized by specific indicators that allow measuring advances, based on initial baseline values documented in a database. These are examples of indicators for the five variables:

a) Cost reduction: “Increase of the average productivity per hectare of cocoa from 400 to 600 pounds”
b) Production volume: “Increase of the organic coffee plantation area from 500 to 750 hectares”
c) Quality: “Certified cocoa farms (organic, fair-trade & rainforest-alliance) up from 2000 to 3000”
d) New products: “Introduction of at least 5 new coffee products into special markets”
e) New markets: “At least 5 new commercial agreements to enter special markets”

Monitoring the indicators by collaborating with associations and PPP partners

The indicators are measured in the context of cooperation agreements with PPP partners who implement the upgrading strategy in coordination with GTZ. As upgrading projects are generally co-financed by GTZ, indicators are integrated into the project agreements with the ´local executors´, often associations. Usually they have to be more detailed specifying targets to be achieved. Examples of an agreement with a producer assocation are:

Production volume: “Pruning practices allow the rehabilitation of at least 100 hectares of cocoa and also an increase of the production volume of the association of small producers XY from 75 metric tons (2006) to 150 metric tons (2007). Verification instrument: Pruning reports; purchase register of the main gathering center.”

New products and markets: “Through the implementation of a new marketing strategy, the association of small producers XY has established a new commercial agreement with duration of at least one year and the launch of a new product to the organic coffees market. Initial situation: 1 effective commercial agreement, 2 products on the market, none of them organic. Verification instrument: Implementation report of the commercial strategy, signed commercial agreement, pictures of the new products”

During project execution the cooperation partners report periodically – for example every 6 months – on project progress according to the indicators. Further payments are made only, if reports fulfill the requirements and deliver the data agreed.

Source: GTZ PAC Project, Ecuador

The decisive point is to recognize the systemic nature of value chain upgrading. The different aspects of upgrading are interlinked. For example, technical improvements can only be realized if new and better services are used. Improved quality and new products have to show up at market outlets at some stage.

Box 11.12 Case: Monitoring selected agribusiness subsector parameters in Peru

Project objectives

In its second component, the PDRS programme pursues the objective to integrate small farmers into national and export oriented value chains. To raise the export volume not only productivity and product quality have to improve, but new export channels should be opened and the portfolio of exportable products should increase.

Monitoring value chain upgrading

Statistical figures show that the export volume of products supported by the programme has multiplied in the period 2003-2005, for example in organic coffee from the San Martin region which increased from 66 tons in 2003 to 384 tons in 2005 or beans from Piura (from 9 tons to 234 tons). The increasing percentage of exports shows in subsector parameters, e.g.
- the increase in the share of total production commercialized outside the region (up by 8,3%)
- the increase in number of export contracts with producer associations (from 2 to 8)
- the reduction of the rejection rates for export goods at assembly points (by 40%)

Source: GTZ Peru

The upgrading of a value chain is subject to important external factors, especially the development of market demand and trade policy. Therefore, another important task of impact monitoring is verifying the initial assumptions and preconditions for upgrading to actually produce the expected economic growth. Hence, project management also has to observe the economic and political environment of the value chain promotion project.

Impact hypothesis 3: Economic Growth

Ultimately, the upgrading should result in greater value added. There is one single parameter measuring sustainable growth, i.e. the total value added or value chain turnover, defined as the sales price of the final product multiplied by number of units sold. According to the scope of the value chain project, several product variants and outlets may have to be added up. Although this indicator is clear-cut, measuring it is not as straightforward as it appears. One problem is that the value chain turnover may be subject to fluctuations over time. In agricultural and food value chains this is a particularly critical issue as production volumes vary with climatic conditions. Therefore, a one-time increase is not convincing. To be rated as a lasting impact, the value added should show an upward trend over several years. However, complete time series of market data are not always available and chain promotion projects often end before a new data series can be completed.

There are two possible answers to this challenge. One is to focus on data from key companies. The number of export companies is normally small enough to obtain complete data on export volume and value of a particular product. Sales value on the domestic market may be inferred from the turnover of important processors or traders.

Second, data collection can concentrate on those product variants and marketing channels that have been added as a result of upgrading. For example, in a case where the upgrading vision is to commercialize high-value vegetables in hotels or supermarkets, the evolution of sales at selected outlets stands for the overall value added.

Another option is supporting the public agencies responsible for producing economic statistics, i.e. the competent government departments, the statistics office and customs authorities asking for the relevant data in return.

An example for the second option is the impact of promoting organic cashew in Cambodia, presented in box 11.14.

