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STRIVING TOWARD A COMPETITIVE INDUSTRY

THE IMPORTANCE OF DYNAMIC VALUE CHAIN FACILITATION

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ABSTRACT

The value chain approach offers a comprehensive means for assessing and understanding relationships and dynamics within a market system. Such information is vital for stakeholders in developing an industry upgrading strategy, including a series of specific interventions that can lead to more competitive markets. Such analysis, however, is not static. Systemic constraints and opportunities within a market system are constantly shifting, and have a direct influence on the upgrading strategy. It is critical that dynamic facilitation is applied to not only capture and read these signals, but to actively respond with new interventions to ensure the necessary outcome is achieved.

This paper will highlight the importance of dynamic facilitation within the value chain approach. Specifically, it will examine approaches for embedding active read-and-respond mechanisms within the management systems of a facilitator, while providing practical examples of how a program actively applies a follow-on facilitation strategy.

EVOLVING FRAMEWORKS FOR ANALYSIS

Increasingly, donors have applied the value chain framework as a means for assessing a market system and identifying the necessary interventions to address related opportunities and constraints. Traditional analysis has focused on the transaction level, incorporating a mapping of market actors along the functions and market channels of a particular industry. This is often complemented by a breakdown of production costs from raw material to finished product to identify inefficiencies from a cost perspective, which are often benchmarked against similar industries in other countries.

More recently, analysis has incorporated the application of a series of filters or lenses that assess different functions within the market system. These include:

- **Enabling Environment.** An evaluation of the international, regional and domestic enabling environment may reveal legal or regulatory constraints to engaging in commercial activities. Adherence to specific market standards or certifications may increase operational costs for market actors, while failure to comply may limit end market outlets.

- **Horizontal and Vertical Relationships.** Vertical linkages can occur between any two levels of the value chain, and are often driven by the shared recognition among market actors that more closely integrated structures may result in improved efficiencies or meet other industry operational requirements. Similarly, horizontal linkages are often driven by market actors who understand the need to enhance their competitive position through economies of scale or shared innovation. Understanding the drivers or inhibitors of such relationships is a critical step in formulation of an upgrading strategy.

- **Support Markets.** Support markets may include both financial and non-financial services, and input supply markets. Immature or non-existent support markets will retard growth among market actors within the core value chain, while a dynamic support services market can fuel innovation as well as upgrading. A facilitator must understand the interconnectedness between support markets and the core value chain as a critical factor for competitiveness.

- **End Markets.** An industry must understand end-market dynamics and shifting consumer preferences and respond with a value proposition or differentiated offer in order to remain competitive. Differentiation may be achieved through product, operations or brand depending on the industry dynamics.

A USAID-funded program titled Production, Finance, and Improved Technologies (PROFIT) has extended analysis of an industry to include an examination of the systemic opportunities and constraints among market actors. Systemic refers to those underlying factors which may inhibit the future growth or competitiveness of an industry as defined by the following:

1. **Relationships.** How do market actors work together within an industry? Are relationships short-term and predatory, or are they strategic, transparent and based upon a long-term vision of competitiveness?

2. **Learning and Innovation.** To what extent are new ideas and concepts valued by market actors? Does uncertainty within the system deter the adoption and testing of new ideas, or are market actors willing to share information, learn market trends, and innovate to meet changing consumer preferences. The extent to which an industry is constantly reading and responding with ongoing innovation is a direct factor for increased competitiveness.

3. **Benefit Flows.** How are benefit flows shared within the industry? Are benefits limited to a few lead firms, or do they extent to other market actors thus providing incentives for continued learning and innovation?[1]

By applying an examination of systemic opportunities and constraints, a facilitator may have a better understanding of the behaviors and incentives within a market system. For example, an unsupportive (fraught with corruption) or repressive enabling environment may limit the time horizon under which transactions take place, leading to uncertainty, risk and predatory behavior within the market system. The degree to which market actors are willing to learn and innovate may be limited, thus inhibiting competitiveness within the system. An enabling environment that is favorable to commercial activity may result in more supportive relationships between market actors, and a willingness to share benefits, risk and investment for long-term results.

