

# **Value Chain Analysis for Policy-Makers and Practitioners**

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## Foreword

The process of globalization has brought far-reaching impacts on the structure and sourcing of production, as well as the nature of market opportunities and competitive pressures for producers, around the world. Global buyers, who weave international networks for the sourcing, production, distribution and sale of goods and services, have received particular attention as they are, perhaps, the most apparent manifestation of what true global production systems involve. Receiving less media attention, but of equal importance, are the changes in production and sourcing behaviour of regional, national and even local producers, which is where the vast majority of the global workforce is to be found.

From the perspective of the ILO's Enterprise Development Programme, the promotion of decent work in enterprises is a key concern. To reach this goal, it is necessary to support the development of competitive enterprises whose investments in people, know-how, processes, equipment and good conditions of work are integral elements of an upgrading strategy – this approach forms the basis for achieving decent work and long-term competitive advantage.

The ILO and other development agencies recognise that upgrading along these lines cannot be done on an individual enterprise basis, but rather, requires a systemic view that applies methodologies based upon approaches such as value chain analysis and clustering. Value chain analysis (VCA) has become an increasingly useful approach to gain a comprehensive view of the various inter-locking stages involved from taking a good or service from the raw material to production and then to the consumer. Many interesting sectoral-specific examples of such a VCA tool have also flourished in recent years. However, a gap was identified where the insights of VCA could provide useful information for policymakers, at national and local levels, who must take important economic and social decisions, especially in countries who are trying to upgrade their industries.

In response to this need, the ILO and Rockefeller Foundation have partnered in the development of this VCA guide that is targeted specifically toward policy-makers and planners at different levels of government, business associations and trade unions and others responsible for developing strategies for enterprise development and local economic development.

This guide, written by Professor Hubert Schmitz, provides an excellent reference to this approach. It has been written in an accessible language, so those who are unfamiliar with VCA terminology will, nevertheless, be able to pick it up and make good use of it. It has also been structured to be flexible and user-friendly.

We are grateful for the collaboration that has resulted in this guide, and would like to acknowledge the efforts of Katherine Mc Fate of the Rockefeller Foundation and Anne Posthuma of the ILO who conceived of this project and provided support and comments that saw it through to completion. We hope that you will find this guide to be a useful reference.

Michael Henriques  
Director EMP/ENT  
ILO Geneva

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Many ideas contained in this paper were discussed in interviews and workshops held at several organizations, including ILO, UNIDO, ITC, USAID, ACDI-VOCA, MOIT-Jakarta, and BM Analysts-Durban. These discussions helped to identify the key points of interest to policy-makers and practitioners.

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I am grateful to all the above for their support, but the responsibility for everything said in this paper is mine alone.

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## **Introduction**

### **Who is this guide for?**

Are you a policy maker in the Ministry of Industry and Trade, trying to improve the competitiveness of small and medium enterprises?

Do you work in a local government agency with a brief to improve the earning opportunities of entrepreneurs and workers?

Are you the President of a Business Association that seeks to reposition local enterprises in the global economy?

Are you the Head of a Trade Union concerned about the threat of foreign competition for local jobs?

Do you run a NGO project that tries to improve the conformance of local producers with global labour and environmental standards?

Are you in charge of a bilateral donor project that seeks to reduce poverty by helping small enterprises to produce for distant markets?

Are you the Governor of a region trying to make foreign donor agencies fit in with your developmental agenda?

Are you a strategist in a multilateral agency seeking to achieve complementarity of donor inputs for small enterprise development?

Are you a consultant or advisor working for any of the above?

Are you a researcher studying the circumstances that enable regions to switch from the low to the high road of achieving competitiveness?

If your answer is YES to any of these questions, then the global value chain approach can help you do your job better. The approach comes from academic research on how local enterprises fit into the global economy, but this guide is designed for practioners and policy-makers.

## **How the guide is organized**

Section 1 presents the key insights of the value chain approach and the questions it raises about how the global economy is organized and how local enterprises can participate more effectively in it. Section 2 sets out why this new analytical approach is important for policy-makers and practitioners. Sections 3 to 8 tackle specific policy problems and provide practical ideas about how to address these challenges. The section headings should help you to find quickly what is most relevant for your situation. To some extent the sections build on each other, but the guide can be read selectively.

# 1. ■ Key insights from global value chain analysis

This guide has been written for policy-makers and practitioners who share a common goal: to improve the ability of local enterprises to compete in the global economy – and generate sustainable jobs and income for local people. There is no shortage of views on how to achieve this. Some believe that the key lies in a) ensuring that regulations and policies do not hold back small enterprises and b) providing access to training and credit. These factors are indeed important but not sufficient.

Recent work on local networks and clusters suggests that improving local relationships is critical, highlighting the relationships amongst local enterprises and the relationships between these enterprises and support institutions. The central message is that the density and quality of local relationships matter for competing in global markets. Even though actual experiences vary a great deal, the research on industrial clusters overturned the pessimism about export possibilities that used to dominate the small enterprise literature. There are some impressive success stories of local enterprises from the developed and developing countries breaking into global markets (Pyke and Sengenberger, 1992; Nadvi and Schmitz, 1999). However, we now recognise that these success stories cannot be explained by local relationships alone. The connections between the local enterprises and their global customers are also factors of success. Enterprises are not exporting into an anonymous global market; often they feed into supply chains that are governed by powerful global actors. Value chain analysis demonstrates that the relationships with

these global actors exert a major influence on upgrading and earning opportunities of local enterprises.<sup>1</sup>

## 1.1 What is a global value chain?

A value chain is the sequence of activities required to make a product or provide a service. In itself, this is a simple idea: school children know that their wooden desks started as a tree that had to be felled, transported to a sawmill and cut up; the planks of wood were then sold to carpenters who transformed them into desks that were then sold to shops or directly to schools. School children may not know about the numerous additional activities carried out along the chain, for example: drying of the wood, the certification that the timber comes from managed forests, the design of the desk, adding metal fixtures, painting, inspecting quality, etc. Adding these activities is merely a refinement of a simple idea.

The idea of a value chain becomes useful for analytical and policy purposes, once we include three further features:

first, the activities are often carried out in different parts of the world, hence the term *global* value chain;

second, some activities add more value and are more lucrative than others (the policy-makers' concern is to help local enterprises to move into the lucrative activities);

third, some actors in the chain have power over the others.

The powerful actors are often called the 'lead firms' who seek to 'govern' the chain. They set and/or enforce the terms under which the others in the chain operate. A central concern of value chain analysis is to "unpack" the relationships between global lead firms and local producers – and the opportunities and constraints that result from entering such relationships.<sup>2</sup>

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<sup>1</sup> The theoretical and empirical importance of this argument is put forward in a number of recent works, including Humphrey and Schmitz (2002), Humphrey (2003), Schmitz (2004), and Giuliani et al (2005).

<sup>2</sup> For a more detailed explanation of the approach and case studies which show its relevance in both developed and developing countries, see Schmitz (2004).

## 1.2 Why and how value chains are governed

Why would lead firms go to the trouble and expense of setting up and supervising supply chains? No firm will incur the expense of developing arrangements with specific suppliers in order to purchase products that the market freely provides. There are two reasons why the global buyers do not rely on the market and create and control value chains:

*Product definition:* the more the buyers pursue a strategy of product differentiation, for example, through design and branding, the greater the need to provide suppliers with precise product specification and to ensure that these specifications are met.

*Risk of supplier failure:* the increasing importance of non-price competition based on factors such as quality, response time and reliability of delivery, together with increasing concerns about safety and standards, means that buyers have become more vulnerable to shortcomings in the performance of suppliers.

Not all chains are governed by powerful lead firms. Some chains are merely strings of market-based relationships: there are market transactions but little exchange of other information or learning occurs. In others, there is intensive interaction between buyers and sellers along the chain, but the power dynamics between enterprises are unequal. More systematically, one can distinguish between four basic types of relationships (Humphrey and Schmitz, 2002):

*(Arm's length) market relations:* buyer and supplier do not need to develop close relationships because the product is standardised or easily customised. A range of firms can meet the buyer's requirements and the switching costs are low.

*Balanced networks:* firms develop information-intensive relationships, frequently dividing essential competences between them. The interaction is characterised by reciprocal dependence. The buyer may specify certain product performance standards or process standards to be attained, and is confident that the supplier can meet them.

*Captive networks:* in this case, the buyer exercises a high degree of control over other firms in the chain. The buyer specifies the characteristics of the product to be made by the suppliers and the processes to be followed and monitors that their instructions have been carried out. This occurs when a buyer has doubts about the competence of firms in the supply chain.

*Hierarchy:* the lead firm takes direct ownership of some operations in the chain. The case of the intra-firm trade between a transnational company and its subsidiary falls into this category.

This typology is not the only one that could be used. (In fact, some authors suggest a slightly different typology see, for example, Gereffi, Humphrey and Sturgeon, 2005.) What is important to keep in mind is that there are different kinds of value chains and different chains may require different responses from policy-makers and local firms. For example, local firms seeking to sell their own products in global markets need different kinds of support compared with firms that make sub-products to the specifications of big global buyers.

In short, *relationships matter*.<sup>3</sup> If policy-makers expect local firms to learn from participating in the global economy, they need to know whether these firms engage merely in transaction (buying or selling) or interaction (which also involves intensive exchange of information and transfer of ideas). They need to be aware of power and inequality in the chain. Working for powerful players can bring great benefits, but will also severely limit what the firms or government agencies can achieve.

### **1.3 Why chain governance matters**

How value chains are governed by global lead firms is important for the following reasons:

*Value chains shape market access.* Even when developed countries dismantle trade barriers, developing country producers do not automatically gain access to developed country markets because the chains which producers feed into

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<sup>3</sup> McCormick and Schmitz (2002: 93-94) set out criteria for distinguishing between relationships.

are often controlled by a limited number of buyers. In order to participate in export manufacturing for North American and Western European markets, developing country producers need access to the lead firms of these chains. These lead firms “undertake the functional integration and coordination of internationally dispersed activities” (Gereffi, 1999: 41). The decisions of lead firms create winners and losers in the developing world. For example, research on the UK-Africa horticulture chain suggests that small growers are marginalised – not because of the efficiency advantage of large growers but because of the lead firms’ sourcing strategies. Traceability is critical for these firms if they are to meet health, safety, environmental, and labour standards demanded by consumers, NGOs and government agencies (Dolan and Humphrey, 2000, 2004). Small farmers often cannot get into these export markets because they cannot meet global lead firm demands for traceability.

*Captive chains can create a fast track to the acquisition of production capabilities.* Producers who gain access to the chains’ lead firms often find themselves on a steep learning curve. The lead firms are very demanding with regard to reducing cost, raising quality and increasing speed. They also transmit best practices and provide hands-on advice – and pressure! – concerning how to improve production flows and raise skills. This combination of high pressure and high support (which is often found in the highly governed chains) explains how relatively underdeveloped regions can become major export producers in a short period of time. The Brazilian shoe industry in the early 1970s and the Vietnamese garment industry in the late 1990s are good examples. There is now broad agreement in the literature that this upgrading effect is particularly significant for local producers new to the global market (Gereffi, 1999; Keesing and Lall, 1992; Piore and Ruiz Durán, 1998). At the same time, tight chain control, which facilitates the fast acquisition of production capabilities, can create barriers for the acquisition of design and marketing capabilities. Local producers will not be encouraged to encroach on the core competencies of the global buyer (Schmitz and Knorringa, 2000).