Box 11.13 Tool: Monitoring value added / economic growth

Criteria for observing change (time series)

- Increase in value added - volumes and final product price paid at defined selling points
- Turnover in market channels that have been opened anew – as a result of the upgrading

Alternative criterion for observing change

- Increase in turnover of lead firms and/or exporters

Criteria for attributing change to chain promotion projects

- Structure of the increase in VC turnover: The observed increase in prices and/or volumes is in line with the type of upgrading that has been taking place.

Source: own concept

The growth in total value added is distributed along the value chain and to external operators providing inputs and services. Hence, it is the basis for any increases in income generated by upgrading the value chain. Therefore, the increase in value chain turnover is an indicator of income increase at the same time.

Box 11.14 Case: Increase in sales value of organic cashew kernels, Cambodia

Background

Cambodia exports most of its cashew production. 95% of exports go to Vietnam in the form of raw nuts. Demand and sales volumes are growing. However, value addition is low, as only 1% of cashew is processed into kernels in the country. The upgrading vision is to obtain higher end prices by (a) increasing processing, and (b) switching to organic cashew. The strategy was to build up a new value chain for processed organic cashew, including organic certification, organization of producers and new export linkaes to international wholesalers.

Measuring impact on sales value

750 organic cashew farmers have been certified (internally) and started exporting organic cashew. As organic cashew is a new product and value chain, the value created equals the total value of organic kernels exported. In the first year of export 120 tons (8 containers) of organic kernels could be exported earning about 700.000 US$. The volume is equivalent to 1% of cashew exports. However, the price per unit of product is almost double, as the organic variant receives a markup of 30 %, and processed nuts have a 60% higher sales value per unit. If organic cashew kernels replace the conventional raw cashew, the value-added increases by 80%. The availability of the new product attracts international investors. If a planned foreign direct investment is realized, processing capacity will go up to 5000 tons.

These figures are easy to find, as there are only 1 or 2 exporters in the value chain.

Source: C.T.A. Trade Promotion Project, Cambodia

Impact hypothesis 4 Income and poverty alleviation

As long as value added is growing, it is fair to assume that the income of operators and service providers is also growing. The question is how the additional income is distributed along the value chain and whether poor people get a share of it. This is a matter of numbers in the first place. The total number of poor producers and employees participating in the value chain is a first indication of the poverty alleviation that can be *potentially* achieved. However, sheer numbers are not suffcient. They need to be complemented by separate studies showing how much of the value added is actually captured by poor operators and employees.

Besides a higher household income, other benefits of chain upgrading are also relevant for poor people, such as enhanced food security, stabilization of revenues and the intra-household distribution of cash income between men and women.

Box 11.15 Tool: Monitoring impact on income and poverty

Criteria for observing change

- Total number of poor enterpreneurs / farms (below e.g. 2 USD/day) benefitting from value chain upgrading
- Number of poor (below e.g. 2 USD/day) having been integrated into the value chain as employees
- Change in income of poor moving them beyond the poverty line (e.g. 2 US$/day)

Methods for attributing change to chain promotion projects

- Case studies and model calculations of small enterprise or farm income
- Case studies on the poverty status of particular groups participating in the value chain

Source: own concept

Box 11.16 complements box 11.11 which refers to the same programme. Here, the issue is the monitoring of small farm income using a case study methodology.

Box 11.16 Case: Monitoring income increase of cocoa and coffee farms, Ecuador

Case studies on farm income incease

Small cocoa and coffee producers belong to poverty groups within their respective value chains in Ecuador. Income monitoring therefore focuses on the development of these groups. GTZ uses a case study method in which data are collected from selected farms benefitting from the programme. Variables include productivity per ha, labour utilization, cost of production, production volume, and the structure of family income and expenditures.

The structure of family income is an interesting variable: It shows the relative importance of the income from principal crops (cocoa or coffee) related to the value chain vis-a-vis income from other crops and, more importantly, via-a-vis other sources of household income, especially wage labour and remittances. To the extent that the other sources recede, the income improvement can be traced back to the upgrading in the principal crop.

Monitoring results

Case studies conducted with producers of UNOCACE, an association of 920 small organic cacao growers, have been monitoring the families since 2004 and have shown a family income increase of 43% between 2004 and 2006 generated through program activities. A similar study conducted in FAPECAFES, an association of small specialty coffee producers with around 1000 affiliates, shows an increase of the income of these families of 70% between 2004 and 2006.

Source: GTZ PAC Project, Ecuador

Another example of income and poverty monitoring comes from Cambodia. The case presents a survey method to assessing poverty impact.

Box 11.17 Case: Monitoring income and poverty impact in the rice chain, Cambodia

Background

The goal of the Rural Development Programme Kampot/Kampong Thom, Cambodia (RDP) is to contribute to poverty alleviation and economic development in two provinces of Cambodia. One of the major fields of work is the establishment and qualification of service providers in key areas of rural development, in particular in the field of agricultural subsistence and market production. Rice is the most important agricultural product in the RDP area, both in terms of food security and economic value. The key hypothesis of the programme is that supporting a rice specialty - organic rice - will generate income for poor farmers and improve subsistence levels at the same time. The main fields of upgrading have been technical services, the formation of farmer cooperatives, the introduction of organic certification and support of the rice trade.