THE PROJECT DESIGN CYCLE

It is not, however, analysis alone that will guide competitiveness of a market system, but the ability to understand these concepts and intervene accordingly. Increasingly, donor-funded value chain projects have adopted a project cycle that assesses an industry system, develops an upgrading or competitiveness strategy, implements market facilitation interventions, and provides ongoing monitoring and performance measurement. Figure 1 below offers a summarization of this project cycle:[2]

Figure 1: Project Cycle

By linking analysis with an overall vision for competitiveness, a facilitator is able to develop an upgrading strategy which informs a series of strategic interventions.

FROM ANALYSIS TO IMPLEMENTATION: DYNAMIC FACILITATION OF THE COMPETITIVENESS STRATEGY

As donors increasingly embrace the project design cycle, a noticeable bias has been placed on the upfront analysis and intervention design. In other words, it is common to spend significant time and resources on value chain selection and analysis, as well as the development of a competitiveness strategy in coordination with key stakeholders or market actors. Such activities typically generate a series of interventions that guide implementation for the remainder of the project.

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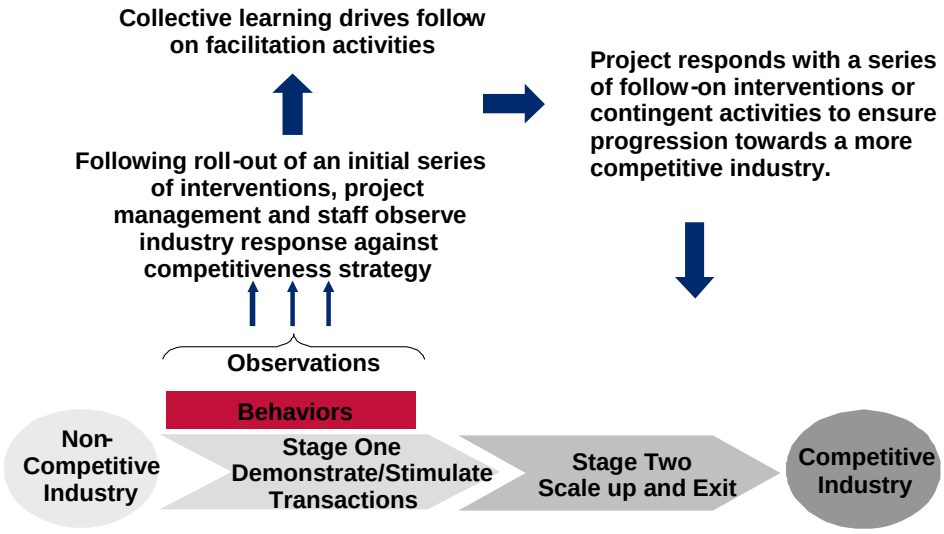
[1] Field, Michael and David Knopp. July 2008. "Increasing Competitiveness in Agriculture – A Value Chain Systems Approach" Making Markets Work - Training Programme," Springfield Centre, Glasgow, UK.
[2] Downing, Jeanne. June 5-8, 2007. *"Design for Competitiveness."* USAID Value Chain Development Workshop, Addis Ababa, Ethiopia, June 5-8, 2007.

While such an approach is a significant (and welcome) departure from the supply-side tendencies of the late 1990s, it still makes a hasty assumption—that consumer preferences and end-market demand will remain static throughout the period of implementation. This assumption not only limits the impact of donor support, but virtually ensures a program's activities (particularly in the later years) will be misaligned with the evolving constraints and opportunities within the market system.

This paper focuses on the importance of dynamic facilitation as the critical factor when guiding development of a value chain system. Every donor intervention will generate a market response. It is the task of a facilitator to observe the market reactions stemming from the initial series of interventions, analyze the response, contrast against planned expectations within the competitiveness strategy and respond strategically with follow-on interventions.

