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GLOBALIZATION AND THE SMALL FIRM: AN INDUSTRY VALUE CHAIN APPROACH TO ECONOMIC GROWTH AND POVERTY REDUCTION

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FOREWORD

This position paper articulates the overall USAID AMAP BDS¹ Knowledge and Practice strategy. The paper argues that linking the poor to growth opportunities is key to generating sustainable economic growth with poverty reduction. Moreover, in light of intensified global competitive pressures, such efforts must focus on the performance of the whole industry in which small firms participate. This includes the business enabling environment and essential supporting and service markets. It also includes the degree to which vertical and horizontal relationships among industry participants contribute to overall industry competitiveness and impact the millions of small firms upon which many of these industries in developing countries depend.

This paper translates recent research into practical approaches for designing interventions that foster economic growth to reduce poverty. The paper starts with the conceptual and moves toward the project cycle, offering practical guidance to the project designer in selecting industries for intervention, analyzing selected industries, developing a vision for competitiveness, and designing project interventions.

The intended audience for this paper is the broader enterprise community, including both donors and practitioners, and project designers seeking to achieve economic growth and poverty reduction.

This paper presents an approach to intervening in globalized markets aimed at:

- Improving the competitiveness of micro and small enterprise (MSE)-dominated industries, and
- Expanding the depth and breadth of benefits to MSEs participating in competitive industries.

This paper is intended to open a dialogue on programs that link economic growth with poverty reduction. Your comments on this paper are warmly welcome. Please send them to the following address:

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¹ United States Agency for International Development Accelerated Microenterprise Advancement Project – Business Development Services Indefinite Quantity Contract.

I. INTRODUCTION

In light of the threats and opportunities that globalization poses, can small firms and the industries they dominate compete in globalized² markets, and, if so, how? This is the central question of this paper and the impetus behind USAID’s research and knowledge generation program, AMAP BDS Knowledge and Practice (K&P). With a goal of economic growth with poverty reduction, AMAP BDS K&P aims to better understand the contributions that MSEs can make to industry competitiveness and the benefits that these small and very small firms can gain as a result.

The benefits, however, cannot be taken for granted. Participation is not tantamount to gain. To enhance MSE benefits, AMAP BDS seeks to identify ways both to take advantage of the opportunities that globalization offers and to address many of its threats.

To answer the question “Can MSEs and the industries they dominate compete in

globalized markets?” we begin with a discussion of *why* it is important for small firms to be able to compete. Next, we address the *how*, and/or under what conditions MSEs and MSE-dominated industries can compete. We explore competitiveness using a framework that focuses on: (1) identifying competitive advantage among MSE-dominated industries; (2) designing a commercial upgrading³ strategy for an industry (to turn competitive advantage into competitiveness); and (3) ensuring the sustainability of competitiveness over time.

The final section offers an approach to intervening that answers the question of *what* to do to promote the competitiveness of MSEs and MSE-dominated industries. This section translates the above framework into action steps for program design.

deliver products and services to local and regional markets, even these have come under the pressure of globalization. The term “global markets,” on the other hand, refers to markets in which the final consumers for a good or service reside in different parts of the world.

³ Gereffi and Memedovic 2003; Humphrey 2004.

² In this paper, “globalized” refers to markets affected by globalization. While many MSEs

II. AN ECONOMIC GROWTH STRATEGY THAT INCLUDES THE POOR

A. THE RATIONALE FOR A STRATEGY OF ECONOMIC GROWTH WITH POVERTY REDUCTION

Recent years have seen a growing emphasis on the part of donors and development practitioners on reducing global poverty, as evidenced by the first Millennium Development Goal. As the importance of “reducing by half the people living on less than a dollar a day” has grown, most donors engaged in enterprise development have focused support on small and medium-sized enterprises (SMEs), with the justification that SMEs are the best generators of jobs for the poor.

Yet most of the world’s poor live in rural areas where there are few small and fewer medium-sized enterprise-generated job possibilities and many more MSE opportunities. USAID is one of the few donors with an office dedicated to the development of micro enterprises, and yet USAID’s development goal is centered on economic growth rather than poverty reduction.

Donor perception of a dichotomy between growth, on the one hand, and poverty reduction, on the other may have led to less than optimal strategies to support both. While political pressure to reduce poverty has intensified in many agencies, research has made clear that economic growth and poverty reduction are inexorably linked. David Dollar and Aart Kraay’s paper,

“Growth Is Good for the Poor,” (March 2000) sent a message that has reverberated around the halls of many donor agencies, calling for development strategies that focus on economic growth as a means of reducing poverty.

But while Dollar and Kraay argue that the poor and rich benefit alike from growth, others hotly debate this assertion. Branko Milanovic, a senior associate at the Carnegie Endowment for International Peace, found corroborating evidence that growth—in the aggregate—has a positive effect on poverty reduction. However, he also concluded that rapid economic growth reduces poverty in different contexts at different rates.⁴

Likewise, Ravallion (2004) found that in countries where there are large income gaps between the rich and the poor, the rich benefit from economic growth far earlier and for longer than the poor.⁵ Where income gaps are relatively small, as in some countries in East, Southeast, and South Asia, growth translates into poverty reduction much more quickly and efficiently.

Peter Timmer in “How Well Do the Poor Connect to the Growth Process?” posits that where the disparities between the rich and the poor are less severe, economic growth is more sustainable than in countries with highly skewed income distributions.

C. K. Prahalad and S. L. Hart argue that broad distribution of wealth creation is itself a growth multiplier.⁶ Broad-based

growth reduces poverty, diminishing the burden on public resources to mitigate poverty’s adverse effects. More importantly, broad-based growth increases the purchasing power of poor consumers who will increase their consumption of goods and services that are more often locally produced than those of wealthy consumers. This demand for goods and services, in turn, creates demand for a larger workforce that is capable of producing those goods and services, which in turn increases employment, wages, and consumption.

The extent to which income from economic growth multiplies through an economy is dependent on the depth and breadth of benefits that a growing industry generates. If this growth is concentrated, the multiplication effects will be narrower; and if growth is broad (meaning that many benefit from it), the industry growth’s ripple effects will be similarly broad.

B. SMALL ENTERPRISES: LINKING ECONOMIC GROWTH AND POVERTY REDUCTION

If we accept that broad-based economic growth (growth with equity) is better, i.e., more sustainable, and faster, then what is the best way to achieve it? The strategic options are some combination of investing in enterprises with the capacity to provide jobs for large numbers of the poor and in industries where the

poor participate through large numbers of micro- and small enterprises.

Employment through growing firms provides a reliable wage at little or no risk to the employee and, depending on the business environment, may ensure safer working conditions than home-based or micro enterprises. Microenterprise employment involves significant risk taking by the enterprise owner, which translates into wage insecurity; depending on the business enabling environment, it may ensure safer working conditions than those offered to employees of larger firms.

From a development strategy perspective, the best way to achieve growth with equity depends on the country and the industries through which it can create competitive advantage. Most emerging economies have a comparative advantage in the provision of labor and land and the exploitation of certain natural resource and climactic advantages over more developed OECD (Organisation for Economic Co-operation and Development) countries. Conversely, with the possible exception of China and some South and Southeast Asian economies, investment capital is scarce, and instability in the business enabling environment has not favored the emergence of capital-intensive industries.

Exploiting these comparative advantages, the dominant industries in these countries tend to be characterized by high levels of MSE participation. Any strategy in these economies that seeks to achieve broad-based economic growth and poverty reduction will need to focus on the creation of competitive advantage in those industries with the

capacity to be globally competitive, i.e., those with high levels of MSE participation.

