

## Value Chains, Networks, and Corporations

**Micheal Porter** from Harvard Business School **first described value chains in 1985** as the high-level interrelationship between a business' key operations or activities that are involved in delivering value to that business' customers. **Value chain definition has evolved over time** and it is relevant to mention a more recent definition elaborated by Downing et al. (2007, p.9), that broaden the concept *“the full range of activities that are required to bring a product from its conception to its end use. These include design, production, marketing, distribution, and support to get the product to the final user. The activities that comprise a value chain may be contained with a single firm or may embrace many firms. They can be limited to a single country or stretch across national boundaries.”*

As highlighted by Altenburg (2007), **the novelty of value chain approaches resided in the search for drivers of competitive advantages beyond the neoclassical factor cost differential**, building on location-specific conditions, and external economies, such as linkages with supporting industries, competition, consumers' demand and government regulation. Sturgeon (2000) expands on Porter's concept highlighting the **distinction between “chains” and “networks”**, and making distinctions at organizational and spatial scale, where the **“chain” maps the vertical sequence** of events leading to the delivery, consumption, and maintenance of a particular good and service, while a **“network” maps both the vertical and horizontal linkages** between economic actors.

Figure 2 – Porter Value Chain

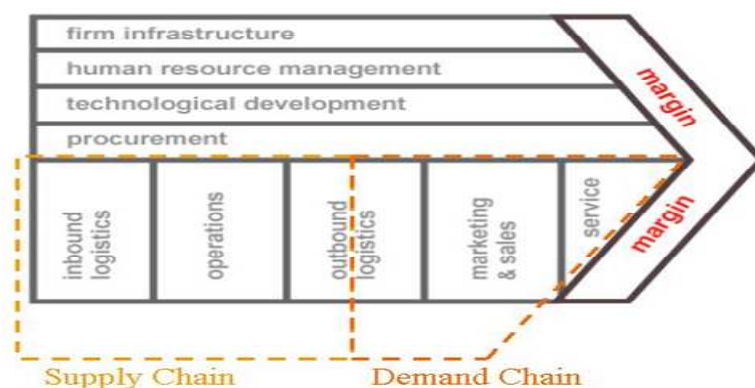


Table 2 – Organizational Scale – Value Chain and Production Network,

Name	Definition	Other names
<b>Value Chain</b>	Sequence of productive (i.e., value added) activities leading to end use	<ul style="list-style-type: none"> <li>- Supply chain</li> <li>- commodity chain</li> <li>- production chain</li> <li>- activities chain</li> <li>- pipeline</li> </ul>
<b>Production Network</b>	Two or more value-chains that share at least one actor (network linkage)	<ul style="list-style-type: none"> <li>- Value network</li> <li>- input-output matrix</li> <li>- supply-base</li> </ul>

Source: Porter, 2000, *mimeo*

The French researchers that developed the *filière* approach (Malaussis before and Raike, Jensen, Ponte, 2000) brought *important contributions to the understanding of the later defined value chains studying vertical integration in agriculture*. **Filière authors have drawn scholars' attention on the uneven power and influence degree of different stakeholders on the governance of a value chain and on creating or releasing barriers to entry**, and generating producers rents.

As seen in Gereffi et al. (2005) in global value chains key, lead actors are often present. This or these actors, depending on the type of chain, have the power and the capability to define and impose the parameter of the contracts in the value chain.

### Market-led Development

While **high-value agricultural production is considered** (Carletto, Kirk, Wiinetr, Davis, 2007) to be one of **the most important mechanisms to extend the benefits of globalization, yet there is an enormous gap in how benefits and margins are shared** along value chains. As Binswanger and Deininger (1997) highlight, market failure is pervasive in underdeveloped agriculture. The table below provides some examples of **market distortions** that are **widespread** in developing world that can be resumed by a line from Grossman and Stiglitz (1977): *“as long as there is imperfect information or an incomplete set of markets, then maximizing the well-being of shareholders does not lead either to economic efficiency of general well-being.”*

Sources of Market distortion and Failure	Sources of distortion in Agriculture
The existence of monopolies, cartels and market power	High transaction costs (e.g.: in altering production modes)
Externalities	Social (labour conditions), Environmental (e.g.: soil erosion and Salinization) Health (e.g.: Obesity)
Collectively produced and/or consumed goods	Indivisibility of many rural investments (e.g.: R&D, marketing, roads, and irrigation).
Imperfect information	Information asymmetry (e.g.: between smallholders and wholesalers)

Elaboration of the author, based on Stiglitz (1994, 1998), Binswanger and Deininger (1997)