The continual process of reading, reacting and comparing results against planned expectations is the key to dynamic facilitation. It not only ensures that a program responds flexibly to the evolving market system, but also enables the facilitator to make strategic decisions on interventions vis-à-vis a program's limited time and resources, and progress towards an industry's competitiveness objectives. Figure 2 below offers an overview of the dynamic facilitation concept.[3]

Figure 2: Dynamic Facilitation in Practice



STRUCTURES AND PROCESSES FOR DYNAMIC FACILITATION

It is necessary that the appropriate structures and processes are in place to allow for dynamic management. These may range from internal structures that guide the facilitation process to centralized funding pools that provide flexibility in implementation.

Under the PROFIT project, a management structure was institutionalized that allowed project staff to read and respond to market signals, while ensuring facilitation activities maintained consistency with overall program objectives. Specifically, the project developed an "Industry Pathway" for each targeted sector. A Pathway is essentially a

[3] Concepts for this diagram derived from Bear, Marshall and Mike Field. 2 June 2008. "Managing the Process of Change: Useful Frameworks for Implementers of Making Markets Work for the Poor Programmes." Enterprise Development & Microfinance, Vol 19.

sequence of expected observations or behavior changes among key market actors that are needed to achieve a competitive industry.[4]

Following an initial set of interventions, PROFIT staff was able to compare the actual response by market actors against anticipated behaviour to determine progress along the Pathway. Based upon this information, staff then re-adjusted or responded with new follow-on interventions to ensure that progress along the Pathway was achieved. By reading and observing the market reaction to their facilitation activities, PROFIT was able to discern whether their activities were generating the intended effect. Moreover, the Pathway allowed them to plan and manage their facilitation strategies within the overall PROFIT timeline and budget.

The USAID-funded Kenya Business Development Services Program (Kenya BDS) was designed as a value chain market facilitation program targeting the tree fruit and Lake Victoria fish sectors. Supporting this process was a Market Intervention Fund, a centralized pool of funding representing approximately 44 percent of the entire Kenya BDS budget. None of the activities supported through the Market Intervention Fund were pre-determined. Rather, as inefficiencies and bottlenecks were identified along the value chain, the program responded with targeted interventions.

The timeliness and flexibility provided through the Market Intervention Fund allowed staff to practice dynamic management in the field. When a strategic opportunity or constraint was identified, an intervention could be immediately designed and implemented with just a few weeks notice. If an intervention was having an adverse effect on market development, it could be cancelled or adjusted midstream. The Kenya BDS field team was not bound by pre-determined commitments to subcontractors or experts. Rather, the method of implementation, as well as the intensity of intervention varied depending upon each particular constraint. Local facilitators were contracted through a competitive tendering process to facilitate particular business service markets. Direct partnerships were struck with lead firms to buy down risk, foster new relationships and stimulate behavior change within the industry.[5] Alliances were forged with associations to support activities such as awareness creation, or even the development of self-regulation within particular industries.

Both PROFIT and Kenya BDS applied a combination of these structures and processes to support dynamic management of their programs. PROFIT also maintained a centralized pool of funding housed within the project which could be used to buy down risk or engage the private sector as needed. As detailed in Figure 3 below, while the program did not apply a formal Industry Pathway, facilitation activities supported by Kenya BDS were always time-bound (one year or less) and based upon an overall sector upgrading strategy. Depending on the market response from the initial activity, decisions were made on the nature, intensity and timing of follow-on interventions.