C. GLOBALIZATION'S EFFECT ON MSE-DOMINATED INDUSTRIES⁷

Globalization—a process by which people, companies, goods and services, capital, and information and ideas are exchanged across international boundaries—is shaping opportunities for growth and poverty reduction in developing countries. Driven by international trade, spurred by market liberalization, and aided by technology, globalization has propelled competitiveness on a worldwide scale.

Whereas historically firms have tended to compete against other firms in the same country, with globalization, industries in one country are competing against the same industry in another country. Consequently, firm-level competitiveness is no longer sufficient; rather the entire market system that delivers a product from its inception to the consumer must be able to compete against market systems elsewhere.

Thus, donors concerned about growth that reduces poverty must focus not only on the small and very small firms that the poor own and operate, but also on the industries in which large numbers of the poor participate.

Two diametrically opposed camps are debating globalization's impact on poor countries (and by implication on their industries).

1. PROPONENTS OF GLOBALIZATION

According to Anthony Giddens at the London School of Economics, poor countries with open economies have enjoyed higher than average growth rates, and no country—he argues—has prospered while disengaged from the world economy.

According to its proponents, globalization combined with trade liberalization is opening up unprecedented opportunities for developing countries, especially for those that can compete in the world marketplace.

Multinational corporations are looking for investment opportunities in developing and emerging markets and for opportunities for outsourcing production and/or retail operations. Links between firms in developed and developing countries are resulting in flows of information, know-how, and skills. These flows inject innovation into developing world and emerging markets, sometimes in the form of technologies that bring upgrading into the financial reach of small firms.

Globalization is also contributing to the increasing differentiation and segmentation of global and regional markets, thereby creating a wide range of niche market opportunities. Niche markets can be excellent opportunities for MSE-dominated industries because of the small production volumes demanded.

For firms in these industries to remain competitive, volatile niche markets require a high degree of innovation and rapid communication of information and learning from the consumer to the producer. Examples include handicrafts,

tourism, and specialty foods, with its constant demand for innovation.

2. OPPONENTS OF GLOBALIZATION

Globalization opponents claim that the creation of an unfettered international free market has benefited multinational corporations in the Western world at the expense of local enterprises, local cultures, and the poor. They argue that globalization poses significant threats to the poor in developing countries, where weak and undeveloped supply chains cannot compete with more capitalized and efficient international chains.

Industries and firms with little innovation find it harder to generate positive returns in undifferentiated product markets. In such markets, MSEs can only

only gain competitive advantage by lowering their prices. Yet competition based on price too often leads to an immiseration cycle.

Finally, where firms are disconnected, competing rather than cooperating, they are unable to contend with linked enterprises that generate collective efficiencies and/or vertically integrated firms.

3. GLOBALIZATION TO INCREASE EQUALITY

Anthony Giddens asserts that “globalization can be a medium of increasing equality if it is not simply condemned to be a medium of increasing inequality.” This requires investments in strategies that reduce inequities in the context of an increasingly globalizing economy.

Bruno and others (1998) similarly suggest, “. . . policies aimed at helping the poor accumulate assets . . . when driven by market rather than redistributive means are important instruments for achieving higher growth.

⁴ Milanovic 2002.

⁵ Timmer 1997.

⁶ Prahalad and Hart 1999.

⁷ In this paper, the level of MSE participation in an industry is measured by the number of participating firms and the employment they generate.

III. IDENTIFYING COMPETITIVE ADVANTAGE OF MSE-DOMINATED INDUSTRIES

A. THE COMPARATIVE ADVANTAGE⁸ OF SMALL FIRMS

MSEs do not and cannot contribute to the competitiveness of all industries. Public investments and/or policies to promote MSE participation in industries where they are unlikely to be competitive will most probably not generate sustainable growth. Nonetheless, there are industries that—as a result of the nature of their critical functions or structure—do provide opportunities for small firms to participate competitively.

In their seminal book, “Modern Small Industry for Developing Countries” (1965), Staley and Morse recognized that critical functions in many industries favor small firm participation and helped explain why many industries are dominated, at least in number, by small or even very small firms.⁹ Industry functions that favor small firms are characterized by one or more of the following:

- Seasonal in nature
- Low-capital requirements
- Relative labor intensiveness
- Nonrepetitive production processes
- Small production volumes

Bigger firms tend to eschew seasonal production cycles because of the high-fixed costs in the off-season. Similarly, labor-intensive industries that require low levels of capital (horticulture, a range of tourism services and apparel piecework, are examples) offer few ad-

vantages to larger firms. Furthermore, nonrepetitive production processes and small production volumes that do not offer scale advantages are of little interest to large firms.

B. CREATING COMPETITIVE ADVANTAGE

While Staley and Morse shed light on the types of activities and/or industries where small firms have a comparative advantage, as Porter makes clear, this does not always translate into competitive advantage. A number of researchers, including Porter, speak to strategies for creating competitive advantage.

End-market characteristics are key to how or whether this advantage can be created by industries dominated by MSEs (in terms of numbers of enterprises). A firm or industry can achieve higher levels of growth and competitiveness through one or more of the following three strategies (Porter 1980; Schumpeter 1934):

1. **Improved efficiency/cost advantage:** The price at which the industry can get an acceptable (for example, at minimal quality requirements) product or service to the consumer.
2. **Product differentiation:** The uniqueness of the product or service in terms of its

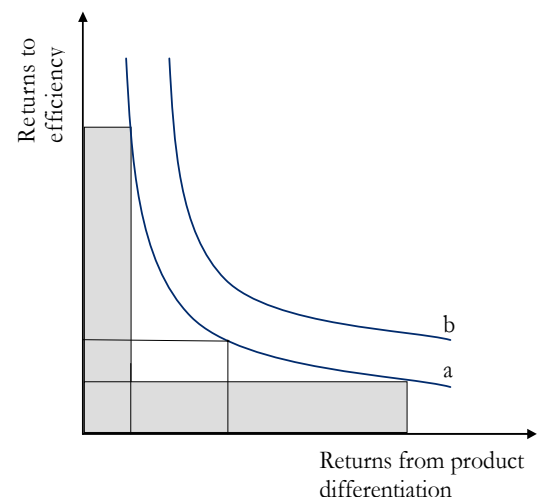
price/quality ratio and capacity for branding (for example, fair trade, social issue, design and/or purchase cachet, and so on) relative to other competitive products or services.

3. **Shaping demand around unique characteristics:** An industry’s ability to take advantage of changes in demand (for example, a shift in demand from commodity coffee to specialty coffee).

1. EFFICIENCY AND PRODUCT DIFFERENTIATION

Individual firms maximize profits by selling products or services characterized by some level of differentiation and delivered into a marketplace with some level of efficiency. Everything else being equal, the more highly differentiated a product or service is in a market, so long as demand exists, the higher the

Figure 1: Factors in MSE-Dominated Industry Competitiveness



premiums that it will attract. Likewise the more efficient the production process, the higher the returns to the producer, regardless of the final price.

Figure 1 illustrates the tradeoffs between returns to efficiency and product differentiation. The shaded rectangular boxes represent total revenue from the sale of a product or service. Any point on the curve (a) maximizes returns for a particular product or service. New entrants in a market with a differentiated product can optimize profits from a strategy primarily focused on product differentiation.

Over time, other firms can copy the designs or production process, thus increasing competition and forcing down returns. For the same firm to optimize revenues over time, it will have to increase efficiencies. Failing to do so will cause returns to fall. Eventually as competitors adopt more efficient production practices, firms will either face declining returns—the space below curve (a)—or develop a new product or service as illustrated by curve (b).

2. CHANGING DEMAND

The third strategy for creating competitive advantage relates to changing or shaping demand based on unique characteristics of a product or service. MSEs are more likely to benefit from demand creation strategies that link product or service attributes to the MSEs who produce them either by their proximity or practices. (See text box.)

3. AGGLOMERATION STRATEGIES FOR MSEs

What are the implications of these strategies for creating competitiveness for small firm-dominated industries?