In addition, Alternburg (2007) outlines that: *“with the exception of some emerging Trans National Companies (TNCs) from newly industrialized Asian countries, lead firms are almost exclusively based and embedded in OECD countries.”* **Structural factors, market failures and colonial inheritances** have posed for decades **entry barriers to the equitable participation of farmers**, in particular small-scale farmers into the agri-food market, limiting the effectiveness of market-led agricultural development (Bezemer and Headey, 2008). Kydd and Dorward (2003) provide an interesting reading of how coordination failures in the agri-food systems in Least Developed Countries (LDCs) have generated market failures, simplifying **dominant agricultural development policies into two broad phases: state- and market- led development**. The first was dominant until the mid-seventies stressing *“the role of the state in actively intervening in, and taking over, strategic economic activities* (Kydd and Dorward 2003, p.2)”. During this phase many public and parastatal marketing bodies were set-up to support the spread and adoption of innovation among small-scale farmers. Weak private sector and poor market infrastructures generated a poor investment climate, unattractive for investment opportunities, as well as important coordination challenges. Mistrust towards private sector firms and the *“belief in the need for the state to actively intervene to direct the economy to achieve both productive and welfare objectives”* (Kydd and Dorward 2003, p.2) completed the picture. These were the main reasons to justify state intervention, but by the early **80’s many experiences in state-led agricultural development were seen by donor agencies as a failure**. The weakness of the incredible number of parastatal rural institutions, the use of development programs to extend the areas of political and power influence, corruption and inefficient systems unable

to spread technologies, with a heavy burden on public sector budgets were among the reasons that brought this approach to fail. Donors and international agencies **reaction was mainly guided by neo-classical theory**, as the one that *“postulate(s) maximizing behavior plus interactions through a complete set of perfectly competitive markets”* (Hoff 2000, p.2), limiting the functions of the state only to the pure public goods. **This has resulted in a reduction of interventions towards** goods that had been, so far, generally recognized as **public goods in agriculture**: research of pro-poor technologies; extension programmes to inform the development and spread the adoption of these technologies; market regulation & information; and physical infrastructure.

**Market-led development approach**, beyond the definition of the role of states **has brought a series of privatization, deregulation and liberalization in agricultural markets**. These new approach that emerged from the early 80's was supposed to be set up suited to cater to the needs of a diversified rural economy, and therefore to respond to the needs of rural poor. **But the reduction in public expenditure in agriculture has not been compensated by a rise in private sector investment** (Zezza, et al., 2007). **The reforms of the 80's have left a vacuum** on the Developing Countries states competencies **on Rural Non-Farm activities**, and while recognizing important weaknesses of *integrated rural development* **FAO has called** (FAO, 1998, p.330) public sectors to promote Rural Non-Farm Activities, since 1998. In 2005, Stiglitz (2007) estimated that Trans National Corporations (TNCs) channeled almost \$200 Billion each year in Foreign Direct Investment in developing countries. **This investment level can certainly reduce the resources** (technology, skills, infrastructures) **gap** developing countries suffer from, generating economic benefit, **but have generated** as well *“negative social, political and environmental externalities, and therefore highlighting the market failures for which companies do not pay the cost”* (Stiglitz, 2007, p.192). Even recognizing the benefit they bring to developing countries in which they invest, there is still one big question on how the revenues generated along the value chain are shared, and which business models can guarantee a different attribution of value along global value chains<sup>1</sup>. Many authors and agencies have focused for many years on researching the TNCs linkages with small-scale farmers, in particular, as reported by Altenburg (2007), UNCTAD (2001) research has shown how the perception of TNCs' role in developing countries has evolved and changed over the years. UNCTAD research has shown how most of the actors of the development context (NGOs, CSOs, governments, etc.) have moved from blaming TNCs for their quasi-monopolistic power in markets to being considered as an important driver of growth. **In recent years TNCs direct investment has shown** (Altenburg, 2007) **how it can help raising standards and productivity, and generate technological spillover from their operations in developing economies**.

### Market-led approaches

**The majority of market-based approaches can be broken down into three groups, based on the unit they analyze** and seek to influence: an individual enterprise, the value chain, or the market system.

#### **1. Enterprises**

The individual enterprise has been the focus of numerous poverty reduction efforts. There is growing interest for enterprise development, particularly for small and medium-sized businesses (SMEs), which may include co-operative enterprises formed by small-scale producers:

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<sup>1</sup>In 2005 Wal-Mart had more than \$250 bn of revenues, higher than the GDP of all sub-Saharan Africa (Stiglitz, 2007).

- **financial support**, in the form of microfinance; ‘missing middle’ finance, which tries to fill the gap between microfinance and commercial finance; first loss capital; patient/long-term capital; or venture capital;
- **technical assistance**, for example, mentorship or peer networks etc.; and
- **capacity building**, for example in financial literacy and book-keeping.