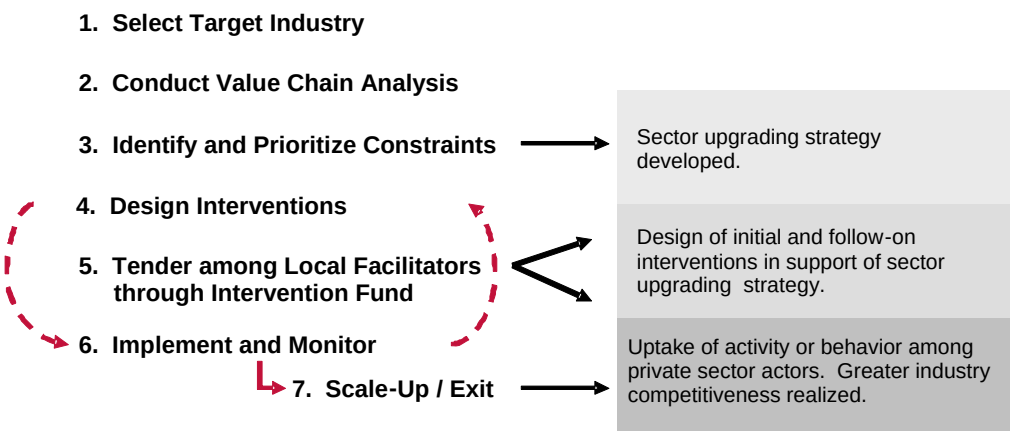
It is worth noting that at the onset of their respective programs, both PROFIT and Kenya BDS already had buy-in at the donor level to a value chain approach, allowing them to commence operations without pre-defined market interventions.

This may present a challenge to those donors seeking already established work-plans or pre-budgeted activities from their implementing partners. Wherever possible, it must be emphasized that markets are dynamic and require flexibility for program partners to read and respond as needed.

[4] Pathway observations are based upon international and local analysis of competitive behavior for the targeted industry and then integrated within the specific country context of the Program.

[5] Buying-down risk refers to any activity or incentive a facilitator may present to encourage a market actor to experiment or test a behavior that may be outside of their traditional scope of operation.

Figure 3: Kenya BDS—Flexibility in Implementation



Regardless of the nature of intervention, facilitation activities supported by both programs shared a common objective: to catalyze a broader industry response while stimulating the participation of new private sector entrants.

PRACTICAL EXAMPLES OF DYNAMIC MANAGEMENT

Through these structures and processes both Kenya BDS and PROFIT were able to engage in dynamic management of their programs. Following are four examples whereby an initial intervention was carried out based upon an identified value chain constraint, and stemming from the market reaction, program staff had to re-adjust and respond with follow-on facilitation strategies to ensure end objectives were met.

EXAMPLE 1: MARKET ACCESS—DEVELOPING THE VALUE PROPOSITION

Value chain analysis under Kenya BDS revealed that severe misalignments in the marketing of avocados challenged smallholder farmers and lead firms alike and inhibited competitiveness of the overall industry. Largely a smallholder crop in Kenya, the marketing of avocados was dominated by informal brokers that fed on misinformation among market actors. Relationships were largely adversarial. Prices would fluctuate daily, while farmers could not rely on when a broker would even appear to buy their fruit. Lead firms were also constrained by the daily price haggling with brokers. With the uncertainty in supply, it was difficult to conduct forward marketing with global procurement agents. Finally, increasingly rigid food safety standards in Europe pressured exporters to market fruit that was not only traceable to farm-gate, but also within the prescribed maximum residue levels.

Based upon this market constraint, Kenya BDS facilitated the development of rural professional brokerage services that could offer bulking, linkage, traceability, forecasting and food safety services for smallholders and firms exporting avocados to the EU market. Following the initial capacity-building of each firm and their related out-grower networks, supply contracts were signed with designated lead exporters which offered a guaranteed price and market for farmers. Kenya BDS also provided cost-sharing assistance to the brokerage firms during the initial season as they demonstrated their value to both farmer and buyer.