SHAPING CONSUMER DEMAND

In the coffee industry, competitive advantage could be created by shifting demand from commodity to specialty coffee using locational, product quality, fair trade, and perhaps environmental factors that are valued by consumers.

Crafts sold through fair trade channels appeal to consumers' desire to contribute to the poor in developing countries or to contribute to sustainable practices that preserve valued environments.

For the most part, Staley and Morse's industry characteristics that favor small firms describe functions and activities that support product differentiation more than efficiency. MSEs and MSE-dominated industries rarely gain competitiveness based largely on efficiency, typically achieved through capital intensity, low labor costs or scale economies.

Nonetheless, all firms must realize some efficiency level to compete. As shown in Figure 1 above, even when competitive advantage is created through quality and/or product differentiation, further competition will require firms and industries to increasingly reduce costs and improve efficiencies to sustain competitiveness.

For small firms, realizing economies and improving efficiencies must come from improved agglomeration strate-

gies. To achieve efficiencies, MSE-dominated industries with many different firms must be able to improve their cooperation vertically with firms up and down the chain as well as horizontally with large numbers of small suppliers.

Agglomeration economies refer to strategies for realizing external economies or collective efficiencies. For instance, when many small suppliers to larger firms work collectively, they may be able to substantially reduce the transaction costs for larger buyers of doing business with them. Clearly it is easier for an exporter to purchase goods from an organized group of 1,000 farmers than from 1,000 individuals. While associations, cooperatives, or more loosely organized producer groups are types of agglomeration strategies, brokers can also play this role.

Vertical cooperation is critical to being able to move a product efficiently from inception to the final market. To some extent, moving goods efficiently along a chain requires good infrastructure, communication technology, and an appreciation for on-time delivery. However, relationships among firms also affect their efficiency.

When firms higher up a chain engage in predatory or nontransparent behavior, firms down the chain will have little incentive to act as good-faith suppliers. When trust, learning and benefits are shared among firms (vertically and horizontally), there is a greater likelihood of generating collective efficiencies.

Improving efficiency among firms, linked either vertically or horizontally, can accrue from inter-firm cooperation—aimed at reducing transaction costs, lowering risks, or enhancing bar-

gaining power. It can also accrue from improvements in organization, or from the use of communication technologies. Microfinance has demonstrated the power of various organizational innovations—such as solidarity groups and village-based loan officers—in reducing transaction costs. Technological innovations, such as cellular phones, Internet kiosks and radio-based communication also offer opportunities for small-firm dominated industries to achieve collective efficiencies.

C. GLOBALIZATION: THREATS AND OPPORTUNITIES

MSE-dominated industries have been both threatened and provided with advantages as a result of dynamic trends related to globalization. Sometimes the trends appear to be favoring competition based on efficiency; in other cases, they favor competition based on differentiation; and in still other cases, they suggest opportunities for affecting and taking advantage of changes in demand. The trends and their impacts on MSE-dominated industries include the following.

1. TRADE LIBERALIZATION AND THE REDUCTION OF TARIFF AND NONTARIFF TRADE BARRIERS

Liberalization of global markets confers advantages to the most efficient producers; for labor-intensive processes, production advantages rest with lower cost labor markets. Market liberalization resulting from uni-, bi- and multi-lateral trade agreements (removal of tariff and nontariff restrictions on imports, free

trade agreements, and African, Caribbean and Pacific agreements) has also forced many firms and industries serving local and national markets into decline, as they now have to compete against imports from more efficient industries in other countries.

2. CONSOLIDATION OF NATIONAL AND GLOBAL RETAILERS

Consolidation of national and global retailers has reduced the number of markets where smaller firms can sell their products, while exerting far more control over the production specifications, including quality, quantity, and delivery timing. As large retailers gain market share, their need to control product quality has forced many middlemen and intermediaries—who specialized in delivering products into multiple markets—out of business.

At the same time, consolidating market power into a decreasing number of global retailers has generated short-term opportunities (since global retailers are constantly looking for lower-production costs) for many MSEs that are engaged in labor-intensive production processes.

3. CONSUMER CONCERNS AND STANDARDS

In recent years, increased consumer awareness has given rise to higher consumer standards. In response, a myriad of international standards has emerged (for example, those of the International Labour Organization [ILO] and International Organization for Standardization [ISO], Hazard Analysis And Critical Control Point [HACCP], and European Retailers Produce Working Group Good Agricultural Practices [Eurep-

GAP]) that are forcing small-scale suppliers to complying retailers to make impossibly high investments.

Since compliance verification costs are essentially the same for a large firm as a small one, small firms face high inspection costs unless they can obtain compliance certification for large numbers of firms linked by common practice into groups, associations, or cooperatives. In a number of countries, the cost of complying with EurepGAP horticulture standards is forcing the smallest growers out of the market.

However, where MSEs manage to realize scale efficiencies through a range of agglomeration strategies, producing according to buyer or international standards can provide either substantial premiums or access to markets unavailable to MSEs that are not organized into effective groups.

4. GROWTH IN BRANDING

Liberalization increases competition, which in turn reduces returns to firms that fail to distinguish their product or service using nonprice or branding strategies. The benefits (profits) of product branding generally accrue to the retailer or manufacturer owning the brand. Whether manufacturer- or retailer-branding strategies create opportunities for MSEs depends on the degree to which products attributes are associated with MSE producers either by proximity and/or practice.

Blue Mountain Coffee is a brand of origin conferring price premiums to all firms, micro and large, producing coffee in the vicinity of Blue Mountain, Jamaica. The link to MSEs by proximity increases the likelihood that MSE cof-

fee producers of Blue Mountain Jamaica will benefit.

Ethnic, organic, conservation label, and fair trade branding strategies or those that use specialized producer groups (such as the disabled, orphans, and so on) require certain practices by participating MSEs—the result of which is either higher premiums for participating MSEs or entry into markets unavailable to noncomplying producers. Branding strategies built on a retailer or manufacturer's name, e.g., Nike®, The GAP®, and Levi-Strauss®, do not have attributes that link MSEs to the brand by proximity or practice. Participating MSEs in this instance are reduced to selling cheap labor.

5. CORPORATE SOCIAL RESPONSIBILITY (CSR)

CSR is a rapidly emerging trend in retail markets. An increasing number of companies have corporate social responsibility policies. Some do so as a way of branding or differentiating themselves in a marketplace (for example, Ben & Jerry's® and Starbucks®), while others do so as a means to attract and maintain a dedicated and committed work force (H&M®). Still other companies subscribe to CSR good conduct to protect themselves from adverse consumer response.

Overall, CSR has been a greater threat to than an opportunity for MSEs.¹⁰ The principal reasons for this are the high costs associated with certification, training and ensuring compliance to CSR practices by very small firms. As consumers become aware of the implication of globalization trends on very small firms, there is an increasingly vo-

cal call for CSR practices to include fair price and practice for small firms and thereby mitigate the marginalization of MSEs due to high compliance costs.

6. NICHE AND SPECIALTY MARKETS

Niche and specialty markets by definition are small and serve limited markets. A characteristic of globalized markets is the expanding consumer preference for new, innovative, and distinctive products. Because the niche market is small, buyers serving this market tend to source products or inputs from smaller suppliers. There are niche market opportunities for handicrafts, textiles and a wide range of food products including ethnic, organic, fair trade, conservation, MSE-produced, heritage products¹¹ and marketing based on developing consumers' understanding of producers' culture, living conditions, etc.

Because of the dynamic nature of niche markets, they either expand to the point where they are less or no longer niche (such as organic foods in North America and Western Europe), or they disappear. Since two characteristics of niche markets are small production runs and in many cases, labor-intensive practices, MSEs have an advantage in the short term. In the longer term, the rapid demand for innovation in niche markets requires that participating firms be able to access the information needed to respond to consumer demand.