…continued

Survey Method

After 3 years of promoting the value chain, the programme conducted an assessment survey of members of organic rice cooperatives in 2006. The survey assessed the following aspects:

- satisfaction with service delivery of cooperatives
- farmers capability to sell their organic produce
- general farm income and
- impact on household level.

The survey used a 10% sample of the farmer's association membership population and was designed to reveal change over time. No control groups were interviewed. Farmers were asked to rank the quality of the services received, the relative importance of their different economic activities, and the additional advantages they get from participating in the organic rice initiative. Answers give an indication about the factors determining farm development. In addition, the study included a model calculation of the additional income per hectare and per household.

Results

The survey shows that farmers have experienced a stabilization of their livelihood and incomes. Based on average figures the additional annual income from organic rice production is around US$ 28 per household. Compared to the average labour wage per day for work in paddy fields or construction sites, this is equivalent to almost 24 labour days. Other social benefits frequently stated include the acquisition of new skills and know how, motivation and increased feeling of self-esteem; and a greater experience of solidarity and team spirit among the members of cooperatives.

Source: GTZ Cambodia

The cases show that income increases can indeed be attributed to value chain upgrading, if the groups benefiting keep within manageable limits and/or the chain operators are well organised.

As soon as large numbers of beneficiaries are concerned, the change can only be captured by statistical methods. Unfortunately, business and income statistics are not very reliable in most poor countries.

(Task 11.3) Managing for development results

Managing for development results (MDR) is emerging as the conceptual foundation for designing and running M&E systems in development cooperation. At an international roundtables of donor agencies in Marrakech Iin 2004, a series of principles for MDR have been formulated. According to the agreement "…the principles of MDR are

- Focusing the dialogue on results at all phases of the development process
- Aligning programming, monitoring and evaluation with results
- Keeping measurement and reporting simple
- Managing for, not by, results
- Using results information for learning and decision making" (OECD, 2006, p.3).

The Development Assistance Committee (DAC) of the OECD has published a sourcebook on the management for development results (OECD, 2006) elaborating on these principles. Earlier, the DAC also stipulated quality criteria for aid evaluation (see OECD, 1991). The results framework and monitoring tools for chain promotion have been treated in the preceding sections 11.1 and 11.2. This last section presents know-how on the management and organizational aspects of impact orientation.

Using monitoring data for managing value chain promotion projects

Impact monitoring is an instrument of project management. It has to be built into a management cycle that starts by clarifying the information needs of managers, and ends with the use of the information to perform management tasks and take decisions. The management needs ultimately determine which level of the results framework to focus on and which monitoring tools to use.

The use of impact monitoring data for managing chain promotion projects can be classified into three categories: M&E feeds into

- Short-term operational management
- Strategic management, and
- Reporting

Short-term management mainly needs information about the use of outputs. The information generated here is used to improve the delivery of services to partners. Other instruments are activity and financial monitoring.

Strategic Monitoring needs information about the different levels of the results framework so as to update impact hypotheses and adjust the project strategy if necessary. Of particular relevance is the monitoring of upgrading outcome. In a dynamic environment, project managers have to make sure the upgrading vision is realistic and the project keeps track.

The preparation of reports taps into all monitoring data telling the story of the project. It uses the results famework to show the ongoing change at each level. Accounting for funds received uses monitoring data of the impact level.

Finally, project managers and decision makers in economic development should use monitoring information to prepare evaluations, compare the different project approaches and learn for the future.

Organizing the monitoring function

To avoid that impact monitoring becomes a burden, it has to be organized as efficiently as possible. The first consideration here is cost. There is an upper limit to the cost of monitoring. A general recommendation says that the expenditures for impact monitoring should amount

to 5% of the total public investment on average. Depending on the scope of promotion a maximum of 6-8% should not be exceeded. Box 11.18 shows a real example, the cost calculation for impact monitoring in the case of an SME promotion program in Vietnam. The budget amounts to about 5% of the total annual budget of the programme.