*Gains are distributed unevenly across value chains.* Understanding the governance of a chain helps to understand the distribution of gains along the chain. Kaplinsky (2000) suggests that the ability to govern often rests in intangible competences (R&D, design, branding, marketing) characterised by high barriers to entry. The high returns reaped usually go to developed country firms. In contrast, developing country firms tend to be locked into tangible (production) activities, producing to the standards set by the lead firms; suffering from intense competition and reaping low returns. These distribution issues are critical to debates about the benefits of global economic integration. Nadvi (2004b) shows that – in spite of inequalities along the chain – the job and earning opportunities for workers, especially for young women, have improved enormously over time.

These are just some of the reasons for turning to global value chain analysis. The main proposition of this Guide is that the approach is useful not just for analysts of economic development but also for policy-makers and practitioners. The next section provides the general reasons and subsequent sections then address specific policy issues.



## 2. Why the value chain approach is important for policy and practice

As set out in the opening paragraphs, this guide targets policy-makers and practitioners who seek to:

enhance the ability of local enterprises to compete in the global economy and

improve the earning opportunities and working conditions of local people.

### **The big picture**

Coming up with good economic policy appropriate to the level of development in an industry and country requires an understanding of how local enterprises fit into the global economy. This is a big question. How can it be made manageable? The way forward is to focus on the sectors in which the local enterprises specialise and then ask how the global market for products from this sector, is organized. As pointed out before, often these markets are not free-for-all open spaces. The spaces are coordinated by global buyers who source different parts and services from around the world. There is increasing functional integration between internationally dispersed activities. The outsourcing of manufacturing and service activities from the high wage to the low wage economies accelerates this trend.

The Indian software industry provides a good example of how developing country enterprises can take advantage of this trend. India has become a successful exporter of software. By 2004, export revenues from software had grown to \$12.0 billion, a rise from \$3.4 billion five years before. These export revenues came predominantly from software-service provision, rather than complete software packages. Indian firms did not compete head-to-head with global companies such as Microsoft, Oracle or SAP. Instead, they piggy-backed on the global trend to

outsourcing of services by providing software services tailored to the demands of global businesses.

The general point to be made here is that grasping the big picture is important, not just for the entrepreneurs, but also for the policy-makers. Should they help local enterprises to find a niche in global value chains coordinated by outside enterprises? Or should they provide support for local enterprises so that they can produce and market their own product overseas? In some markets it remains possible to develop your own design and brand, make the product to your own specification, and then export it directly. For example, some furniture makers in Damietta, Egypt, have taken this route successfully with support from the Industrial Modernisation Centre in Cairo. But helping a local furniture enterprise get on the radar screen of IKEA, so that it can produce furniture to the buyer's specification would require a different kind of support. Understanding value chains in an industry allows policy-makers and practitioners to provide relevant and appropriate support to local enterprises. This is discussed in more depth in **Sections 3 and 4.**

### **Chain links and bottlenecks**

In all countries excellence can be found in some individual enterprises. Discussion on improving competitiveness often concentrates on how to achieve more of such individual excellence. This is useful but not sufficient. The competitiveness of the individual firm depends upon the competitiveness of the value chain to which it belongs. "Competitive pressure to achieve efficiency gains obliges companies to interact more closely with partners upstream and downstream in the value-adding process." (Altenburg, 2004: 4)

The implication for policy-makers is that linkages deserve more attention, both domestic and global. The quality of domestic linkages and domestic support systems plays a critical role in creating international competitiveness. Being competitive internationally requires an effective domestic value chain. This means suppliers that provide on-time delivery of high quality inputs, as well as support institutions that can test the quality of the inputs and certify conformance with international standards.

Value chain analysis helps the policymaker to find out where the bottlenecks are. Which part of the chain holds up progress in the others? Which bottlenecks deserve priority attention of government? Which can be expected to be resolved by the private sector and which require public-private partnership? Where can the donor agencies help?

These are typical questions for a Ministry of Industry and Trade. Such ministries typically have sectoral departments and priorities. Mapping the relevant value chain helps these departments to identify where there are weak links. Knock-on effects up and down the chain become more apparent, complex interdependencies can be visualised and communicated more easily. Thus, the value chain approach provides a framework for sector-specific action.

The value chain perspective ensures that this action plan does not stop with domestic linkages. It highlights the importance of facilitating linkages with the global economy. This includes improvements in infrastructure, customs and visa procedures, which enable enterprises to move goods and people quickly in out of the country. Most countries have progressed in this respect. Less recognised – and more difficult to implement – is the support for finding customers in other countries. Later in this guide we will discuss how local enterprises can be helped to connect with capable buyers; see **Section 4**. The main general point is that the value chain approach, by tracing the connections from the buyers to the producers helps to establish priorities for action.<sup>4</sup> It can also be used for drawing national and foreign support agencies into a common strategy, as discussed in **Section 8**.

### **Leverage points for policy initiatives**

Understanding the centrality of relationships helps to identify leverage points and ways to intervene. The leverage created when lead firms from developed countries govern a chain has been recognised by government and non-governmental agencies concerned with raising labour and environmental

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<sup>4</sup> For good examples of why it is important to adopt a value chain approach and how difficult it can be to make it work, see the experiences made in the South African auto and furniture industries (Morris, 2001; Morris and Barnes, 2004).

standards. For example, the UK government's ethical trade initiative recognizes the power of lead firms in ensuring that workers making goods for the UK market have decent working conditions. The size and market share of the big importers or retailers gives them great clout with developing country firms and governments. While this approach has potential, making it work requires more than putting pressure on big retailers to use their muscle. The critical factors that make such a strategy work and the extent to which it can be used to reach informal workers will be discussed in **Section 6** of this guide.

### **Funnel for technical assistance**

Multilateral and bilateral donor agencies have, for decades, sought ways of providing effective technical assistance to developing country producers. Progress was at best modest. Recently these agencies have embarked on experiments of fostering TNC-SME partnerships. The central idea is to combine technical assistance with connectivity. The lead firms of chains become the entry points for reaching out to a multitude of distant small- and medium-sized suppliers. It is recognised, however, that some buyers may require "mentoring" in order to fulfil this funnel and transmission function. The UN Global Compact, UNIDO, GTZ, DFID, the Prince of Wales Fund and other organizations are experimenting with this approach, but more areas of application need to be explored. For example, Dolan and Humphrey (2000, 2004) highlight the critical role played by UK supermarkets and importers in horticultural value chains and point to the importance of working with these buyers in initiatives to promote local production of export horticulture crops. **Sections 5 and 6** will show how the value chain approach guides practitioners and shows a new way of helping local enterprises gain market access or upgrade their capabilities.

The above serves merely as an initial indication of why the global value chain approach is important for policy-makers and practitioners. The following sections of this Guide will discuss these issues further and explore others. It is assumed throughout that the overriding goal is to help local enterprises compete in the global economy and to improve the earning opportunities for local people. We will proceed, however by

Why the value chain approach is important for policy and practice

examining more discrete, specific problems and then show how the value chain approach can help deal with them.



# 3. Customer demand as the driver of change

## 3.1 What is the policy problem?

Public policy aimed at the private sector typically tries to influence decisions of entrepreneurs (owners and/or managers) so that they can grow and improve their performance. However, entrepreneurs are (often rightfully) sceptical of the advice they receive from government agencies or consultants employed by local or foreign support institutions. Entrepreneurs do, however, listen to their customers. If policy-makers and practitioners start with this fact, they can more productively engage with the private sector.

### **Bringing the customer perspective into the upgrading process**

Programmes aimed at improving the capabilities of enterprises, particularly small- and medium-sized enterprises, often provide a selection of services that are deemed to provide support for enterprise upgrading in critical areas. These might be management skills, equipment purchasing and use, quality systems or human resource development. Who decides which of the services are really needed? In many cases, it is the service providers themselves. They have certain ideas about the problems that SMEs face. In other cases, the SMEs decide themselves. This is the "production ? out" approach, which upgrades the capability of the producer, expecting that this will lead to success in the market.

The "market ? in" approach starts with the customer and the market. It asks what are the critical success factors needed to win business from buyers; and it analyses the gaps between the requirements of the buyers and the capabilities of the suppliers.

In many cases, it is necessary to go to the buyers themselves to find this out. This was highlighted by an upgrading project for

the small auto component manufacturers in South Africa. The component manufacturers were asked to rate the importance of a series of critical success factors (price, quality, reliability of delivery, speed of response, product design, etc.) for their customers and also to evaluate their own performance on each of these items. The same questions were then addressed to the customers of these firms. The customers had a very different perception of what aspects of supplier performance really mattered, and also different assessments of the level of competence of the suppliers. If service delivery had been based upon the manufacturers' own assessments, resources would have been wasted in improving performance in areas that would not have been priorities for the buyers.

### 3.2 Identifying areas in need of improvement

Value chain analysis has generated a simple and effective tool: comparing producers' assessment of their own competitiveness with the buyers' assessment of the producers' competitiveness. For this technique to work, it is essential to break down what one means by competitiveness and to operationalise the components in simple terms. For example, in the garment or footwear industry, the relevant criteria are:

Product quality

Price

Time from order to delivery

Punctual delivery

Flexibility

Innovative design.

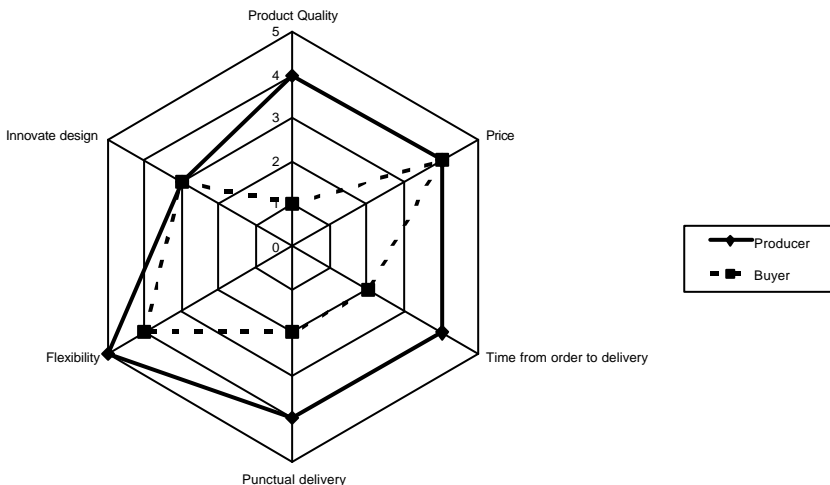
Producers might perform poorly in terms of, for example, quality and punctuality, but well in terms of price and flexibility. Such differences emerge clearly if one asks the buyers to rate their suppliers' performance using a five-point scale for each of the above criteria. Suppliers can then be asked to rate their own performance using the same criteria and scale. The comparison of this self-assessment with the buyer's assessment is a powerful tool for helping the entrepreneurs to identify *where* they might be failing and *where* they need to improve. In the



Dominican Republic, this tool was used, to good effect, to help local garment manufacturers recognise in which specific areas they needed to change and invest (Bessant and Kaplinsky, 1995). It has also been used in other cases, including the furniture industry of South Africa, Brazil and Indonesia (Kaplinsky et al., 2003; Navas-Aleman, 2004; Ewasechko, 2004).