REDUCING THE COST OF AND INCREASING ACCESS TO INFORMATION

ITC, one of India's largest agribusiness corporations, established over 6,000 Internet kiosks in rural villages. Internet access in rural villages lowers ITC's costs of providing extension services, provides producers with access to price information, and reduces village producer dependence on middlemen. In addition, a wide range of service providers from health care to private education firms are now using the Internet to deliver services on a commercial basis to the rural poor.

7. INCREASING DIVISIBILITY OF CAPITAL

Driven largely by technological innovation, one trend in the globalized market is the decreasing firm size at which economies of scale can be reached. Internet access and computers have driven down the cost of accessing information even for small firms. Small-scale traders in Africa and Asia are using cellular phones and short message service (SMS) text messaging to access market price information to decide to which market they should sell their products.

Other examples of cost-effective technologies for small firms are drip irrigation and microfinance. The per square

meter cost of drip irrigating 1,000 square meters of vegetables is not substantially higher than the per square meter cost of irrigating one hectare or 10,000 square meters. The microfinance revolution has made financial capital far more accessible for millions of the world's poor than it was 30 years ago.

There are few industries in which technological advances have failed to significantly reduce machinery and equipment costs.

8. CONSTANT DEMAND FOR INNOVATION

Globalization is increasing the rate at which newer and better products are developed. MSEs and the industries in which they participate are disadvantaged in many emerging economies because of the inability of these countries to conduct research and development into new products. Conversely, very large firms with significant capital investments in current production lines are

often adverse to making new investments and taking on the risks of new product development. As a result, innovation often follows the path of niche products. Where the production and distribution of new products requires processes that confer advantage to small and very small firms, these firms will benefit.

The analysis of dynamic global trends makes clear that competitive advantage evolves with the marketplace. There is constant market pressure for improved efficiency, innovation and redefinition of consumer demand by producers. If small firms and small-firm dominated industries in developing countries are to cultivate, realize and sustain a competitive advantage, they must address the pressure for "social responsibility," meet standards, brand products, define new niche markets, improve efficiencies through technologies or social organization and continually innovate.

⁸ Comparative advantage is the set of resource endowments (human, natural, infrastructure and capital) that firms or industries can draw upon to deliver a good or service into a market for a lower opportunity cost in one country compared to another country. Competitive advantage refers to a firm or industry's strategies, skills, knowledge, resources or competencies that make it compete effectively with other firms or industries as a result of cost advantage, product differentiation and/or the ability to shape or exploit changes in demand.

⁹ Staley and Morse used the automobile industry as an example in which more than 4,000 firms were involved in the production of a single automobile, the majority of which employed fewer than 50 people.

¹⁰ Kula 2005a.

¹¹ "Heritage products" refers to revived older varieties of crops and products traditional to a given locality. Examples include fruit varieties that have distinct flavors but which are no longer widely grown due to a shorter shelf-life or smaller size.

III. TURNING COMPETITIVE ADVANTAGE INTO ECONOMIC GROWTH WITH POVERTY REDUCTION

Having identified their end-market competitive advantage using a mix of improved efficiency, product or service differentiation and advantages offered by changes in demand, industry stakeholders must resolve key constraints to take advantage of the opportunities that will generate real payoffs in terms of firm and industry growth. Research has demonstrated that turning competitive advantage into industry competitiveness is closely linked to the degree to which private sector stakeholders—committed to establishing and maintaining learning and benefit flows throughout the value chain—drive this process.¹²

This paper recommends a “value chain” framework to understand and untangle the fabric of an industry’s performance from product inception to final consumption. The framework provides a comprehensive taxonomy for organizing and understanding constraints to industry competitiveness and for systematically identifying potential interventions. It incorporates the intellectual contributions of the value chain literature by focusing on the relationships and power dynamics among firms in a value chain, on learning and innovation sources, on distribution of benefits, and on incentives for behavior change.

Many have referred to upgrading as requiring a new “mindset” for producers who have long been engaged in subsidized or noncompetitive industries. By analyzing and understanding the dynamics of incentives for affecting this mindset, this framework represents a

tool for upgrading value chains and industries.

A. WHAT IS A VALUE CHAIN?

A value chain is a supply chain made up of a series of actors—from input suppliers to producers and processors to exporters and buyers—engaged in the full range of activities required to bring a product from its conception to its end use. Value chain activities can be contained in a single geographical location or spread over wider areas. As defined by the Global Value Chains Initiative,¹³ global value chains are divided among multiple firms and are spread across wide swaths of geographic space.

As the product market grows and more product and money flows up and down the chain, demand is generated for services—referred to here as supporting markets. The supporting markets include sector-specific and crosscutting financial and business services.

The chain operates in a business enabling environment that can be at once global, national and local. The global business enabling environment can include trade multi- and bi-lateral agreements and worldwide standards. The national environment can include political stability, transparency, tariff and non-tariff trade policies, and the array of laws and regulations that can hinder or expedite business and trade. The local environment is primarily comprised of policies, the subjective interpretation

GROWING VALUE CHAINS LEAD TO AN ECONOMIC CLUSTER

In Mozambique, growth of the horticulture and oilseeds value chains attracted investment in new services—such as equipment dealers, a diesel fuel depot and agents to assist with land leasing—to meet the needs of recently arrived farmers and the smallholders with whom they subcontract.

However, this first-tier service market’s growth attracted additional service providers, leading to the emergence of an economic cluster. These secondary services included computer services and accounting services, as well as restaurants, tailors, and the like.

AMAP BDS views the growth in core value chains as a process that drives the development of services leading to the emergence of clusters.

Source: Kula and Farmer 2004.

of laws and regulations by regional and local officials. Transparency is often an issue in the local business enabling environment. Public infrastructure can also be included in this environment.

The growth of value chains clarifies some important concepts about how product and service markets¹⁴ grow. Product markets grow vertically before they grow horizontally. Without the capacity to get a product to market through input suppliers, producers, processors, wholesalers/exporters and finally to retailers, industries are unable to generate sufficient income for investment in upgrading services, such as product development, training, and other business services. Thus the vertical chain must be developed and strengthened before first- or subsequent tiers of services emerge.

B. VALUE CHAIN ANALYSIS FURTHERS SUBSECTOR ANALYSIS

Value chain analysis can be seen as a continuation of the work begun under subsector analysis. The Global Value Chains Initiative articulates four key points of value chain analysis that differentiate it from subsector analysis.

1. INTER-FIRM COOPERATION

Inter-firm cooperation has been the key to competitiveness in global markets in the late 20th and early 21st century. This cooperation generates external economies that lead to enhanced competitiveness.

2. POWER RELATIONSHIPS

Power relationships are important to firms in a chain. Win-win relationships among firms in a chain and the resultant benefit distributions between supplier and buyer can translate into increased collective efficiencies, external economies of scale and improved competi-

tiveness. At the same time, power imbalances can create upgrading disincentives.

3. DISTRIBUTION OF BENEFITS

Distribution of benefits creates upgrading incentives or disincentives. Power in value chains typically translates into benefits. The firms able to wield power through branding or access to worldwide suppliers and those traders in a chain able to control information can often exact a larger share of benefits from producers and suppliers. Understanding value chain power dynamics can point to interventions that improve the benefits to MSEs participating in competitive value chains.

4. LEARNING AND INNOVATION

Learning and innovation are essential both to create and sustain competitiveness. For small producers to compete and upgrade in response to market opportunities, they must have access to new skills, know-how and learning on a continuous basis. In some chains, learning comes primarily from buyers; in other chains, input suppliers are the sources of innovation. Regardless of the source, learning is central to intervention strategies aimed at improving and sustaining value chain and MSE competitiveness.