Following this initial intervention, Kenya BDS staff observed a series of unforeseen consequences in the market. First, unlike vegetables, avocados are limited to one primary harvest each year. Therefore, while the brokerage firms covered their costs during peak harvest, they were left with no cash-flow during the off season. Second, performance of the brokerage firms' field staff was sub-par. Examination revealed that most of the field staff was paid a set monthly salary, leaving little incentive to maximize yields and sales. Finally, the initial approach by Kenya BDS in

attaching a brokerage firm with a lead exporter and already identified production clusters led to an assumed client base for the brokerage firm, and limited the competitive forces which should normally take place between service providers.

Based upon these developments, Kenya BDS field staff responded with a series of follow-on facilitation activities to realign market signals, promote ownership and self-selection, and encourage competition among brokerage firms. Technical assistance in business strategy was provided to each of the brokerage firms to assist them to better articulate their value proposition, as well as explore additional areas for revenue. Following this intervention, each brokerage firm expanded their service offering into additional yet complementary areas. One firm incorporated spraying services into their offering, another expanded bulking and brokerage services in vegetables, while another extended services to include both grade 1 and grade 2 fruit.

Kenya BDS management also exposed the brokerage firms to pure competitive forces. At the commencement of the following season, marketing meetings were held in the production areas whereby brokerage firms had to aggressively market their services. Eventual selection of brokerage firms was done entirely by farmers and formalized through a service agreement. The simple coordination of these events underscored to brokerage firms the importance of value in service delivery. Finally, Kenya BDS provided assistance to brokerage firms to switch staff remuneration to performance-based commission. This had a profound effect on the supply of quality fruit, as employees were paid a percentage-based fee on product acceptable to the buyer. By observing the market reaction from the initial set of brokerage interventions, Kenya BDS was able to respond with a series of follow-on activities to ensure successful uptake within the tree fruit industry.

EXAMPLE 2: DYNAMIC FACILITATION OF THE GRAFTING AND PRUNING SERVICE MARKET

Low yields and non-marketable varieties were another constraint identified by Kenya BDS as hampering the competitiveness of the tree fruit industry. Much of this could be attributed to the simple lack of grafting and pruning services in the field. Many farmers were unaware of the unexploited business opportunity of their avocado tree, as well as the varieties in demand in the domestic and export market. Moreover, they did not know how to graft, nor possess the equipment or inputs (quality planting materials or scions) to ensure a successful propagation. In addition to the high levels of non-marketable varieties, the little pruning taking place in the field resulted in low yields and high levels of pest and disease infestation.

In response to this constraint, Kenya BDS supported an intervention to develop the market for grafting and pruning services in Central Kenya. Through support to a local facilitator, 95 individuals were competitively selected and developed as grafting and pruning experts. Training was offered on the technical aspects of grafting and pruning, as well as general business and financial management and marketing. The program also facilitated access to commercial working capital for tools and equipment.

Kenya BDS observed that commercial uptake of the service was immediate among smallholder farmers, which had a positive effect on increased yields and production of export-variety avocados. Stemming from this intervention, however, was an unanticipated result that threatened the newly emerging service market. Field staff noticed that imitation (referred to by farmers as "quack") service providers offering grafting and pruning services quickly arose in response to market demand. While this "crowding-in" effect was an encouraged behavior response for market development, it threatened the viability of the newly emerging services. Those without proper training and the requisite clean planting materials were grafting scions onto trees with very high failure rates (i.e., the scion did not take), while pruning was conducted haphazardly. Poor delivery from the untrained providers threatened future market demand.

Based upon these emerging market dynamics, Kenya BDS management was faced with a dilemma. Should the program completely step away and let pure market forces take effect? Eventually word of mouth and client satisfaction would filter those performing service providers from the less capable. This came with its own set of risks. As the market for grafting and pruning services was immature (effective supply and demand had not yet taken root), multiple bad experiences with a provider at this early stage may completely destroy future uptake among farmers. After weighing these options Kenya BDS decided it was prudent to introduce a few light and targeted follow-on activities to assist the well-trained service providers to differentiate their offering.