The effectiveness of the tool is enhanced if it is visualised as a radar chart – sometimes called a star diagram. Figure 1 gives an example; it shows how shoe manufacturer SwingSole views his own performance and how his buyer LinKaris (fictitious names) views that performance. SwingSole's view, that he is very competitive on price, is confirmed by LinKaris, but she differs with him on other criteria. The difference is particularly stark with regard to quality and punctuality. It seems that these two areas need priority attention. Does the problem lie within SwingSole's own factory? Does it lie with his suppliers? Or with the way they interact? Of course, there is no certainty that SwingSole accepts LinKaris's view. But he is more likely to react to her (the buyer's) view than that of government officials or consultants.

Figure 1 : Comparing the views of producer and buyer



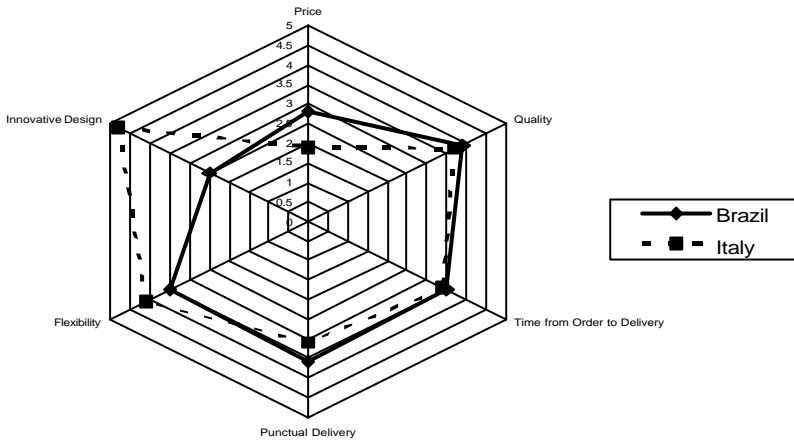
The problem with the above example is that policy-makers do not want to deal with individual enterprises. They want to bring about a willingness to change in the industry as a whole. In order to do this, the same technique can be used. A sample of producers can be asked to rate their own performance and the responses can then be averaged. Similarly, a number of buyers can be asked to rate the performance of producers in cluster X. Of course, they have to be relevant buyers with direct experience of sourcing from cluster X. Buyers usually source from more than one cluster and can thus make a judgement on the strength and weaknesses of producers in cluster X – taking into account the performance of rivals from other clusters in the world. Such comparisons of clusters or regions, based on buyer perceptions, can also be a powerful way to induce change.<sup>5</sup>

Figure 2 shows an example, based on interviews with US and UK buyers of leather footwear (Schmitz and Knorrington, 2000). These buyers were asked to rate the performance of their suppliers in various countries. The figure shows how suppliers in two countries – Brazil and Italy – compare. When Brazilian shoe producers and policy-makers were shown this comparison they were very proud that, in terms of quality and speed, they could match the Italians. Of course, they knew that the Italians were world champions in design, but they were dismayed that they were so far behind (in the view of the buyers). This diagram, and the discussion it provoked, contributed to a rise in Brazilian investment in design facilities and capabilities, by both the private and the public sector.

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<sup>5</sup> The details of conducting such an exercise are explained in the manual for value chain research by McCormick and Schmitz (2002, chapters 10 and 13).

Figure 2 : Buyers' views of Brazilian and Italian shoe makers – a comparison



It is not the purpose of this guide to go through the technical details of making such radar charts, nor discuss the variations in which they can be used.<sup>6</sup> The purpose is to demonstrate a way of breaking resistance to change in the enterprises targeted by the policy maker. This simple tool benefits the policy-makers and practitioners in two ways:

it helps to shake up the entrepreneurs and make them hungry for outside assistance;

it helps the policy-makers and practitioners to find a focus for their policies, programmes or projects.

### 3.3 Finding and building core competence

Value chain analysis can also be used to sensitise small and medium enterprises in a more fundamental sense. In many situations they do not see where they fit into the bigger picture. They may find it difficult to identify their core competence. They may not realise the full impact that new open-trade regimes and global sourcing have upon their competitiveness, or even their survival. In order to compete in the global economy it is critical

<sup>6</sup> The tool has a number of variations, discussed in the references mentioned above and in the resource pack *Manufacturing Excellence* (B&M Analysts, 2003).

to find one's core competence. Identifying this core competence means being able to answer two questions:

What product or service can the enterprise offer that is of particular value to customers?

Would it be difficult for others to copy this product or service?

Core competence can be built in different ways  
(B&M Analysts, 2003):

Novelty in product or service	Offering something no one else can
Novelty in process	Offering it in ways others can't match; for example, cheaper or faster
Complexity	Offering something that others find difficult to master
Customisation	Offering something tailored to specific customers.

The concept of core competence was developed for the corporate sector, but is even more relevant for SMEs. In the corporate world, discussions of core competence often turn on which product companies should concentrate on? Lap-tops or desk-tops? Women or men's shoes? For big enterprises, such decisions may be critical. For small or medium enterprises, such choices rarely exist. They need to decide which *part* of a product they want to focus on, or which specific activities, they want to carry out. Thinking in terms of value chains helps them to identify their "niche". This niche can consist, for example, of helping others in the chain to connect through specialised logistic services.

Value chain analysis emphasises that enterprises carry out bundles of activities. Deciding which part of the bundle they need to shed (or which new part they need to add) is a central part of a firm's strategic plan. What part of the chain do they want to occupy? What are the barriers of entry at this point of the chain? What income stream can they expect?

Entrepreneurs are unlikely to find the answer to these questions on their own. This is an area where management consultants can help. Much management advice for SMEs, subsidised by public bodies, aims to help entrepreneurs do better what they are doing, often driving them deeper into overcrowded sectors. What entrepreneurs need, however, is strategic help to see the

big picture and identify a specific spot that they can profitably occupy.<sup>7</sup> This is a hugely difficult undertaking in today's complex globally interconnected world. The value chain approach helps to set boundaries to the search. The boundary is not local versus global, but a particular local-global axis.

To illustrate, let us compare standard market analysis and the value chain analysis of markets. In the garment industry, standard market analysis will look at issues such as seasons, predicted fashions, consumer confidence, etc. in a given export region or country. Value chain analysis will help local producers to pay attention to differences between global buyers and the specific demands of particular buyers who supply these export markets. Recognising their specific needs will provide a way to focus on improving existing practices within local enterprises or on finding a new export niche.

Thus, global value chain analysis can help local enterprises – and the institutions supporting them – engage in a process that helps them to participate in the global economy in an informed and gainful way.

To sum up, we live in a buyer-driven world. As markets become more differentiated and complex, and as buyers become more demanding, the "market ? in" approach becomes essential for directing upgrading efforts and service delivery. Policy-makers, in order to be effective, need to learn to work with these drivers of change. The value chain analysis can help them do so. It provides policy-makers with a pair of glasses through which they can see how local enterprises fit into the global economy and it provides all the actors with the tools to identify where improvements will be necessary to make these linkages.

Using the approach does not mean clinging to a particular part of a value chain. In fact, it could lead the enterprises to see that their current spot in a chain is becoming overcrowded so that moving up or out is a sensible response. The next section

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<sup>7</sup> The resource pack *Manufacturing Excellence* (B&M Analysts, 2003) sets out the steps which enterprises need to take in order to find their core competence.

Value chain analysis for policy-makers and practitioners

shows how to encourage local producers to explore different parts of the chain or access entirely new markets.

# 4. Gaining market access

## 4.1 What is the policy problem?

Most countries have a considerable number of programmes and projects aimed at strengthening the competitiveness of SMEs. As discussed in the previous section, such assistance is often too supply-oriented (overly focussed on inputs for production - skills, technology, raw materials, credit) and not sufficiently concerned with who buys the outputs.

Attempts to identify more demand-oriented assistance measures have often involved taking producers to trade fairs. Subsidising visits to or exhibits at international trade fairs is supposed to expose producers to new product ideas and allow them to receive customer feedback. However, the critical question is whether such participation in trade fairs leads to new customers and new orders. In many cases, it does not.

The trade fair is often not the relevant marketing channel. Trade fair access *is* relevant when: (a) many producers confront many buyers; and (b) the producer defines the product (as with the craft market). There are many situations, however, when these conditions are not met.

In export markets in particular, it is very common that: (a) multiple small producers confront a few (big) buyers; and (b) the buyer defines the product. These buyers rarely use trade fairs to find new suppliers – as stressed by a director of Li&Fung, one of the biggest chain coordinators in Asia. In these situations, participation in trade fairs is not an effective way forward.

This point can be underlined with statistics from the twice-yearly shoe fair in Düsseldorf, the main fair for the European market. In spite of their very large and increasing market share, developing country producers are poorly represented there. They access this market by supplying big buyers (who define the product). In contrast, a large contingent of the exhibitors at

this fair comes from Italy and Spain; they seek to sell their own designs direct to a multitude of retailers. The organization of the value chain is very different and this needs to be taken into account when deciding how to support the marketing efforts of local producers.

Therefore, for policy-makers and practitioners, it is not sufficient to switch from supply to demand-oriented measures. Only certain kinds of demand-focussed support will be appropriate for different value chains. Knowing the way the value chain operates will lead to more appropriate interventions.

## **4.2 How can the value chain approach help?**

“Learning-by-visiting” is sometimes criticised as subsidised tourism. In many cases, however, it is an effective way of opening the minds of entrepreneurs. The question is always “visiting what?” The value chain approach points to a specific set of places and actors.

Take the case of producers aspiring to export sports wear to new markets. An appropriate learning tour might include visits to: the retail environment to see where the products are displayed and sold to the consumer; the retail company that organizes the sales; the design department (or agency) that defines the product; and, the logistics firms that organize the transport and just-in-time delivery. In other words, the aim of the (subsidised) visit is to give the producer a first hand impression of the final market, the organization of the chain, the instruments at the disposal of the various actors in the chain and the pressures under which they operate. Such “chain visits” are rare, but are increasingly relevant where policy-makers want to assist their local producers to access new markets. Since access to these markets is often not free but controlled by the chain coordinator, it is important for local enterprises to learn how the chains are coordinated and gain access to this coordinator or lead firm.

Finding out how a chain works may be quite a challenge. Where big retailers source directly from the supplier, the relationships are clear. But they are more difficult to suss out when lead firms source indirectly. A number of major US, UK and German retailers source garments and soft furnishings



through the Hong Kong based firm Li&Fung. Who defines the product? Who decides where it is sourced? Answering these questions would be on the agenda of the visiting mission. Another important question is: what parts of the chain offer the best opportunities for the entrepreneurs? While the manufacturing stage is often overcrowded, other stages may well offer better opportunities, for example, logistics, design or maintenance services.

An important detail is that the missions investigating such issues in the course of their “chain visits” include not just the aspiring entrepreneurs but also the policy-makers and practitioners. They too need to learn how the real world works in order to communicate with the entrepreneurs and provide effective support.<sup>8</sup>

Setting up such visits may seem a daunting task for the local policy-maker or association. However, they should keep in mind that buyers are constantly scouting for new suppliers and may, indeed, welcome the approach. In some cases, aid agencies might be able to help in organising and co-funding the visit. Instead of sending consultants to the developing countries, aid agencies should devote more effort to bringing developing country producers and government officials to the developed countries, helping them to learn how the markets are organized and what consumers expect.