C. THE VALUE CHAIN FRAMEWORK

Value chain analysis is essential for developing an upgrading strategy. It includes an assessment of the factors that affect value chain performance, includ-

ing tangible constraints such as access to finance, technology and markets, and less tangible dynamics that involve the nature of relationships and incentives that can equally constrain competitiveness.

Understanding how industries in which MSEs participate can become more competitive requires a systemic view of the markets, industries, and firms. The value chain framework ensures both systematic and systemic analysis of the value chain and the factors and relationships affecting its competitiveness.

D. FACTORS AFFECTING VALUE CHAIN COMPETITIVENESS

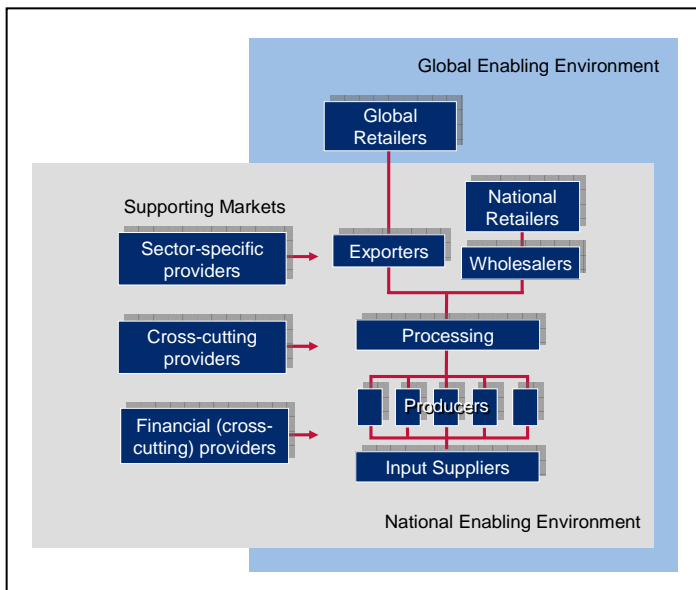
1. BUSINESS ENABLING ENVIRONMENT

The business enabling environment consists of:

- International agreements and market standards
- National policy assessments, reform and development, including private sector participation
- Local economic development and legal and regulatory enforcement capacity

International trade agreements and standards such as EurepGAP, as well as governance of global value chains, exert enormous impacts on the threats and opportunities that industries face in developing countries. Trade agreements, such as Lomé or the African Growth and Opportunity Act (AGOA), can open up opportunities for firms, while international standards with expensive

Figure 2: The Value Chain



FACTORS AND RELATIONSHIPS AFFECTING VALUE CHAIN COMPETITIVENESS

FACTORS

1. Business enabling environment
2. End markets
3. Supporting markets, including finance and other sector- and non sector-specific services and products
4. Inter-firm cooperation
 - a. Vertical linkages
 - b. Horizontal linkages
5. Firm-level upgrading (product and process upgrading)

RELATIONSHIPS

1. **Power** dynamics between firms
2. Access to **learning** and **innovation**
3. Distribution of **benefits**

requirements for compliance can just as easily close these trade opportunities.

National and local policies, and the legal and regulatory environment also have well-documented impacts on small firms, their industries and their ability to compete. In Guatemala, for example, export policies impose tariffs that restrict its craft exporters' ability to compete on the global market. In Kenya, the government's neglect of the tree-fruit value chain has allowed producers and exporters to receive and respond to market signals. The situation is very different in the coffee sector where government regulations and monopoly over marketing resulted in diminished incentives to innovate and upgrade.

In many cases the local and regional policy environment provides considerable opportunity for rapid improvement. Many emerging economies passed pro-trade and private sector development laws and regulations in the 1980s and '90s as a result of external

multilateral pressure, but left the implementation of the laws to local officials. In the absence of incentives to change existing policy, local and regional officials tended to protect the status quo.

Alternately, occasionally radical improvements in the policy environment have been implemented when local and regional policymakers recognize the link between how laws and regulations are interpreted and the level of investment, employment and job creation in their constituencies.

2. END MARKETS

End markets for an industry can be local, regional or international. The characteristics of the final product or service that drive demand (i.e., a combination of quality, quantity, price and a range of attributes that define consumer preferences) represent the foundation upon which competitive advantage is defined.

As explained above, competitive advantage is derived from the efficiency at which the demanded characteristics are delivered, the unique quality of the combination of demanded characteristics delivered, and the ability to shape demand to better fit the limitations on what can be delivered. End market demands drive both quality and standards. Analysis of end markets therefore needs to demonstrate the competitiveness potential that the upgrading strategy is designed to improve.

3. SUPPORTING MARKETS

Supporting markets are key to firm-level upgrading and include finance, business services, and input markets that support the core product market.

Supporting markets can be crosscutting or sector-specific and involve embedded business services or value chain finance that flow up and down the chain. They are referred to as markets to indicate that they are commercial and provided by the private sector. The de-

mand for the goods and services that supporting markets provide is derived from the growth of the core value chain. New technologies or technical services can have a substantial effect on the core value chain's competitiveness, even changing the competitive dynamic in certain markets.

4. INTER-FIRM COOPERATION

Vertical Linkages

Vertical linkages in a value chain are defined as the linkages among firms between input or raw material supply and final market distribution.

Vertical linkages are critical for getting a product from inception to the market, and for transferring learning and embedded financial and business services from one firm to another along the chain. The efficiency of the transactions between vertically related firms in a value chain affects the entire industry's competitiveness.

Horizontal Linkages

Horizontal linkages among producers or artisans are needed to reduce the transaction costs of working with many small suppliers. For small producers, they can generate external economies and improve bargaining power.

Horizontal linkages can help small firms to generate economies, for example, by buying in bulk or by filling large orders, which can contribute to competitiveness and increase their bargaining power.

Horizontal linkages among MSEs can take the form of informal or formal groupings of MSEs, as well as MSE networks that are managed through a third party (such as a lead firm, broker,

trader, and so on). Key to gaining value from horizontal cooperation is recognizing joint constraints that require collective action.

5. FIRM-LEVEL UPGRADING

Firm-level upgrading refers to changes made by firms to improve their competitiveness through product development and improvements in production techniques or processes.

Firm-level upgrading requires access to information, technology and capital or finance. Product development and improvements in production processes are integral to sustained competitiveness through enabling firms to meet the market's constant demand for innovation.

E. RELATIONSHIPS AFFECTING VALUE CHAIN COMPETITIVENESS—PLB

1. POWER

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

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

Power in commercial relationships is primarily derived from owning the key determinants that drive sales. For ex-

ample, unbranded food products are typically purchased based on the confidence the customers have in the retail store selling the food. In this case, the retail store often wields the power.

If the product is branded and that product has strong consumer demand, then the power usually resides with the manufacturer (owners of the product brand, such as Coca-Cola®). If the brand is defined by locality, skill-set or social story, then the power rests with the entity that owns these determinants.

Often, branding includes some combination of store brand, product brand or characteristic brand. For example, Jamaican Blue coffee sold at Starbucks® has retail branding and characteristic branding that combine to drive sales.

Power in value chains is highly dynamic since it is ultimately dependent on the end consumer and how he or she values a product or service.

2. LEARNING AND INNOVATION

Learning and innovation are key to creating and sustaining an industry's competitive advantage since industry upgrading is dependent on knowledge of what the market requires and the potential returns on investments in upgrading. It is essential that learning and innovation flow through the value chain in order to optimize these returns. When learning and innovation are not an integral part of an industry's norms, the industry's competitive position cannot be sustained.

The process of acquiring new knowledge or skills is not necessarily straightforward. Learning and innovating in a

systemic sense are closely tied to the incentives that encourage or discourage the delivery and absorption of new knowledge or skills, and the types of mechanisms that are in place to affect their transfer.