A self-accreditation program was developed to set apart those service providers who received proper technical training. (The accreditation program was eventually adopted by the Ministry of Agriculture for extension service delivery.) Two professional associations were also formed for accredited providers. The associations undertook activities to boost their client-base through proactive marketing campaigns, development of an identification card for providers and a set of minimum standards for service delivery, such as the commitment to use only certified and labeled quality scions, as well as providing a free grafting should the first service fail. Through these various follow-on interventions, Kenya BDS management was able to ensure continued development of the service market.

EXAMPLE 3: FROM EMBEDDED TO STAND-ALONE BUSINESS SERVICES

When Kenya BDS brokered supply contract relationships between smallholder avocado farmers and lead firms in Central Kenya, it was seen that the provision of embedded services to the smallholder would have an important impact on increasing yields and productivity, while strengthening the trust and long-term relationship between producer and buyer. During the first year of implementation, the exporter provided agrochemical spraying services, pesticide inputs, fertilizer, field agronomists, graders, pickers and transporters to 405 farmers under a pilot scheme. The cost of each service was embedded in the final price offered to farmers for grade 1 fruit.

Kenya BDS observed that the embedded services had the intended effect, as grade 1 yields more then tripled during the first season alone. Equally important, it allowed farmers that had never before applied formal crop husbandry to make the connection between such investments and increased productivity. Stemming from this success, an additional 800 farmers joined the program.

While increased yields and a crowding-in effect among smallholder farmers had been achieved, field staff also noted market behavior which was unforeseen. In order to maximize their income and avoid deductions from the embedded services, some farmers began "side-selling" their fruit to spot-market brokers rather than honor their lead firm commitments. Other farmers were actually "over-serviced" by the many embedded services offered by the exporter. With basic activities such as picking and grading now assumed by the lead firm, some farmers assumed the impression that they really had to do nothing. In other words, they became lazy.

The combination of over-servicing the farmer coupled with increased side-selling began to affect the bottom-line of the lead firm. Faced with this growing financial constraint, the lead firm expressed a desire to "break-out" the embedded services as stand-alone offerings. Kenya BDS shared the similar concern with the lead firm, and also concluded that the value of crop husbandry services had already been adequately demonstrated among smallholder farmers. To ease the financial strain on the exporter and realign market incentives, a follow-on intervention was introduced by Kenya BDS to transform the embedded services as stand-alone offerings.

In coordination with Kenya BDS, agrochemical sprayers once employed by the lead firm were released as individual service providers[6], while a loan product was developed with Equity Bank to offer smallholder farmers with standing supply contracts agrochemical inputs on credit. Upon each sale to the exporter, the Bank would deduct a percentage of the loan outstanding before rendering payment to the farmer. With formal loan arrangements in place with a well-known commercial bank, farmers were less likely to side-sell. Following sensitization on quality and sizing, farmers were given responsibility for both picking and grading their fruits on-farm before delivery to the collection center. By de-linking such services from their original embedded offering, Kenya BDS was able to ease the financial strain on the lead firm and reinforce commercial signals among smallholder farmers. Most importantly, the program was able to increase outreach as stand-alone providers competed for new clients.

EXAMPLE 4: ENSURING LONG-TERM INDUSTRY DEVELOPMENT - VET SERVICES IN ZAMBIA

PROFIT identified poor animal health among smallholders (who own 70 percent of herd total) as a primary constraint affecting the competitiveness of Zambia's beef industry. This was largely attributed to the lack of private veterinary services targeting smallholder farmers, as well as the logistical challenges given their dispersed location in hard-to-reach areas.

To assist this support function, PROFIT facilitated the development of a vet services model whereby private vets would bundle together a pre-paid package of preventative health services that would be delivered through trained community members under contract from the formal vet business. Referred to as community livestock workers (CLWs), the intervention was intended to lower the cost of transaction while building a long-term relationship—through the CLW—between the vet and smallholders within the community.