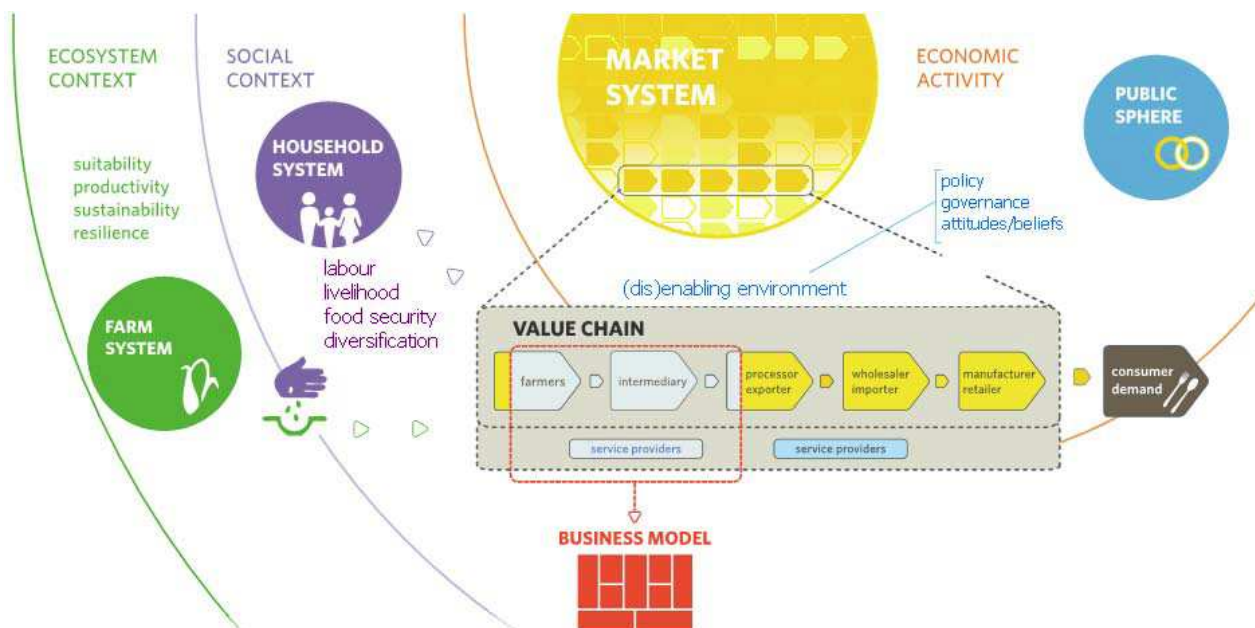
**Social entrepreneurs**, who use sustainable and scalable for-profit business models to create social and economic value, attract capital from foundations and socially responsible investors. Investing in social entrepreneurs and inclusive businesses is sometimes known as ‘**impact investing**’, which means **investing for social and economic returns**.

## **2. Value chains**

The **value chain approach** to development and poverty alleviation **involves looking at each link** in this chain, considering how each one relates to those before and after it, **and how much value (or profit) each link creates or captures**. For example, using Porter’s concept, NGOs can help producers near the beginning of the value chain capture more value (and profit) by processing or refining a product before they trade it to the next member of the value chain. **Value chain projects focus on business-to-business relationships**, and they encompass a range of activities intended to make value chains more effective and inclusive, including changing and strengthening relationships between links, and improving the flow of information, resources, and goods along the chain.

## **3. Market systems**

The enterprise and value chain approaches are limited in their focus to one or a few market actors and products. **A more recent systemic approach to understanding markets has become influential. ‘Systems thinking’**, a concept which was adapted by Peter Senge and others from its scientific use to analyze organizations and businesses, **defines a ‘system’ as a set of variables that influence one another**. Systems thinking emphasizes that cause and effect may not be close to one another in time or space, that feedback loops can amplify or nullify actions, and that small changes can create big results. A systems thinking approach to markets understands their **complexity and dynamism**. **It emphasizes the importance of understanding all elements in a system, including government, infrastructure, and hidden forces such as cultural beliefs and practices**, which are often ignored in more limited market based approaches. Because changes to a system may produce unexpected results, it is important to monitor market interventions closely to detect unintended consequences, and address those that are negative.



### Key questions:

1. Can different entry points and targets selected in a specific market-based approach generate different conditions for livelihood improvement and local economic development?
2. What are the costs and benefits of each approach with relation to your organization capabilities? Who are the actors that need to work together to make each of approach work?
3. Can small-scale farmers organize to meet the demand of corporate giants? Can distribution systems be adapted to make markets work better for the poor?

### Recommended resources:

Making Markets Empower the Poor: Programme perspectives on using markets to empower women and men living in poverty - <http://policy-practice.oxfam.org.uk/publications/making-markets-empower-the-poor-programme-perspectives-on-using-markets-to-empo-188950>

*The Missing Middle in Agricultural Finance: Relieving the capital constraint on smallholder groups and other agricultural SMEs*, Oxfam Research Report, Oxfam, Oxford. - <http://policy-practice.oxfam.org.uk/publications/the-missing-middle-in-agricultural-finance-relieving-the-capital-constraint-on-112348>

Aspen Network of Development Entrepreneurs - <http://www.aspeninstitute.org/policy-work/aspen-network-development-entrepreneurs>

Linking Worlds Platform - <http://www.linkingworlds.org/>

Stiglitz J., (2006), *Making Globalization Work*, New York, W.W. Norton & Company, Inc.