For firms and industries to constantly innovate for better performance, there has to be mechanisms either internal to the firm and industry (staff-to-staff or firm-to-firm as part of another transaction) or external (firm-to-firm exchange specific to the transfer of skills and know-how). The most competitive industries are those that institutionalize learning mechanisms.

In relatively flat value chains, where production is sold and consumed locally, learning tends to be limited. Local production offers little differentiation in terms of products or even production processes as local incentives push the producers to limit risk taking.

However, even with strong incentives to limit learning and innovation, fostering access to a new market (typically requiring a change in product or process) or new support markets that deliver new technology can substantially shift the learning dynamic.

In more sophisticated value chains there are typically some mechanisms and incentives in place to stimulate innovation and learning, but there are also counter incentives based on power dynamics, access to benefits and low risk tolerance that limit adoption rates or the effectiveness of some mechanisms.

3. BENEFITS

Benefits must be sufficient to provide incentives for changes in behavior patterns that entail taking on new risks and the adoption of innovations, if industries are to maintain their competitiveness.

Benefits are closely related to power relationships and learning. In the context of MSE development, benefits are much broader than just increases in income, although that is an important part of the equation. Benefits can also mean reduced market risk (more stable income) and increased value of assets.

The dynamics that drive where and how benefits accrue are tied to how power is wielded (who owns the determinant of a sale) and whether innovation and learning are actively encouraged through appropriate mechanisms.

The distribution of benefits depends not only on these factors, but also on

the strength of a value chain's infrastructure—the quality of the business enabling environment, the number and nature of vertical linkages, the effectiveness of cooperation to address joint constraints, and the depth and robustness of support markets.

Artificial or highly distorted distribution structures that come about due to a poor business enabling environment, predatory behavior in vertical linkages, lack of effective response to joint constraints, or weak or nonexistent support markets can exacerbate a behavior cycle. The result will be to skew the flows of benefits and ultimately limit an industry's competitiveness.

¹² McCormick and Schmitz 2002; Pietrobelli and Rabellotti 2004.

¹³ See www.ids.ac.uk/globalvaluechains

¹⁴ Meaning those service markets that serve the core product market—not service markets such as tourism or information technology, which can be industries in and of themselves.

IV. THE PROGRAM DESIGN PROCESS—INTEGRATING COMPETITIVENESS, ECONOMIC GROWTH AND POVERTY REDUCTION OBJECTIVES

A. CAVEATS AND AUDIENCES

The value chain framework is a conceptual roadmap for an intervention design approach. AMAP BDS aims to translate the breadth of research on value chains, competitiveness and enterprise development into practical approaches for promoting the private sector.

This section guides the reader through a systematic process for the design and implementation of interventions to achieve higher levels of economic growth, poverty reduction and industry competitiveness. It is not, however, a “how-to” manual; rather this section suggests approaches and tools, many of which may merit a longer discussion than space here allows. The reader is encouraged to explore these tools in more detail.

In a globalized economy, the competitiveness of industries is critical to sustaining growth in efficiency, output and incomes. The challenge for donors and development practitioners is to develop interventions that contribute to sustainable growth in industries with the potential to be competitive in increasingly globalized markets and with significant participation by small and very small firms. This section lays out a process to address this challenge.

Project or program design guides often have a cookbook quality to them, inviting the reader to take a step-by-step

approach—the end result of which should be the desired outcome. The stepwise approach reduces the risk that important factors are omitted. Like any good cookbook, a good project design process should begin with caveats.

Even the best program design is more of an art than a science. Systematic approaches can reduce the chance of serious errors, but they can also introduce and magnify errors. The factors that contribute to the performance and success of firms and industries can be estimated, but they are difficult or expensive to quantify accurately. Interactions between factors are even harder to quantify.

In reducing the art and increasing the science of development, many important elements can be lost. The reader is encouraged to embrace the “art” by being flexible and willing to modify project implementation based on lessons learned, while pursuing a more systematic program design approach.

Competitiveness is not a discrete point somewhere in a particular firm’s or industry’s future. While one can take a range of steps to become more competitive, competitiveness is a process. No firm or industry can remain competitive after having just once identified a strategy to increase its efficiency, product quality and differentiation, and exploit new demand. As the marketplace changes, new entrants will appear, driving down margins; new technolo-

gies will be introduced; and consumer demand will change. Because competitiveness is dynamic, program design must pay as much attention to creating a process for industry participants as to ensuring that the conditions at any point in time are met that allow or enable an industry to become more competitive.

Finally, it is important to note that, in many instances, the most successful development programs bear little resemblance in their implementation to their original design. Exercising care in intervention design and ensuring that it responds to the local environment helps to ensure the initial design’s appropriateness and relevance. Nonetheless, the fact remains that things change; there are rarely enough time and resources given to project design; and flexibility in project design and implementation are critical to successful outcomes.

B. APPROACH

Shifting from the conceptual to the practical, we now present the step-by-step process from industry selection to impact assessment. It responds to the challenge of translating the value chain framework into a practical approach to designing and implementing interventions. Each step in the proposed project design process draws from the value chain framework and attempts to answer the following questions:

- In what kinds of industries can micro- and small firms participate and compete?
- How can industries and especially the micro- and small firms within them most effectively improve their ability to compete in globalized markets?
- How can the micro- and small firms participating in a particular industry both contribute to and benefit from gains in industry competitiveness?
- How can industry stakeholders institutionalize and drive a continuous process of assessing and modifying an industry competitiveness strategy?¹⁵

In the program design process, using sound industry selection criteria and value chain analysis, it is important to avoid reinventing the wheel. While there is always a need to collect primary data from interviews and documentation on sales, imports, exports, employment, trade, taxation, and so on, the researcher should always begin with an inventory of existing reports, analyses, and industry assessments. Building on existing information will save the assessment team a lot of time, save the donor a lot of money, and minimize the risk that the value chain analysis becomes another dust collector on the shelf.

The value chain assessment approach to program design is comprised of five discrete steps.

1. INDUSTRY/VALUE CHAIN SELECTION

Select an industry or industries with significant potential for competitive-

ness, employment growth, MSE participation, and, in some instances, other cross-cutting objectives.

2. INDUSTRY/VALUE CHAIN ANALYSIS

Conduct a value chain analysis of the factors and relationships influencing competitiveness including identifying potential interventions to assist in the creation of industry competitive advantage.

3. INDUSTRY COMPETITIVENESS STRATEGY

Develop a participatory industry competitiveness strategy that emphasizes creating a process in which industry stakeholders are able to sustain competitiveness and an equitable distribution of benefits to participating firms, regardless of their size, while donor interventions minimize adverse market distortions.

4. IMPLEMENTATION ACTION PLAN

Develop an implementation action plan that provides guidance on how—in practical terms—to initiate a competitiveness strategy for the selected industry.

5. PERFORMANCE MONITORING AND IMPACT ASSESSMENT

Establish a performance monitoring and impact assessment system. A well-designed performance monitoring and impact assessment process provides information to program managers and implementers that is critical to assessing the effectiveness of particular interventions so that changes and modifications

can be introduced to optimize project impact before, rather than after, a project ends.

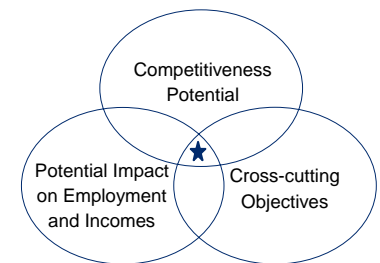
C. STEP ONE: INDUSTRY SELECTION



The goal of industry selection is to identify those industries with significant growth potential that are capable of generating a significant return to donor investments as well as a significant impact on employment, incomes and cross-cutting issues important to the donor.

Three independent selection criteria guide the industry selection process (see Figure 3).