### 4.3 The limitations of the value chain approach

Value chain analysis is very effective in tracing product flows, showing the value adding stages, identifying key actors and the relationships with other actors in the chain. It is actor oriented. Often, however, these actors operate within certain rules that

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<sup>8</sup> The International Trade Centre has in fact used this approach. A ‘market orientation tour’ was organized for 30 entrepreneurs of the Ugandan and Kenyan processed food industry. This was however thought to be too expensive and not repeated. ITC now prefers to bring buyers to workshops in the producing countries; the pressures and opportunities along the chain are then explained and discussed during the workshop. Clearly this is a less expensive approach but is it as effective in terms of participant learning? Such issues do not have an easy answer. It all depends on how well the chain tours or workshops are organized, how the participants are selected and how the costs are shared.

are set by others. Trade rules and standards are obvious examples. Value chain analysis needs to be complemented with information on these rules. Providing information on the trade rules that apply in distant countries is widely seen as an important function of government.

Providing producers with information on the tariffs, quotas, quality standards, labour standards and environmental standards imposed by the importing country is in itself not difficult. Providing this information in a specific and meaningful way is more complicated. An ideal way of doing this is to include information on such rules in the visiting programme outlined above.

In summary, helping producers to gain access to distant new markets requires a new approach: one that prioritises visiting the companies that coordinate the chains from producers to the final market, and getting to know the blockages and opportunities that arise throughout the chain.

# 5. Upgrading local enterprises' capabilities

## 5.1 What is the policy problem?

For some years the favoured approach for upgrading capabilities of SMEs has been to provide Business Development Services (BDS). However, there is increasing uncertainty concerning the effectiveness of stand-alone BDS. What are alternative approaches?

In justification of the BDS approach, reference is often made to the Third Italy. A recent evaluation confirmed that “the local availability of specialised services is one of the competitive assets of the Italian SME production systems”, but then added that the “Italian BDS centres generally play a limited role to promote technological innovation and management changes in the firms serviced” (Pietrobelli and Rabellotti, 2002: 67). In other words, the services provided by technology or marketing institutes were less important than often portrayed in accounts of the industrial clusters in Italy.

With regard to developing countries, BDS continue to be favoured by donor and government agencies. There has been an enormous amount of debate about what role these agencies should play: should they get involved in the provision of such services or concentrate on creating a market for them, so that private providers would emerge? The latter view won the argument even though it remains controversial whether the targeted SMEs can bear the full cost of the service provided.<sup>9</sup>

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<sup>9</sup> The analytically most insightful and politically most realistic assessment has been provided by Altnburg and Stamm (2004). Differentiating between types of BDS, they identify those situations where BDS are best provided on a purely market basis and where donors should support the creation of such markets. However, they also identify situations of market failure where state- or donor-led provision of subsidised services is justified, in particular where these services provide public goods. Equally important, they stress that realistic design or reform of service provision needs to take into account the interests and ambitions of government agencies.

The more important question, however, is how much these stand-alone services actually matter for the upgrading of SMEs. Their relevance was, in fact, questioned a long time ago in a study that seems to have been forgotten. An evaluation of the promotion of rural small industrial enterprises in nine countries, carried out by UNDP et al. (1988), concluded that buyers are more effective in transmitting the capabilities required to compete in distant markets than publicly funded business development services. More recently, a study of BDS for small enterprises in Thailand and Vietnam concluded, “services provided through the business relationships were the most prevalent and diverse type of service in both countries” (Anderson, 2000: 3). In other words, trading relationships contributed more to the upgrading of small enterprises than stand alone services. This is also the conclusion of an ILO/AFE study: “it is the exporters (traders) who provide the majority of business services to small-scale enterprises in the craft sector of Ghana. These services include market access, product design, quality control, and production training. The exporters provide these services to the producers as part of their commercial transactions with them. They are therefore referred to as “embedded services” (ILO/AFE, 2002: 10).

This recognition of embedded services coincides with a central message of recent value chain research: buyers often play a major role in helping local producers to upgrade their processes and products. Under what circumstances does this upgrading occur? Can policy-makers harness or create these circumstances to encourage more upgrading by private market actors? The remainder of this section seeks to answer these questions.

## **5.2 How can the value chain approach help?**

A lot of knowledge is transferred along the value chain from the buyer to the producer. Such specific knowledge is critical for upgrading products and processes. This is not new. But recent value chain research adds an important insight: the upgrading opportunities of local enterprises differ according to the type of value chain they feed into. In other words, the way trade is organized matters.

Over the last two decades, the importance of trade coordinated by global buyers has greatly increased. This has had a major impact on local producers' ability to upgrade their capabilities and produce for global markets. Working to the specifications of large global buyers often provides a fast track to upgrading processes and products. The evidence comes from many sectors, including garments, footwear, furniture and electronics (Gereffi, 1999; Hobday, 1995; Humphrey and Schmitz, 2004; Loebis and Schmitz, 2005; Nadvi and Thoburn, 2004; Schmitz and Knorrinda, 2000).

In order to explain this finding, one needs to understand why global buyers set and enforce the terms under which other firms in the chain operate. Why do they go to the trouble and expense of setting up and supervising supply chains? The central reason is a fear of not having the product to the right specification, at the right time in the right place – or the “risk of supplier failure”.

The fast upgrading of the suppliers results from the dual role of the buyers: they are extremely demanding, but they also need to provide assistance so that these demands are met. Much of this assistance takes place in the context of detailed monitoring, i.e. not just exposing failures, but also showing how these failures can be overcome. It is this combination of high challenge and support that propels the supplier forward and leads to fast improvement in processes and products.

But global buyers do not always play this enabling role. There are cases where they provide no support and others where they block producers' ambitions. The main aim of this section is to discuss how the positive experiences can be used for future initiatives. Fortunately, we can draw on recent experiments conducted by global, national and local support organizations.

### **UN initiative**

The United Nations is using the muscle and tapping the resources of transnational companies to promote the development of small- and medium-sized enterprises in poor countries. The most prominent examples are the UN “Global Compact”, run from New York (see [www.unglobalcompact.org](http://www.unglobalcompact.org)) and UNIDO's Business Partnership Programme run from

Vienna (see [www.unido.org](http://www.unido.org)). Entering into operational partnership with private business is a fairly new development for the UN and reflects the growing recognition that, in order to help SMEs compete in the global economy, it is also necessary to work with those who decide where and how products are sourced.

UNIDO has tried this approach in its Partnership Programme for the Auto Components Industry in India. The programme provides technical assistance to small- and medium-sized suppliers of components; the assistance comes from the lead firm or first tier supplier, complemented by institutions linked to the auto chain. UNIDO claims that the first phase of this programme has led to substantial improvements in product quality, efficiency and speed and helped to introduce a culture of continuous improvement (UNIDO, 2002c:16). A second phase of this programme is underway (UNIDO, 2003).

The organization has also produced a Guide, which sets out the principles for conducting Business Partnership Programmes along the value chain (UNIDO, 2002c). Two questions remain: can such programmes be “scaled up”? Are UN institutions the appropriate organizations to do this work? They have the status, some (not many) people with the required competences, but no financial resources of their own.

Private enterprises, especially trans-national corporations, seem to like being associated with UN initiatives, but it remains to be seen whether they are prepared to make the required investment to make these partnerships work. They often need to learn how to assist small- and medium-sized enterprises and how to work with other stakeholders. The hope that big injections of money by transnational corporations would propel such partnerships is not realistic. The corporations remain cautious and resist becoming “cash cows” for partnership programmes (borne out by interviews with stakeholders in UNIDO’s initiatives).

Other multilateral and bilateral agencies have begun to experiment with the approach (UN Global Compact, UNCTAD, IFC, DFID, GTZ). Best practices have yet to be distilled but there is agreement that simple matchmaking exercises (bringing

buyer and producer together) rarely lead to sustainable linkages (Ruffing, 2003; Lauridsen, 2004).

### **A national example from the UK**

The value chain approach can also be adopted for practical purposes at the national level. An example is the UK Textile and Clothing Industry Forum. This is a three- year £3.75m joint government/industry initiative to develop a supply chain development programme (started in 2001). Activities centre on “live” projects involving retailers and suppliers. Participating enterprises are expected to obtain tangible improvements in:

Design: new product development and co-development;

Manufacturing: aiming for world class performance;

Delivery: physical logistics and inventory management;

Supply chain management: the value of collaboration.

For the policy-makers, the two key questions are: How do we deliver assistance to participating enterprises? How do we disseminate positive lessons to others? Participating enterprises are required to: have senior management “buy-in”, undergo diagnosis by external consultants; hold on-site workshops involving a cross-functional team that will “own” the implementation process; and agree to regular reviews to ensure that the changes are on track.

The lessons of these experiences are (supposed to be) shared with the industry as a whole through:

[www.industryforum.net](http://www.industryforum.net) – a dedicated website;

Case studies;

Workshops;

Training programmes.

Evaluations of this initiative are not yet available. Such evaluations will need to distinguish between:

Benefits to participating enterprises. This is the easiest part of the evaluation because there are agreed operational measures (such as increased stock turns, shorter lead times, customer satisfaction, rate of product innovation, reduced overall cost of

product development, reduction in number of late design changes).

Benefits to the industry as a whole. These are much more difficult to measure but can be considerable. Supplier X who participates in the “live projects” is not only supplier to retailer A but also to retailers G and K who will, in turn, benefit but also be challenged.

Sustainability. Can the government withdraw/reduce its subsidy to the programme without the programme collapsing?

There are other ongoing chain-specific initiatives in the UK. The pioneer is the Industry Forum for the Motor Industry. It focuses on the component suppliers that work for the multinational assemblers, tries to bring together customers and suppliers, provides hands on assistance for suppliers of all size, and makes available case material on supply chain development and what that means for upgrading individual enterprises

[www.http://www.industryforum.co.uk/casestudies/supply.shtml](http://www.industryforum.co.uk/casestudies/supply.shtml).

Typically, the case material is very rich on specific chains and specific companies, but poor on issues of concern for the policy-maker. For example: what exactly was the role of government agencies in the initial phase and in later phases? How did the cost recovery change over time? What role did industry associations play? Were the trade unions involved? How was conflict mediated? Which of the lessons from upgrading programmes for *national* chains are applicable to programmes aimed at producers feeding into global chains?<sup>10</sup>

### **A local pioneer**

The principles of the value chain approach can also be used by local support agencies concerned with the upgrading of SMEs. An example, which went largely unnoticed but was pioneering at the time, was the “Programme to Upgrade Small Suppliers” carried out by the Brazilian Small and Medium Enterprise

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<sup>10</sup> The UK study “Using Supply Chains to Transfer Learning about Best Practice” attempts to identify positive policy lessons, but was hampered by the fact that “the blocking factors currently overwhelm those facilitating the diffusion of supply chain learning” (Bessant et al, 1999, p.iv).



Service (SEBRAE) in the state of Rio Grande do Sul in the mid 1990s. This programme was aimed at small firms who provided specialised components or services; it sought to raise their quality and delivery standards. To do so, it linked the small enterprises into existing supply chains.

In the case of footwear, the entry point was large shoe manufacturers. Through them, contact was established with their small suppliers. Upgrading focused on training for both the contractor and the small suppliers. Issues covered were both technical and behavioural, as it was recognised that improvements could only be made if the two sides respected and trusted each other.