While initial demonstration and targeted capacity-building led to a steady uptake among smallholders, PROFIT observed a number of divergences from their expected industry response. In some communities, vet service providers had difficulty collecting payment from their smallholder clients. Such hesitancy was based upon a lack of trust by the farmers, as the service providers represented a new entity outside their traditional friends and family network. It was also revealed that some private-sector vets were hesitant to embrace the CLW delivery model, fearing that a third party would not maintain their level of quality in service provision thus threatening their reputation. Therefore, rather than take on a supervisory role, many of the vets proceeded to deliver the services directly. This was both inefficient and commercially unviable. PROFIT staff also observed that among those graduating vets entering the workforce, most sought employment in urban dog and cat clinics instead of entering the private vet industry.[7]

Faced with these unanticipated industry behaviors, PROFIT responded with a series of follow-on activities to ensure they maintained progress along their Industry Pathway. Targeted interventions were enacted to assist vets in building trust and relationships with their CLWs. PROFIT also worked with private vets to establish standards for CLWs to offer basic herd health services, while collaborating with the Government Vet Office to refine policy guidelines on the delivery of such services by the private sector.[8] Finally, the staff decided to target the focal point where career decisions were made—the universities. A follow-on intervention was rolled out to raise awareness, while facilitating entry into the workforce through formal attachment programs. Industry-wide network meetings were held to facilitate linkages with key stakeholders in the sector and universities to openly discuss and strategize the development of rural

[6] A follow-on intervention was implemented by Kenya BDS to build the capacity of stand-alone sprayers as individual business service providers. Assistance included training in cash flow management and enterprise budgeting, as well as marketing and other forms of operating a business. A refresher course was also provided in the technical aspects of agrochemical spray application.
[7] Bear, Marshall and Mike Field. 2 June 2008. "Managing the Process of Change: Useful Frameworks for Implementers of Making Markets Work for the Poor Programmes." Enterprise Development & Microfinance, Vol 19.
[8] There were no private sector standards recognized by the Government however PROFIT deduced such regulation was needed to ensure a minimum quality of service delivery.

vet services as a viable career. To support entry into the workforce, an internship program was also facilitated to provide graduating vets a platform for learning practical skills in the private sector, while sensitizing on rural smallholders as a burgeoning client base. [9]

NOT A LINEAR PROCESS

While an initial set of facilitation activities may achieve their intended effect of stimulating a market response, it is important to recognize that those activities are often accompanied with unintended behaviors or consequences that require follow-on assistance. It is therefore critical that a value chain program possesses the necessary structures and processes to read, observe, and react in a dynamic manner.

Under Kenya BDS, the application of time-bound interventions (less than one year) supported through a flexible funding pool allowed them to address systemic market constraints in a dynamic manner and respond immediately with follow-on activities. A shift from embedded to stand-alone business services protected the commercial viability of lead exporters while allowing further growth and outreach within the support services market. Follow-on targeted assistance to grafting and pruning service providers allowed them to professionalize and differentiate their offer from less qualified imitators. Once value was demonstrated, assistance to avocado brokerage firms was re-adjusted to ensure staff incentives were properly aligned with the strategic interests of each firm.

Similarly under PROFIT, through a real-time knowledge management system the project was able to capture and observe industry behavior stemming from their initial facilitation activities, benchmark the market response against their Industry Pathway, and respond accordingly to ensure end objectives were met. Only through such systems was staff able to understand why vets were hesitant to embrace the community-led-worker model, or recognize the long-term threat of a declining vet services supply.

Through these examples it is clear the project design cycle is not a linear process. While initial "informed" interventions can stimulate a market response, it is the duty of a value-chain facilitator to read market behavior, observe divergences from intended results, and respond as necessary. It is this dynamic management which is often overlooked. By institutionalizing the necessary structures and processes from the outset, and providing staff the flexibility and skills to read emerging market signals and respond, a value chain project may engage for more meaningful results.

[9] Field, Michael. March 2008. "Vet Scenarios." PROFIT Project Working Document.