Figure 3: Industry Selection Criteria



The criteria do not necessarily have equal importance or weight; no single criterion is sufficient to determine which industries will provide donors or policymakers with the greatest impact. The three criteria are:

- 1) Competitiveness or growth potential
- 2) Potential impact as measured by the industry's capacity to sustain in-

come gains, employment and asset development

- 3) Cross-cutting criteria as defined by donor priorities including but not limited to gender, the environment, health or regional priorities

1. COMPETITIVENESS POTENTIAL

Significant and sustainable increases in income and employment can only occur as a result of growth in an industry. An industry's *competitiveness potential* is the single most important criteria in selecting an industry for intervention.

Depending on the availability of secondary data sources and the tools and approaches used to assess competitiveness potential, this process can take as few as one to three days or as long as four weeks. Since competitiveness is an industry's ability to sustain increases in some combination of efficiency, product differentiation and access to new demand or markets, measuring competitiveness potential should consider each of these elements.

Resource limitations may require that the assessment team take reasoned shortcuts and use proxy indicators for competitiveness potential.

A number of assessment approaches are summarized in Table 1 below.

A critical factor in determining an industry's competitiveness potential is the presence of, or potential for, private sector leadership in the industry. Leadership in this context refers to entrepreneurs in the industry with the incentives, vision and commitment to address industry-wide constraints and drive upgrading investments, while rec-

ognizing the important role that small firms play.

2. IMPACT

As stated earlier, economic growth is by no means neutral in its impact on poverty. Growth in industries with high employment or high levels of MSE participation will have a larger impact on poverty reduction than in industries with low employment levels. Potential impact at the microenterprise, larger firm and industry levels is an important filter to apply to the subset of industries with a high competitiveness potential to optimize growth with equity.

Additional impact criteria include the multiplier effect of growth in a particular industry. The income and revenue gains from growth are invested in the local and national economy differently across industries. Determining how and where the marginal increase in industry revenue is invested is an important element of impact.

Assessing potential impact requires collecting information from secondary sources, interviews and available statistical information on employment levels, historical industry growth trends, regional and global competitors and changes in demand in the various markets that the selected industry supplies.

3. CROSS-CUTTING ISSUES

Governments and donors often have a complex set of objectives to consider in determining how and where to allocate resources to stimulate economic growth. For some donors, economic growth is the end, for others it is simply a means to a potentially more important end such as increased health, gender

equity, poverty reduction, increased biodiversity, or sustainably managed vulnerable environmental resources.

In an increasing number of countries, economic growth and poverty reduction programs must also take into consideration the impact of HIV/AIDS. In Eastern Europe and some of the former Soviet republics, sex trafficking is associated with a lack of viable alternative opportunities and therefore employment opportunities for at-risk women becomes an important cross-cutting issue.

However, crosscutting criteria should be applied after industries have been screened for their capacity to generate competitive growth with equity, without which the gains from investment in any particular sector or industry are likely to be unsustainable.

4. RESULT OF THE PROCESS

An expected result of the industry selection process is to identify one or more industries with significant potential to generate increased competitiveness, employment and income impact, and that meet the additional cross-cutting criteria of a government or external donor.

Identifying industries with significant competitiveness potential increases the likelihood that any programmatic interventions that arise out of deeper analysis of the factors affecting the productivity of that industry will have greater impact on economic growth, employment and incomes for larger numbers of people than would occur from more *ad hoc* approaches.

5. TOOLS AND FRAMEWORKS TO MEASURE COMPETITIVENESS POTENTIAL

There are a number of tools and frameworks used to assess an industry’s competitiveness; each has its own strengths and weaknesses and varies in its complexity. Table 1 below summarizes the frameworks most often used to assess, or as used as proxy for, a particular industry’s potential competitiveness. The reader is encouraged to read more about these tools in the literature (see references).

A time- or resource-limited team can create its own competitiveness assessment tool that combines elements from more than one framework. Approaches

that are too “quick and dirty” may not yield adequate information in an environment where there are many industries to compare or where factors affecting the competitiveness of a particular industry are changing quickly. Given the critical link between competitiveness and sustainable growth, too much cost cutting in the assessment phase is ill advised.

Porter’s two approaches and the Boston Matrix can only be applied to existing and rather robust industries for which information is available; changes in the business enabling environment can create enormous potential for nascent or brand new industries to be competitive.

Given a favorable business environment and reasonable comparative ad-

vantage, industries can and do emerge and expand rapidly. Ten years ago, China was not a significant exporter of cut flowers to the European Union (EU) market; today it is. In the same industry, Ethiopia had no exports three years ago; today cut flowers represent 20 percent of the value of Ethiopia’s largest export commodity—coffee. A number of countries have become major apparel producers in recent years where the industry was nonexistent only a few years ago.

Industry reports and real or potential investors are useful sources of information in gauging the potential competitiveness of nascent industries. Most industries generate periodic reports on the global market and trends, and many

Table 1: A Comparison of Competitiveness Assessment Tools

Tool	Description	Strengths	Weaknesses
Labor adjusted contribution to GNP	Contribution to GNP/percent of work force employed in sector	Quick measure of relative importance and potential employment effect	Does not measure competitiveness factors; does not directly consider global competitors; assesses past, not potential, importance of sectors
Boston Matrix	Assesses local industry growth and market share against global market growth	Relatively quick reasonable proxy for more detailed tools; assessment data can easily be collected from secondary sources	Does not directly address factors influencing competitiveness; assessment is based on historical data, not potential
Porter’s Five Forces and Porter’s Diamond Framework	Based on five interacting factors critical for an industry to become and remain competitive	Assessment based on factors influencing industry competitiveness; assessment suggests location of driving constraints to industry competitiveness	Assessment is complicated and, where information is not readily available, it can take time to collect data; substantial analysis required before industry selection
End Market Informants	Interviews with highest value end-market buyers regarding future trends and their procurement strategies	End markets define the universe of market opportunities; global buyers are knowledgeable of the competition and factors and trends likely to influence the market—information that is critical to assessing competitiveness	Requires knowledge of the end market buyers; this information is not available in-country; subjective
Investor Road Maps	Maps opportunities, constraints and risks to investment with an emphasis on the business enabling environment, and the existence and quality of critical infrastructure and services	Complementary to value chain analysis, high level of detail on identified opportunities and constraints	Costly as an industry selection tool; does not consider industry efficiency resulting from vertical and horizontal coordination; does not consider global competition

of these are quite useful in identifying new opportunities. Contacting the various commercial attachés of buyer markets may also yield information about investor interest, whether or not trade missions have occurred or are planned, and even where there is a nascent industry.

For obvious reasons, firms that are willing and able to invest in a new market are in the best position to provide reliable information on its competitive potential. Interviewing a single firm is generally not enough because not all firms make good decisions. If larger well-established national or multi-national firms have begun investing in a particular industry, these informants are likely to be more reliable than start-ups or businesses with little experience in the industry. If multiple firms have begun investing in a new market, they and those buying their product can be considered a reliable information source on the competitiveness potential of an industry—at least at a particular point in time.

Cost and accuracy tradeoffs in, and the subjective nature of, assessing an industry's competitiveness potential argue for a hybrid approach that takes into consideration multiple factors, including information provided by key informants, especially buyers who track the global marketplace for a particular industry.

6. TOOLS AND TECHNIQUES TO ASSESS IMPACT

Most of the information used in assessing the potential impact of improved industry performance measured by growth in incomes, employment and

poverty reduction can be obtained through secondary data sources including subsector analyses and government industry reports. Industry labor and employment statistics are also useful.

Estimating the multiplier effect of growth in a particular industry requires rigorous qualitative and quantitative analysis on where increased revenues are invested, how much goes to wages, and what wage earners at different levels do with marginal increases in income, whether it is invested in savings, investment or consumption.