The issues covered in the training sessions were then tested by the fulfilment of existing orders. By doing this, the SEBRAE initiative avoided two common problems: that enterprises are offered assistance before they realise they need it, and that they only realise they have a problem when orders have been lost. The cost of the programme was shared between SEBRAE and the participating enterprises. A local business association and technology centre helped in the implementation. Judging from presentations at seminars of the business association, and from discussions with the various stakeholders, this programme was successful, particularly in reaching the small providers of inputs and services. Unfortunately, the process and its outcome were not documented and their lessons were not used by SEBRAE for further experimentation and implementation elsewhere.

### **Making it work in Africa**

An experience that is more recent and well documented comes from Ghana (AFE, 2004). It is a programme of upgrading small producers of craft products, such as straw baskets. Ghana's craft exports amounted to US\$11.3 million in 2002. This production was coordinated by a small number of Ghanaian export companies. The upgrading programme used these export companies as a funnel for reaching a multitude of small producers in various parts of the country. The programme was funded by the Department for International Development of the UK and carried out by Action for Enterprise (AFE), a small

American organization specialised in private sector development.

While Ghana was able to quadruple its craft exports from 1993 to 2002, further growth was threatened by competition from other developing countries, notably Vietnam. One of the main problems was inconsistent quality. The export companies were fully aware of this but needed help in raising the quality of the output of their many small suppliers. This provided the entry point for the AFE project. AFE worked with the leading Ghanaian export companies to improve their ability to upgrade the processes and products of their small suppliers. Their activities included:

The development of quality management manuals, including quality control check lists and job descriptions for quality monitoring;

The organization of train-the-trainer workshops in quality management;

Piloting of quality management training workshop for basket weavers; and

The organization of a study tour to Vietnam, Ghana's main competitor.

The project showed that:

This approach is feasible, even for more traditional products such as handicrafts. Buyers can be persuaded to participate in upgrading prospects, provided that benefits can be demonstrated clearly (for example, reject rates were halved within a year).

The buyers often lack the capability of helping their suppliers. "The largest constraint was a lack of suitable approaches or delivery mechanisms" (p.23).

For the technical assistance to have a cascading effect, training needs to include the intermediaries who have direct contact with producers.

It can be useful to complement the chain approach with a public education campaign on radio and through market announcements. "It is very difficult for producers weaving

baskets in the rural areas of northern Ghana to understand the quality expectations of customers in Europe” (p.15).

There exists a small, but growing, body of experiments that use the value chain approach to upgrade the capabilities of small and medium enterprises. The main conclusions so far from these experiments are:

Involving buyers in the upgrading of small producers' work is a promising approach.

Mere matchmaking (bringing buyers and producers together) is not sufficient.

Participating buyers and producers can pay for a large part of the cost of assistance projects, but such projects can rarely be entirely self-funded.

Evaluations of these experiments are needed so that more detailed lessons can be learned.<sup>11</sup>

More experiments are needed.

### **5.3 What are the limitations of the value chain approach to upgrading?**

Even without evaluations of practical projects it is possible to anticipate limitations of an approach that uses the chain coordinators (often the buyers) as a funnel for technical assistance to small and medium-sized enterprises.

*Transaction costs.* Some buyers do not want to buy from a multitude of small suppliers. It is more efficient for them to work with a small number of key suppliers, so as to limit transaction costs. Pressures to do so are increasing: buyers need to be able to trace where products come from so that they can “guarantee” that they conform to advertised quality standards, safety standards, labour standards, or environmental standards. For example, UK supermarkets have the option of buying fresh fruit and vegetables from small producers but they prefer to buy

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<sup>11</sup> Lauridsen (2004) provides a valuable assessment of supplier development programmes pursued by central government and donor agencies in Thailand in the 1990s. While concentrating on producer-driven rather than buyer-driven chains, he highlights the institutional problems that arise in top down implementation of such programmes.

from large farms (Dolan and Humphrey, 2000; 2004). Another example is the Indonesian furniture industry (Loebis and Schmitz, 2005): its Scandinavian buyers source from large local producers and help these suppliers to improve their products and processes. Small local producers tend to work for traders who transact rather than interact. When problems arise, this leads to switching partners rather than exploring ways of overcoming future problems. Learning-by-losing-customers is at times inevitable, but not a positive upgrading trajectory.

In principle, there are ways to address this stumbling block. The small producers organize horizontally so that buyers can interact with one collective organization. Or a local entrepreneur could subcontract a group of small producers and ensure in situ that the buyers' requirements are met. Finding such ways of organising the value chain is not difficult. The question for the policymaker is how these relationships can be used to enhance the flow of know-how along the chain. This is the challenge. The Ghanaian case shows that the intermediaries need to be included in the technical assistance projects, but further experimentation and evaluation is needed.

*Conflict with buyer's core competence.* Buyers will only contribute to assistance projects that further their own interests. Projects that strengthen their suppliers' existing position in a chain are, therefore, promising. Buyers are interested in the upgrading of products and processes by their producers, but they are unlikely to be keen to support projects that seek to reposition those producers in the global chain. Buyers would be threatened by a project that strengthened the design and marketing capabilities of local producers, as this could encroach upon their core competence. However, global buyers might help local enterprises to move into less strategic functions, such as logistic services.

This section has been concerned with the process whereby the coordinators of the value chain assist suppliers to improve their capabilities. In labour intensive industries in developing countries, buyers have increasingly taken on an upgrading role. Experience suggests that buyers can act as a funnel for technical assistance to small- and medium-sized suppliers, but many questions remain unanswered. Further experimentation is

required to identify best practice. The objective of such experimentation should not be to replace the prevailing BDS approach based on stand-alone services. There is a need for both approaches. The task is to identify under what circumstances one or the other is more effective. Such an assessment does not yet exist, but we can point to two scenarios in which BDS remain important.

- Finding your first foreign customer(s). As stressed in **Section 4**, supporting participation in trade fairs is an important service for enterprises that operate in markets in which many producers face many buyers. And in markets dominated by few buyers, helping producers to access these buyers and visit their chains is a valuable service.
- Diversifying customers and markets. **Section 3** showed the advantages that come from focussing on core competence and being able to produce to the specifications of a global buyer. In order to avoid over-dependence on this buyer, it becomes important to gradually diversify customers and markets and to operate in several chains simultaneously. This is where BDS remain important. The information, advice and training required for this diversification are unlikely to come from existing buyers.



# 6 ■ Improving local employment practices and working conditions

## 6.1 What is the policy problem?

The problem for the policy maker can be stated very simply: regulations and standards designed to improve the terms of employment (e.g. social security) or conditions of work (e.g. health and safety standards) are rarely enforced in small and medium sized enterprises in developing countries. *Question:* How can the value chain approach help to enforce such regulations and standards? *Answer:* The approach helps to identify leverage points

## 6.2 How can the value chain approach help?

In order to show how the value chain approach can help with improving conditions of employment and work in supplier firms, let us recall some of the key points made in **Sections 1 and 2**:

Value chain analysis helps to explain the connection between all the actors in a particular chain of production and distribution.

Some value chains are strings of producer-buyer relations in which all parties can act freely. Often, however, there are powerful actors in the chain who control the flow of goods and services.

In labour intensive industries, such as garments or horticulture, the power has shifted from producers to traders or retailers. This is most pronounced in global value chains. In many product lines, global buyers set the terms for others in the chain. They decide what is to be produced, where, by whom, and at what price.

These new rulers of global value chains are vulnerable because they compete in final markets by building up an image. This image would be damaged if their products were made in factories and workshops that do not observe basic labour standards.

Pressure on lead firms of global value chains can be applied to improve working conditions amongst suppliers. Value chain analysis thus helps to identify leverage points for organizations concerned with improving labour standards.

This practical use of value chain analysis is widely known and forms part of the debate on corporate social responsibility. The key point is that the corporations are held accountable, not just for the labour conditions inside their own factories, but also for the labour conditions of the supplying firms. Corporations are expected to take on such responsibility because there is a business case for doing so. The arguments are that a) suppliers are more able to provide high quality and respond at greater speed if their workers are treated well; and b) being associated with exploitative working conditions damages the reputation and image of the corporation.<sup>12</sup>

NGOs in developed countries have clearly recognised the vulnerability of the chains' lead firms and have exerted pressure on these firms to ensure decent working conditions in their supply chains. The campaigns, focussed on retailers and brands such as Nike or The Gap, led these firms to introduce their own code for sourcing. Virtually all sizeable buyers have now adopted a sourcing code indicating their commitment to decent employment practices.<sup>13</sup> For example, buyers sourcing in Egypt and Thailand and actively engaged in coordinating textile and garment chains stressed (in the course of interviews with the author held in Cairo and Bangkok) that they only consider suppliers who are committed to comply with global labour standards.

The implication for policy-makers is not that they become superfluous. As stressed by Barrientos and Barrientos (2002), improvements in employment practices and social protection require work on several fronts. The pressure through the chain is a complement of, and not a substitute for, effective

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<sup>12</sup> For a good overview on corporate social responsibility and implications for small and medium enterprises in developing countries, see UNIDO (2002a).

<sup>13</sup> This paper focuses on the use of leverage for the improvement of employment practices. Such leverage can also be used for improvement of environmental practices, aimed at environmental sustainability of export production. See for example, Guizol et al. (2003), Posthuma (2004), Navas-Aleman and Bazan (2003) and Tewari and Pillai (2005).



legislation. Moreover, the arguments, which the policy-makers (and the trade unionists) can now use, have been transformed. They can argue that compliance with labour standards is not an obstacle, but a requisite for competing in global markets. Economics are on their side, even where politics are not.

Nor have progressive practitioners in local private or public organizations become superfluous. On the contrary, they play an essential role in making the chain approach effective. This will become clear in the following sections that examine whether and how the buyer-driven chain approach works.

### **6.3 Does the buyer-driven approach work?**

How effective are the buyers' codes in improving conditions of employment and work in the supply firms. There are many issues that have a bearing on this question; here we highlight the main ones:

*Employment practices have moved up the agenda.* There is no doubt that issues of child labour and decent working conditions are now on the agenda of firms that supply goods to advanced country buyers. We observed this first hand in the course of interviews in export-oriented clusters in Brazil, Indonesia and Pakistan. Local NGOs and/or trade unions had tried for many years to have these issues discussed in the local business community, but found these attempts were either ignored or rejected. This has changed. As stressed before, manufacturers listen to their buyers. Labour issues are now serious business items on the agenda of local firms and of associations.

*The proliferation of codes generates inefficiency and confusion.* The codes are voluntary and each buyer has adopted his/her own version. This can create inefficiency and confusion since manufacturers tend to work with several buyers. Jorgensen et al. (2003) discussed this problem with many stakeholders and concluded that the problem, while real, tends to be exaggerated. They stress that the codes have a common core and that the efforts required to harmonise the small differences would be huge and merely delay the implementation. One could go a step further and express a warning: focussing on the

differences could be used deliberately to delay implementation.<sup>14</sup>

*Buyers send mixed messages.* Suppliers are often asked to respond to two conflicting sets of buyer requirements. They are asked to conform to their buyers' labour code and, at the same time, are under pressure to lower their prices and speed up delivery. "The pressures of retailers and brand companies' own supply-chain purchasing practices undermine the very labour standards that they claim to support" (Oxfam, 2004: 7). Organizationally, this is easy to explain: company staff dealing with labour standards are rarely in charge of actual sourcing decisions. Intra-company division of labour can thus make it difficult to implement ethical sourcing. In itself this is a management problem that can be overcome. More difficult to overcome are the pressures that confront the buyers. Competition in final markets is often fierce, particularly in labour-intensive products, such as garments and shoes. In some markets, retailers may find that they have little option but to pass these pressures on down the supply chain.