Box 11.18 Case: Cost of Monitoring in the SME promotion programme, Vietnam

Personnel costs 1 Programme M&E Advisor (share of 70 percent) 5 Advisors of Programme Components (share of 5 percent) 4 local staff in provinces (share of 5 percent)	*30,000 €* (running cost per year)
Baseline and follow-up studies Fruit & Vegetable Baseline Study Rattan Baseline Study Catfish Baseline Study Domestic Investment Baseline Report	*80,000 €* (in first and last year of the four-year programme phase)
Other indirect costs Costs of documentation & communication etc.	*1,000 €* (running cost per year)
Total monitoring costs	***51,000 €*** **average cost per year**

Source: GTZ Vietnam

Given the narrow budget restrictions, the monitoring task has to be organized as efficiently as possible. Designing an efficient impact monitoring system for value chain promotion projects should observe the following principles:

- The formulation of indicators should take the initial value chain analyses as a baseline. To the extent possible, indicators should use existing sources of information.
- Data collection should be should be shared between external facilitators and value chain actors. At each level of the results framework, other chain actors have to be involved in the monitoring effort. As upgrading is mainly done by operators and chain actors and they have to follow up their own activities, monitoring data can often be taken from the records of collaborating firms and partner organizations.
- Bundling of monitoring tasks across value chains: While it is indispensable establishing separate impact models for all value chains covered by a development programme, the monitoring tasks at output and outcome level can sometimes be combined. For example, access to microfinance and other services may be relevant in different value chains.
- Collaboration with other agencies active in the respective chain. Several donors investing in parallel need the same or very similar information on the upgrading process and the value added created. Hence, value chain promotion is an ideal opportunity for conducting collaborative monitoring involving different development agencies.

The following box summarizes some important features of the monitoring system employed in the SME promotion programme supported by GTZ in Vietnam.

Box 11.19 Case: Monitoring system of the SME promotion programme, Vietnam

The Monitoring system of the SME programme

The programme pursues the objective to “significantly improve the competitiveness of private small and medium enterprises in Vietnam”. Its value chain component promotes the fresh fruit, vegetable, rattan and fisheries subsectors. The monitoring system can be divided into “strategic monitoring“ and “operative monitoring“. Strategic monitoring includes monitoring the system boundaries, the results framework (impact model), indicators and budget. In turn, the operative monitoring supervises activities, milestones (output and use of output), annual plans of operation, and costs. The monitoring activities are organized into an annual cycle of activities, of which the Strategic Planning & Monitoring (SPM) meeting in October is the most important event. At this occasion, achievements are reviewed and new milestones set. The

monitoring system is closely linked to knowledge management in the programme which encourages active sharing and exchanging of experience and information.

Monitoring tools and sources of information

The monitoring information is documented in

- the Operational Plan, that is the overview of the annual activities of the programme (organized by programme components),
- a table with milestones providing staff with detailed annual objectives and tasks,
- the MS Excel® table "indicator impact monitoring", which is organized by outcome and impact indicators and used to record data on indicator values over time. This is the core document which collects all information gathered. It allows combining different variables flexibly so as to substantiate cause-effect relationships.
- a separate MS Excel® "training and workshop monitoring sheet" performing this function for the respective programme outputs.

The most important sources are statistical data of Vietnamese government organizations, data of the cooperating private partners and business associations, own reports, commissioned studies and studies of other development agencies, such as World Bank.

Responsibilities

The M&E Advisor bears the chief responsibility for coordinating the monitoring system and for making results available. On the one hand, she cooperates with programme advisors and local staff and consultants who collect the data. On the other hand, she closely cooperates with programme leadership interpreting the results. The Chief Technical Advisor uses the information to review and update the project strategy together with Vietnamese partners. He also has the task to promote the impact orientation of the team as a whole.

Source: based on internal reports of the SME promotion programme (also see www.sme-gtz.org.vn)

Impact monitoring in the SME development programme in Vietnam is the example of a system of routine procedures and responsibilities designed to achieve maximum efficiency in generating monitoring data. It is not specific of value chain promotion as such.

Utilizing synergies between monitoring and project implementation

Value chain development is not a stable target. Hence, it may not always be possible to specify precise objectives, at least at the beginning of chain promotion and under conditions of weak economic structure and unpredictable market change. Both planning and monitoring become difficult and, above all, costly.

One way of dealing with this condition is to directly link promotion activities with monitoring. For example, chain promotion projects use business meetings and stakeholder workshops to generate the results framework and formulate indicators. Workshops and meetings serve a double purpose, strengthing the awareness and capacity of chain operators on one side, and generating information to be used in building the monitoring function on the other.

Similarly, strengthening the management capacity of collaborating partner can be combined with using their planning and monitoring capacity. In the case of companies and business associations the information generated to manage business operations would also be made available for the purpose of impact monitoring. The meso level support organizations and public service providers have to perform an information function anyway. Strengthening their capacity includes collaborating in regular monitoring as well.

References and Weblinks

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Weblinks

Links to Literature and websites in different fields of evaluation: www.mande.co.uk/specialist.htm

Monitoring business service development: www.bds-forum.net/m+e.htm

Linklists to evaluation sources: www.policy-evaluation.org