*The top-down approach is insufficient.* The implementation of labour codes, as discussed so far, relies entirely on pressure from above. Jorgensen et al. (2003) investigated whether this system can generate real change. They encountered vastly different views. The positive case was put forward by an Indian apparel supplier, and echoed by many others: buyers' efforts in this area have achieved more in a few years than the Indian labour inspectorates have in 30 years (Jorgensen et al., 2003: 24). However, there are also many sceptics, stressing the limitation of the approach: some suppliers find the top-down approach does not involve them sufficiently in the development and implementation of codes. Workers find that they are not actively involved in the process of change. And institutional stakeholders lament the lack of indigenous roots for the solutions. The issue, therefore, is not whether the top-down approach works, but how it can be complemented. The next

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<sup>14</sup> In the case of the UK Ethical Trading Initiative, however, some harmonisation amongst UK buyers, NGOs and trade union organisations has been achieved and a 'base code' has been agreed. Also the German GTZ-AVE project seeks to replace multiple buyer-specific codes with common standards.

section provides examples of how buyers can work in alliance with other stakeholders.

## 6.4 Involving other stakeholders

This section shows ways of extending the buyer-driven approach and involving other stakeholders actively in the process of generating change. The central proposition is that alliances along the global-local axis (Messner, 2004) are central to bringing about change. However, for this change to be lasting it must include social dialogue and involve key stakeholders in discussions, decision-making and action at the different levels along the global-local chain. Here are some examples of how this can be made to work.

### **The Business Links Initiative in Vietnam<sup>15</sup>**

The Vietnam Business Links Initiative (VBLI) is an alliance led by the International Business Leaders Forum. It involves sportswear companies such as Nike, Pentland and Adidas, international NGOs, the Vietnam Chamber of Commerce and Industry, the Vietnam Leather and Footwear Association, and the governments of both Vietnam and the UK. The objective is to enable local shoe manufacturers to comply with local environmental and health and safety regulations, as well as meet the buyers' social and environmental purchasing criteria. In trying to improve workplace conditions, it focuses in particular on technical factors, such as the choice and handling of chemicals and measures to reduce noise, fumes and dust, which are crucial in providing a healthy and safe environment for workers.

The programme was developed through a consultation process with the footwear industry, worker representatives, government departments, research bodies, multilateral agencies and health and safety organizations. The main elements of the programme are:

*Commitment to Good Practice.* A common health and safety code is being developed for all participating factories. It

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<sup>15</sup> Based on UNIDO (2002a) and [www.iblf.org](http://www.iblf.org).

incorporates standards from the codes of conduct and best practises of all the participating sportswear firms.

*Management Support System.* Support materials such as health and safety guides, management tools, and information directories are being developed to assist factory managers in reviewing the conditions and practices in their workplaces and developing plans for improvement.

*Training.* Modules are being developed to meet the specific training needs of the various stakeholders.

*Monitoring and Inspection.* In the long term it is hoped that the government will take responsibility for monitoring and inspecting factories.

*Research.* Studies are being carried out to help support the development of the programme and to determine its impact.

Initial pilot projects in footwear factories have been carried out. Various practical and low-cost solutions were identified and could be implemented elsewhere. The VBLI is planning to create an exchange programme between factory managers to facilitate learning and innovation. In the long term, the aim is to build the capacity of local institutions to maintain a sustainable programme and to replicate this approach in other sectors and countries. An independent evaluation of the VBLI, which seeks to learn lessons, would be an essential step in this process.

## **A new alliance in Pakistan**

During the late 1990s, reports in the international media highlighted the presence of child labour in Sialkot's export manufacturing clusters, especially in the manufacture of sports goods. These revelations led to demands from Western consumer groups, trade unions and NGOs for a boycott of Sialkot-manufactured footballs. International buyers challenged local suppliers to meet international norms on the elimination of child labour from production. Consequently, in 1997, the Sialkot Chamber of Commerce and Industry (SCCI), with the ILO, UNICEF and leading international sports goods associations, signed the "Atlanta Agreement". Its aim is to remove child labour from the soccer ball cluster through a phased programme.

As shown by Nadvi (2004a), the Atlanta Agreement established the presence in Sialkot of the ILO's International Programme on the Elimination of Child Labour (IPEC).<sup>16</sup> Funded by aid donors, with contributions from local firms through the SCCI, it introduced ILO monitoring of soccer ball production in Sialkot. By 2000, 68 out of a total of some 90 soccer ball exporting firms in the cluster (accounting for over 75 per cent of the cluster's total production) were voluntarily monitored through the IPEC programme. In addition, the agreement supported initiatives by UNICEF and Save the Children Fund (SCF) to provide social protection to former child workers and their families. This sought to address the root causes of child labour through interventions on poverty alleviation and education and included support for schools, training and income-generating activities. The social protection agenda now has the active involvement of local NGOs and local government and promotes a district-wide strategy for universal primary school enrolment; this is a first for any district in Pakistan.

Most global buyers insist that their local suppliers join the ILO-IPEC programme for monitoring purposes. Some leading brand-name buyers have also opted for direct monitoring. The cluster historically relied on rural home-based workers to carry out the more labour-intensive tasks in producing soccer balls. This was where child labour was most common. Subcontractors acted as intermediaries between exporting firms and household stitching units. With the need for effective and cost-efficient monitoring, home-based work has given way to production in designated stitching centres. Under the ILO programme, the manufacturers must register the location of each of their stitching centres, and all production must take place within these centres, which are monitored by ILO-IPEC inspectors.

Thus, there is an alliance of stakeholders engaged in transforming employment practices. Nadvi (2004a) stresses that brand name buyers (pressured by NGOs in final markets) are the key actors in this alliance. They are most vulnerable to child labour scandals because a positive brand image is central to

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<sup>16</sup> IPEC was established in 1992 with the aim of eliminating child labour. The subsequent Worst Forms of Child Labour Convention No. 182 of 1999 has been the most successful, in terms of ratification, in ILO's history.

their competitive strategy. Consequently, it is these buyers who have been most forceful in implementing changes in practices on the part of their suppliers, the cluster's larger producers. In most cases, this involved an internalisation of activities formerly subcontracted to home-based workers. Some large firms set up centrally located factories where workers are transported from distant villages. This allows better monitoring of quality standards and regulating labour norms. As suppliers to the leading brand names, such firms have also had to adhere to the buyer's code of conduct. Local NGOs are monitoring the employment practices of these suppliers.

### **The Ethical Trading Initiative of the UK**

Alliances can also originate at the rich country end. A good example is the UK Ethical Trading Initiative (ETI) which is an alliance of companies, non-governmental organizations, and trade union organizations. It promotes and improves the implementation of corporate codes of practice that cover working conditions in supply chains. Its goal is to ensure that the working conditions of those producing for the UK market meet, or exceed, an agreed set of standards, the ETI Base Code. This Base Code contains nine clauses which reflect the most relevant international standards with respect to labour practices.<sup>17</sup>

The origin of the ETI is interesting because it underlines that buyers – even if well-intentioned – cannot achieve on their own, improvements in working conditions and recognition of their contributions. In the 1990s, companies selling clothing and food in the UK came under increasing pressure – from trade unions, NGOs, and consumers – to ensure decent working conditions for the people who produce the goods they sell. The companies responded by adopting a code of practice setting out minimum labour standards that they expect their suppliers to comply with. However, the companies who adopted such standards soon

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<sup>17</sup> The nine points covered are: no forced labour, no child labour, freedom of association and the right to collective bargaining, safe and hygienic working conditions, living wages, limits to working hours, no discrimination, regularity of employment, no inhumane treatment. Discussions with researchers examining the ETI indicate that the base code is least effective with regard to two of the above points: freedom of association and no discrimination.

found out that they had neither the necessary experience nor the public credibility to make the code work and obtain recognition. They realised they needed to work with civil society organizations with expertise in labour issues and overseas development. This led to the establishment of the ETI in 1998.

Making such alliances work is neither easy nor cheap. Government support has been critical. ETI is funded by a combination of government grant (40 per cent) and membership fees (60 per cent). Members also contribute in kind to ETI's work, notably by contributing staff time and covering travel expenses.

ETI activities are described in detail on its website ([www.ethicaltrade.org](http://www.ethicaltrade.org)). They include:

*Identifying good practice:* experimental projects provide corporate, trade union and NGO members with the opportunity to work together and identify good practice in specific aspects of implementing the base code.

*Monitoring corporate performance:* the progress of corporate members in implementing the base code is monitored through annual reporting review.

*Training:* improving the skills of corporate members and their suppliers in implementing the base code has become essential.

*Building capacity:* ETI supports organizations in selected supplier countries to develop the skills and resources to monitor and improve labour conditions at the local level.

*Sharing lessons:* the progress and difficulties are shared not just amongst members but also beyond, mainly through the website, publications, seminars and conferences.

Critical to the functioning of the ETI is its secretariat, which comprises ten full-time staff and draws on inputs from consultants. Discussions with its members suggest that this is a substantial initiative that could be a role model for other countries.<sup>18</sup>

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<sup>18</sup> There are initiatives in other countries that share some of the ETI features. They have a joint project to exchange experiences, conduct joint research and develop common guidelines for code implementation and monitoring. The partners include

The key question, of course, is whether the ETI has made a difference in the factories and workshops that supply goods for the UK market. ETI has commissioned a two-year study to measure its impact. Without such impact studies, it is difficult to assess the practical relevance of the approach. However, one lesson is already clear: buyer leverage on its own is not sufficient; other stakeholders are needed to monitor progress and ensure standards are met. All three cases presented above point to the need for alliances along the local-global axis that include both public and private actors.

## **6.5 The Limitations of the Value Chain Approach in Ensuring Employment Standards**

The chain approach has attracted a lot of attention, particularly in the context of the debate on social corporate responsibility (DFID, 2003; UNIDO, 2002a), which has drawn attention to the limitations of the value chain approach. Can this approach improve working conditions for those most at risk, especially those who produce for the global market but remain in the informal economy? Does it reach the increasing number of women workers providing goods and services for the global market? Does the reach of the value chain approach vary by industry? This section examines these issues briefly.

### **Differences between industries**

While buyers on their own cannot bring about changes in labour standards, without their leverage the initiatives discussed above would stand little chance of improving working conditions in supplying firms and workshops. But in some industries, even some that are export-intensive, lead firms and/or buyer leverage is indirect, weak or non-existent. This is sometimes forgotten.

The UNIDO (2002a) report on Corporate Social Responsibility emphasises that the way in which leverage can be used varies between and within industries. It suggests that in chains where there is an arm's length relationship between brand owners and

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ETI (UK), Clean Clothes Campaign (Europe), Fair Wear Foundation (The Netherlands), Fair Labor Association (USA), Social Accountability International (international) and Worker Rights Consortium (USA). See [www.jo-in.org](http://www.jo-in.org)



producers – for instance, in the case of agricultural commodities like coffee or cocoa – industry level initiatives are important. For example, the chocolate industry is dominated by a handful of global brands, but the supply chain is highly complex, involving numerous intermediaries and processing stages. Company codes would not work. Some of the chocolate companies have, therefore, accepted the need to use their influence on an industry-wide basis and have drawn up a protocol aimed at eliminating child labour in cocoa production (pp.22 and 27).<sup>19</sup>

Those working in the garment industry have emphasised the importance of differences *within* the industry. This comes out particularly clearly in the work of Doane, Ofreno and Srikajon (2003) on the garment industry in the Philippines and Thailand. They contrast the garment chains controlled by well known retailers or “brand” firms with other chains that are organized very differently. In the second kind of chains, traders and manufacturers come and go, relationships are market-based, and production is for the volatile low end of the market. The workers engaged in producing garments for these markets have precarious work conditions and little chance of improvement. There is no leverage from within the chain and the idea of corporate social responsibility has little relevance.

The value chain approach can highlight the distinctions between different kinds of relationships to help policy-makers understand realistic leverage points and options for moving forward. It can also demonstrate connections between the most disadvantaged workers and other parts of the industry within a particular country.<sup>20</sup> This can lead to an analysis of domestic leverage points. Who holds the power? What is the percentage of labour costs in total costs further up the chain? Would the cost of social protection make the manufacturers or their buyers less competitive? Chain analysis helps to answer such questions (McCormick and Schmitz 2002) and makes it possible to have better-informed negotiations.

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<sup>19</sup> The difficulty of making corporate social responsibility work in the cashew nut sector has been stressed by Kanji (2004).

<sup>20</sup> The methodology required for studying these connections has been set out by McCormick and Schmitz (2002) in the *Manual for Value Chain Research on Homeworkers in the Garment Industry*.

## **Are informal workers included?**

The informal economy provides the only access to income for the majority of the world's poor:

“Throughout the developing world, few poor people have salaried, institutional employment. Instead, they depend overwhelmingly upon earnings from occasional, low-paid wage labour, self-employment from micro-enterprises or employment in small and medium-scale enterprises.” (DFID, *Halving World Poverty by 2015*: 17-18).

An increasing, but unknown proportion of workers, in the informal economy are already integrated into the global economy in a variety of ways: as unregistered waged workers in export firms; as workers supplying these enterprises; and, as own account workers selling products directly or indirectly in export markets. They frequently have to cope with low and erratic incomes, and they typically lack rights, voice and social protection.

The ability of trade to reduce poverty depends on pulling down the value in global chains to benefit such workers. This involves regulation of employment practices, and extending the trade capacity of the informal economy. Advancing research and practice in this field has been the main concern of Women in Informal Employment: Globalizing and Organizing (WIEGO) – the leading global network specifically focused on the changing nature of informal work and employment as a consequence of globalization. It has affiliates in over 25 countries encompassing leading researchers and statisticians, international policy-makers and grassroots organizations of informal workers and producers, see [www.wiego.org](http://www.wiego.org) .

The value chain approach has been central to WIEGO's work because “it mainstreams informal workers and informal enterprises into the economic domain” (Lund and Nicholson, 2003: p. 20). The connections to the national and global economy become visible. This helps “to understand better how workers at different points in the chain of production have differential access to ‘ladders of protection’” (p.19). The agenda and methods for this pioneering work have been set out in a number of recent studies (Barrientos and Barrientos, 2002; Carr

and Chen, 2004; Lund and Nicholson, 2003; WIEGO, 2002). The way forward is clear: the vertical chain approach needs to be combined with a horizontal approach based on local self-help organizations.

### **How useful is the approach for improving the conditions of women workers?**

Campaigners and practitioners in NGOs and trade unions have been particularly concerned with the working conditions of women in enterprises that supply the global market (see box).

#### Conclusions of a recent Oxfam report

“Globalisation has drawn millions of women into paid employment across the developing world. Today, supermarkets and clothing stores source the products that they sell from farms and factories worldwide. At the end of their supply chains, the majority of workers – picking and packing fruit, sewing garments, cutting flowers – are women. Their work is fuelling valuable national export growth. And their jobs could be providing the income, security and support needed to lift them and their families out of poverty. Instead women are systematically being denied their fair share of the benefits brought by globalisation

Commonly hired on short-term contracts – or with no contract at all – women are working at high speed for low wages in unhealthy conditions. They are forced to put in long hours to earn enough to get by. Most have no sick leave or maternity leave, few are enrolled in health or unemployment schemes, and fewer still have savings for the future. Instead of supporting long-term development, trade is reinforcing insecurity and vulnerability for millions of women workers.”

(Oxfam 2004: 4)

The difficulties encountered by women workers in global supply chains are well documented, see for example Barrientos and Barrientos (2002), Smith et al. (2004), Women Working Worldwide (2003), Yimprasert (2003). However, the stark conclusion presented in the OXFAM report above does not capture the opportunities that have opened up for women due to globalization (Carr, 2004; Joeke, 1999; Kabeer, 2000; Kabeer and Mahmud, 2004; Nadvi, 2004b; Wood, 1991). The question is – how do their new roles compare with the hardships faced in more traditional settings? In terms of sheer numbers, the population group that has – on a global scale – benefited most from globalization is young women workers. Although huge problems remain, this transformation is of historical significance and needs to be recognised.

There is an important practical point here: a strategy that starts by noting the improvements for women workers (and then aims at further improvements) is more likely to succeed than one that denies progress has occurred. Even the most critical reports now stress the potential for improvements that can arise from using chain leverage (e.g. Oxfam, 2004). However, leveraging global pressure needs to be combined with local organizing to gain sustainable benefits for vulnerable workers at “the end” of a chain.

## **6.6 Conclusion**

This section has examined the way value chain analysis is being used to improve wages and working conditions in local supplier enterprises. A number of conclusions stand out:

- The chain approach provides an important new instrument for improving working conditions but its power varies with the organization of the chain.
- Leverage is strongest where lead firms’ reputation is enhanced/damaged by the labour standards in supplying firms.
- Buyer pressure from above does not make worker pressure from below redundant. Local-level worker organization continues to be important.

- The claims of some trade unions that worker organization and collective bargaining is the only way to improve employment practices seem misguided.
- The most promising way forward is an alliance along the local-global axis that includes global buyers, local enterprise associations, trade unions and NGOs.

Forming such alliances is difficult. Public support can help get them off the ground.

How much difference the chain approach – with its various add-ons – actually makes to workers in the supplying factories remains to be assessed in impact studies.

The new thinking on improving working conditions, particularly for the most vulnerable workers is summed up neatly in a study on “Ethical Trade in African Horticulture” (see box).

### **The Multi-Stake Holder Approach for Improving Employment Practices**

“Despite the positive steps that producers have taken to comply with codes, a number of employment problems persist, many of which have gender dimensions ... The current focus on ‘snapshot’ auditing has generally failed to move implementation beyond a surface assessment of conditions to the identification and resolution of issues that are of greatest concerns to workers. Participatory social auditing has the potential to create a more dynamic and problem-solving approach ... At the same time, if codes are to bring sustainable and widespread improvements in labour conditions, participatory social auditing can only be one component in a wider process of social change. Ensuring workers’ rights requires leveraging a range of mechanisms, including national legislation, international labour standards, and the efforts of various stakeholders. There is growing recognition, including among buyers in the UK, that a multi-stake holder approach to code implementation incorporating *local* private sector, civil society and government bodies, may have greater potential to effect improvements.” Smith et al. (2004: 31)



# 7. Bringing together key stakeholders

## 7.1 What is the policy problem?

Involving stakeholders has become standard rhetoric in *technical assistance* projects for small and medium sized enterprises (SMEs). Projects concerned with enhancing the competitiveness of local enterprises typically bring together the local stakeholders from the public and private sectors. This is an advance on previous practice in that it recognises that (1) a number of local institutions have an impact on SMEs and (2) the actions of public and private institutions need to reinforce each other in order for change to occur. But too often only local stakeholders are included; powerful but distant buyers (or suppliers) tend to be excluded from consultations and alliances. Where local enterprises work primarily for local markets this is fine, but in export-oriented regions, the exclusion of buyers is a problem, especially if external buyers “pull the strings” and have a direct impact on local outcomes.

## 7.2 How can the value chain approach help?

The proposition put forward here is that the stakeholder approach needs to be revised: the group of actors that needs to be brought to the table cannot be derived from a local cluster or regional development approach alone. The value chain approach helps to make a more relevant selection of stakeholders.

A good example of the prevailing (limited) stakeholder approach is the Bappenas-GTZ Regional Development Project in Indonesia. This project seeks to strengthen SMEs in Central Java by bringing together public and private stakeholders at both district and provincial level and helping them to join together to create new initiatives. In itself this is good and accords with recent thinking on local and regional development. However, the approach ignores a critical insight from the world’s most successful clusters: the dynamism for growth and change

did not come from inside. It came from using global forces to mobilise local potential. Examples include the computer cluster of Hsinchu in Taiwan, the textile cluster of Denizli in Turkey, the furniture cluster of Damietta in Egypt and the surgical instrument cluster of Sialkot in Pakistan. In all cases, the driving force was the connection with the global economy. The case of the Sinos Valley in Brazil is detailed in the Box below.

### **Harnessing global forces to mobilise the local potential**

The footwear cluster of the Sinos Valley in the South of Brazil is a Latin American success story of local enterprises competing in the global economy. In the late 1960s, this cluster was composed of small firms producing for the domestic market. Once it was able to connect with the global market it grew very rapidly. A combination of measures – export incentives from Central Government, organizational support from local government and collective action by the enterprises – was critical in making the connection: the local shoe fair was promoted overseas; foreign buyers were invited to visit; foreign journalists were invited so that they would report on the local industry and the fair; and a consortium of manufacturers took their products to the US and UK in search of export orders. These local efforts coincided with the search of foreign enterprises, mainly from the US, to outsource their shoe production. These US entrepreneurs, attracted by the existence of a cluster and by its deliberate attempts to find new customers, then connected these Brazilian producers to the vast US market. In doing this, these buyers also gave new dynamism to the cluster. They promoted the upgrading of the production capabilities of firms, as well as pushing for, and assisting with, improvements in the supply chain and logistics. The result was a rapid transformation of manufacturing and the local supply chain. Local lead firms emerged as preferred suppliers, “coached” by buyers who played a dual role: they were extremely demanding and had to provide assistance so that their demands could be met.

The trigger for dynamic development is the linkage to a sizeable market with demanding customers. These connections are not just “strings of market-based relationships”; they are intense,



interactive relationships. In the global economy, highly complex and coordinated global value chains dispersed across multiple locations are responsible for the rapid and cost-effective production of goods and services. Working with the companies that lead these chains is critical for transforming local economies.

The problem with current stakeholder approaches is not that they are ignoring global markets. When their goal is increasing production for export, they try to prepare local enterprises and mobilise local institutions for competition in a free and open global market. But the reality is that global markets have become highly structured and many chains are governed by large buyers. Seeking to involve such buyers in local development initiatives is critical to linking into big markets. Buyers from these markets provide specific information on what needs to change to make local enterprises more successful. They might even be persuaded to provide resources for upgrading projects.

Of course it is not easy to involve external actors in local development initiatives. Documented examples are hard to find. Experimenting is therefore necessary. For local communities it would be difficult to do this on their own. Foreign donor support could be of tremendous help. But this would require that donor agencies be staffed by experts who are (a) willing to take risks with new approaches, (b) capable of working with local enterprises and institutions, and (c) have a good understanding of how the global economy really works.

### **7.3 What are the limitations of the revised stakeholder approach?**

While there are few practical experiences to draw upon, inclusion of buyers in local upgrading initiatives seems most likely to succeed where projects seek to strengthen the *existing* position of a cluster in a global chain. This requires process and product upgrading, usually of an incremental kind. Local collective initiatives (cooperatives, producer associations) have an important role to play in expanding infrastructure and strengthening training, testing and certification facilities. These initiatives can probably count on the support of all actors,

including the buyers, since the goal is to make them more efficient participants in the current global chain structure.

Where upgrading is aimed at *repositioning* the cluster in the chain, the project will be more difficult. It will require a more active search, and risky investments in capabilities aimed at reaching new markets or reaching old markets in new ways. Buyers are unlikely to support such initiatives because they might threaten their core competence. For some local enterprises it will be difficult to take a position: they have strong ties with their buyers and with their local colleagues. Conflicts are thus unavoidable, particularly where local enterprises compete in global markets.

#### **7.4 The need for conflict management.**

The role of conflict management in dealing with the centrifugal forces of globalization requires closer attention. Without mediation, conflicts pull local economies apart and upgrading strategies fail. In most cases the state will be seen as the most legitimate mediator. This statement may be contested, given the fascination with the failures of public agencies in economic development debates. But the conclusion to be drawn from these debates is not that public intervention should be minimised, but that a different type of intervention is required. Conflict resolution is one of the interventions that deserve more attention.

Government agencies need help in carrying out this role. Such help can come from various sources. For example, the ILO has a long and rich experience in “social dialogue”. Social dialogue is defined by the ILO to include all types of negotiation, consultation or simply exchange of information between, or among, representatives of governments, employers and workers, on issues of common interest relating to economic and social policy. Government sometimes plays the key convening role in bringing the disputing parties together. This ILO expertise extends to dispute resolution, but is usually confined to problems in the world of work.

Resolving conflicts between groups of entrepreneurs may require expertise from different sources: private organizations such as the Conflict Management Group or the Consensus

Building Institute have been successful in finding negotiated solutions to entrenched conflict in a number of fields such as environmental, industrial, or community disputes. Professionals in conflict mediation have formulated best practice in conflict assessment and consensus building (Susskind et al., 1999). It seems sensible for government agencies to access such expertise as and when required.

The current emphasis in development lies in preventing conflicts by applying participatory approaches. Examples in the field of SME promotion include PACA (participatory appraisal of competitive advantage), an approach developed and applied in many countries by Mesopartner – see [www.mesopartner.com](http://www.mesopartner.com). Another approach, still in the experimental stage, is SHAPE, developed by the International Trade Centre for building sector strategies – see <http://www.intracen.org>. Both approaches, while designed for different purposes, rely on working with multiple stakeholders. The question is whether, in their application, they draw in the most relevant stakeholders. This is where the value chain approach is so useful, because it asks who pulls the strings and considers stakeholders who, although far away, may hold key resources and power.

To summarise, recent debates on promoting local economic development stress the importance of local institutions and the involvement of local stakeholders – this Guide adds two nuances to the debate:

stakeholders who connect the local enterprises with the global market should be involved in consultations and negotiations;

fragmentation and conflicts, that will inevitably occur in collective efforts to upgrade, need to be mediated by some entity beyond the group. Mediating such conflicts and fostering a consensus around upgrading strategies is an important government function.

The value chain approach is critical for the first and various other approaches can help with the second. Here again, we find that the chain approach is most powerful when combined with other approaches.



## **8. ■ Drawing donor agencies into a common strategy**

### **8.1 What is the policy problem?**

Support for small and medium enterprises is popular with multilateral and bilateral donor agencies, as well as NGOs. Substantial foreign resources are available to recipient countries seeking to promote their local enterprises. However, these resources are offered in a very fragmented way. This occurs because there is a proliferation of donor agencies and projects concerned with SMEs and each agency comes with its own agenda. As a result, it is very difficult for recipient country governments to employ the external resources available in a way that supports its own strategy and generate synergies or complementarities among the grant monies. Unintentionally, donor agencies often undermine the governments' ability to strategically promote the competitiveness of SMEs.

Unintended negative effects arise from the direct and indirect transaction costs that are incurred in "servicing" the many donor agencies and projects (Acharya et al., 2004). These costs are exacerbated when donor agencies do not carry out the projects themselves, but work through consultancy firms who bid for these contracts. Much of an agency's time may be spent on enabling the consultants to get to know the local reality. This knowledge is then used to pursue the agenda of the donor agencies. As a result, it is difficult for the national recipient agencies to develop their own agenda and put it into practice.

Aware of such problems, donor agencies have tried to coordinate their efforts. The donor committee for small enterprise development has been successful in organising exchanges of experience at the international level. It has, however, failed to advance donor coordination "on the ground" and the proliferation of agencies and projects continues unchecked in most countries. Recipient governments have been unable to change this, given the shortage of resources for SME development and the lack of a framework for integrating

the contributions of foreign donors. The aim here is to suggest such a framework.

## **8.2 How can the value chain approach encourage more donor coordination?**

The challenge is not just coordination amongst foreign donors but coordination with – or subordination to – the recipient government's own agenda and programme. This presupposes that the government has a framework that the donors can feed into. The value chain approach can help to develop such a framework. Most governments have priority sectors that they seek to strengthen. This applies in particular to regional and local government.

The key task for government is to identify the bottlenecks that hold back the development of their key sectors. These bottlenecks could lie in underdeveloped port facilities, very slow customs clearance, poor quality management in the manufacturing firms, lack of certification agencies and other factors. The value chain approach helps to lay bare these bottlenecks. It helps in particular to visualise flows and identify interdependencies.

The competitiveness of the local or regional economy depends on the functioning of the entire chain. The value chain approach helps to identify all the enterprises that contribute to the production of a good or service and shows which institutions are needed to support these enterprises. Chain maps help to visualise this. They can also be tailored to specific purposes. For example, if speed of response is critical, a chain map can be drawn showing how long it takes for a product to move through the different parts of the chain and where logistics between enterprises and customers could make a difference, how much time is lost in ports and customs, and so on.

The general point is straightforward. For recipient governments to pursue a strategic approach in building up the competitiveness of their sectors, they need a simple (but not simplistic) way of showing where the key problems are and where intervention is required. Chain maps are a useful way of identifying these points and sharing the information with all concerned. This forms a basis for discussing and deciding

where local institutions can resolve the problems and where assistance from donor agencies is required. Adopting this chain approach makes it more likely that local and foreign contributions complement and reinforce each other. Much current action is disconnected and, therefore, fails to have a lasting impact.

Chain analysis and diagrams would need to be developed for all priority sectors. This can be done relatively quickly, especially if these analyses do not aim to provide the definite diagnosis, but are set up as ongoing projects to be updated and modified as new insights are gained or new developments occur.

Donor agencies keen to contribute to SME development in region X can then be invited to contribute to the resolving of some specific problems that have been identified. The need for complementary action from government and other donor agencies will be clear.

The implication is not that all support agencies need to work simultaneously – this is rarely achievable and not even necessary. As shown by Hirschman (1958) a long time ago, making one linkage in the chain effective will create inducements and pressures for tackling the next one. The key is that donor contributions respond to the needs of the recipient region and have an opportunity of working in a cumulative way.

The methodology for enabling recipient governments to do this will need to be developed. Such work need not start from scratch. It can build on experiences gained by organizations such as Mesopartner or ITC in promoting local economic development and trade. The key to the full development of such a methodology is that it be demand-led – led by a government agency serious about applying the methodology and experimenting with it. Some of the financial resources might even come from a donor agency but the recipient country needs to be in charge of the project and drive it forward.

### **8.3 What are the obstacles and limitations?**

The objective of the proposed idea is to draw donor agencies into a common strategy. Obstacles exist on both the donor and

recipient side. Overcoming the donor obstacles will be particularly difficult. In principle, donor agencies are committed to greater coordination. In practice, they are strategising according to their own priorities. While they involve local stakeholders, the programmes or projects remain driven by the donor agencies.

On the recipient side, there are two problems. First, the value chain analysis is ideally conducted by local organizations (government agencies in conjunction with technology centres, business associations, business schools or local universities). Building up the capability to carry out such studies will require some donor support, consisting of preparing guides and providing replicable training workshops. Learning-by-doing will be an essential part of this training.

Second, there is the question of the number of the value chains that need to be studied. In order to be useful, value chain analysis needs to be specific and differentiated by product and market. In some regions, this is not difficult as they specialise in a small number of products. In others, the number of relevant chains will be high and the difficulty of scaling up all the greater. The question then arises as to which chains should receive priority, a question which is inevitably resolved in the course of political negotiation

In conclusion, for most developing countries, access to donor support for SME promotion is not difficult. The problem lies in making the donor contributions effective and using them in such a way that they complement and invigorate the government's own policies and programmes. The value chain approach provides a framework for achieving this, but the tool kit for making this happen needs to be developed through a process of experimentation and cumulative learning.



## Moving Forward

Policy-makers and practitioners throughout the world are trying to help their local enterprises compete in the global economy. Their objectives are faster economic growth and more earning opportunities for local people. Many of them are desperate for clear and feasible methods of achieving these goals.

This guide proposes an approach that has proved to be a powerful analytical tool, and asserts that it can now be adapted to serve pragmatic ends. The value chain approach can be used to help local enterprises map their place in the global economy, upgrade their capabilities, and encourage them to improve working conditions. It can also be used by policy-makers to identify a more relevant set of stakeholders and may provide a framework for coordinating foreign assistance to local economic development.

This is a tall order. The guide cannot offer a blueprint for success. Rather, experimentation with the approach within specific contexts and circumstances will be required. And, to reiterate a point made several times in this Guide, the value chain approach needs to complement and align with other interventions and approaches to achieve maximum impact.

More and more global institutions are now supporting this work. The Rockefeller Foundation has for some time supported the Global Value Chain Initiative (see [www.globalvaluechains.org](http://www.globalvaluechains.org)) and brought together some of the leading analysts and policy-makers in this field. Together with the ILO it has also funded the writing of this Guide.<sup>21</sup> The ILO's Department for Job Creation and Enterprise Development (EMP/ENT) has begun to use the value chain approach in its analysis and practical work ([www.ilo.org/seed](http://www.ilo.org/seed)). UNIDO embraced the value chain approach in its World Industrial Development Report and has begun to use it for upgrading the capabilities of local suppliers. US-AID has launched a programme to help small enterprises to access and benefit from global markets; the programme relies heavily

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<sup>21</sup> The main funders of research on global value chains and development have been DFID, the Rockefeller Foundation and the Volkswagen Foundation. Their support made it possible to establish a conceptual apparatus and empirical basis for value chain analysis.

on the value chain approach and is being carried out in conjunction with ACIDI/VOCA, Action for Enterprise and other organizations that have a track record in small enterprise development. GTZ has commissioned a programme of work on shaping value chains for development. DANIDA and FAO are particularly interested in the relevance of the approach for agricultural development. Belatedly, the International Finance Corporation and the World Bank have begun to explore the relevance of the approach for their work in developing countries. In contrast, WIEGO, Oxfam and other global NGOs have been using the approach for some time to try to improve working conditions in the developing world.

The application of the approach will take time and resources for experimentation; patience and commitment will be needed to evaluate outcomes. The question that should drive the process is not whether the approach works but *under what conditions*. To answer this question, we need multiple experiments, in different sectors and regions.

A useful step in this process might be to bring together all the agencies that are experimenting with the global value chain approach. The purpose would be to exchange experiences, identify what works, specify new questions that need to be answered, discuss how on-going work can be scaled up and create an inventory of learning. Hopefully this initial guide provides a useful input for such a collective enterprise.

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