Calculating the multiplier effect of growth in a particular industry is outside the scope of most industry selection criteria unless this information is already available or has been calculated for an identical or similar industry in another country. In the latter case this multiplier can be cautiously used as proxy in the absence of country-specific information.

7. TOOLS AND TECHNIQUES TO EVALUATE CROSS-CUTTING OBJECTIVES

Information on cross-cutting criteria is often available from secondary sources, particularly if the criteria have been one of the donors' priorities for some time. Alternatively, interviews with other donors and NGOs are a useful source of information.

8. PUTTING IT ALL TOGETHER

Once information is collected on competitiveness potential, impact and cross-cutting objectives, the analysis team

needs to combine these to select the industry or industries that optimize each of these elements. If few industries and few criteria are considered, the decision process is relatively simple. As the number of industries considered and the number of selection criteria grow, so does the complexity of the decision-making process. Where the decision-making process becomes more complex, a decision matrix with weights assigned for the different criteria can be very helpful.

Figure 4: Industry Selection Matrix

CRITERIA	Dairy (milk)	Green Beans	Crafts
<i>Competitiveness</i>			
• Unmet Market Demand (3x)	4 (12)	4 (12)	3 (9)
• Market Growth (3x)	4 (12)	3 (9)	3 (9)
• Potential to Differentiate from Competitors (1x)	3 (3)	2 (2)	3 (3)
<i>Targeting</i>			
• Potential No. of MSMEs (3x)	3 (9)	4 (12)	2 (6)
• Potential Increase in Rural Incomes (1x)	2 (2)	2 (2)	3 (3)
<i>Enabling Environment</i>			
• Government/Donor Involvement (1x)	3 (3)	2 (2)	4 (4)
TOTAL WEIGHTED SCORE	41	39	34

Score of 1-5: (5 = Highest; 1 = Lowest)

Source: Action for Enterprise 2005.

Figure 4 showcases three industries and three criteria for competitiveness and two for impact (targeting). While no cross-cutting criteria are included, Action for Enterprise (AFE) included the involvement of the government as a

positive criterion. It is obviously complicated to pick an industry with so many elements.

To facilitate this process, in discussions with the donor, AFE determined which criteria were the most important and assigned a weight of 3, which were least important and assigned a weight of 1, and which fell somewhere in between and assigned a weight of two. Each industry (dairy, green beans, and crafts) was assigned a rank of 1 to 5 for each criterion.

Multiplying rank times weight yields a weighted score for each criterion. The vertical sum of these yields a score for each industry. In principle, the industry with the highest score has the optimal potential for the criteria identified.

The industry selection matrix is a useful tool to distinguish among multiple criteria and choices where not all criteria are equal in importance. A cautionary note is that the matrix suggests a level of quantitative rigor for a decision-making process that is largely qualitative. As Figure 4 illustrates, the scores for dairy and milk, 41 and 39, respectively, are close enough that a minor change in criteria or weights would reverse the highest score.

9. CHALLENGES

Making the following decisions can lead a policymaker, donor or implementing agency to direct resources to a suboptimal industry selection.

Selecting Favorite Industries

Selecting the favorite industry of a donor agent or policymaker is a surprisingly common decision. Program managers' familiarity with a particular indus-

try or discomfort working with industries with which they are not familiar, or a host country policymaker's preference for a particular industry based on who will benefit can result in suboptimal growth and lesser benefits for the intended beneficiaries.

Temporary Trade Policies

Selecting industries based on preferential but temporary trade policies, for example, apparel investments based only on AGOA opportunities or sugar exports to the EU. It is critical in assessing the potential competitiveness of a particular industry to be aware of the trade policy environment, its terms, conditions and expiration, and how the policy will impact the industry before targeting development resources and investments.

Poverty (Not Growth) Focus

Selecting an industry employing a high proportion of the poor (but with no potential for growth). The compelling moral imperative of alleviating poverty often leads donors to direct resources to supporting firms and industries with very little potential to sustain growth and income. While there are strong rationales for targeting resources based on short-term disaster, hunger and poverty mitigation strategies, these are not likely to result in sustainable growth in incomes, welfare and poverty reduction.

Lack of Broad Impact

Selecting an industry with high growth potential but with little potential to generate broad growth and employment, for example, extractive or specific high-tech industries.

Failing to Compare

Selecting an industry without comparing it to other industries. Assessing an industry's competitiveness has both an absolute and a relative aspect. In a world with limited donor resources to support economic growth, it is important to pick an industry that is likely to have the greatest impact on growth and employment; this requires comparing different industries.

Overlooking External Threats

As indicated above, in a liberalized global marketplace, firms and industries must compete with like industries in other countries even more than with their neighbors. Understanding factors that affect the competitiveness of like industries in other countries is an essential part of the competitiveness analysis, but one that is often left out of the industry selection process.

Prioritizing Cross-Cutting Criteria

Prioritizing cross-cutting criteria over the potential for competitiveness. In many instances, cross-cutting objectives may have a political importance that is equal to or greater than the commitment to economic growth. Prioritizing these at the expense of a particular industry's competitiveness potential can result in public investment in industries that are unable to sustain growth in incomes and employment.

Focus on Previous Investments

Selecting an industry where there has been a significant investment regardless of its competitiveness potential. Many formerly centrally planned economies have industries with substantial but often obsolete investment in infrastructure. Governments encouraged privatization and investment in these indus-

tries without assessing each industry's competitiveness potential in a global marketplace. The quality of existing infrastructure to support the industry is an important element of, but not the driving decision point in, determining the potential competitiveness of an industry.

Unnecessary Complexity

Adding complexity where it does not add value. Recall that the purpose of industry selection is to identify which industry or industries need to be analyzed in further detail. Too detailed or exhaustive selection processes can defeat the purpose of conducting the value chain analysis and add considerable cost to the process.

D. STEP TWO: CONDUCT THE VALUE CHAIN ANALYSIS AND IDENTIFY INTERVENTIONS



Once the industry or industries for analysis have been selected, the analytical team can begin the value chain analysis. The value chain analysis examines the full range of activities that are required to bring a product or service in a particular industry or subsector from its conception to all its end markets.

Good value chain analysis provides a snapshot of an industry at a particular point in time. It can be a valuable tool in the design of interventions to increase the competitiveness of industries, while ensuring an equitable distribution

of the benefits from growth. This analysis is a particularly useful tool for the creation of a private sector-driven vision for change and as a map or plan to help reach the vision.

Good value chain analysis begins with a strong team. An ideal assessment is comprised of: 1) a team leader with expertise in value chain analyses; 2) an industry expert with considerable private sector experience in the product or service analyzed; and 3) a two- to four-member assessment team trained in value chain analysis and the information collection approaches.

Good value chain analysis includes active participation by industry stakeholders including the private sector firms responsible for moving a product or service from conception to consumer, critical service providers and public sector officials capable of influencing the legal, regulatory and policy environment.

The level of effort required to complete a value chain analysis depends on the complexity of the industry, the level of detail that the client requires and the assessment team size. With a three- to five-member team, three to four weeks in the field is adequate in addition to time for preparation and report writing. Smaller and less complicated value chains will take less time, while more complex ones in which the client wants a high level of accuracy and detail may take more.

There are five steps to conducting a value chain analysis.

1. DATA COLLECTION

Collect information from secondary data sources concerning all elements of the value chain, including participants and functions (see Figure 5, below), as well as the factors and relationship dynamics affecting industry performance and that make up the value chain framework detailed in Figure 2, above. The framework provides a structure for organizing the secondary data collected, the analysis of value chain constraints and opportunities, and identified interventions.

After compiling information from secondary sources and statistical databases and, where possible, using these to create a preliminary value chain map, the assessment team interviews the value chain participants. Participants can include global buyers and global industry experts for value chains with actual or potential global markets as well as support service providers.

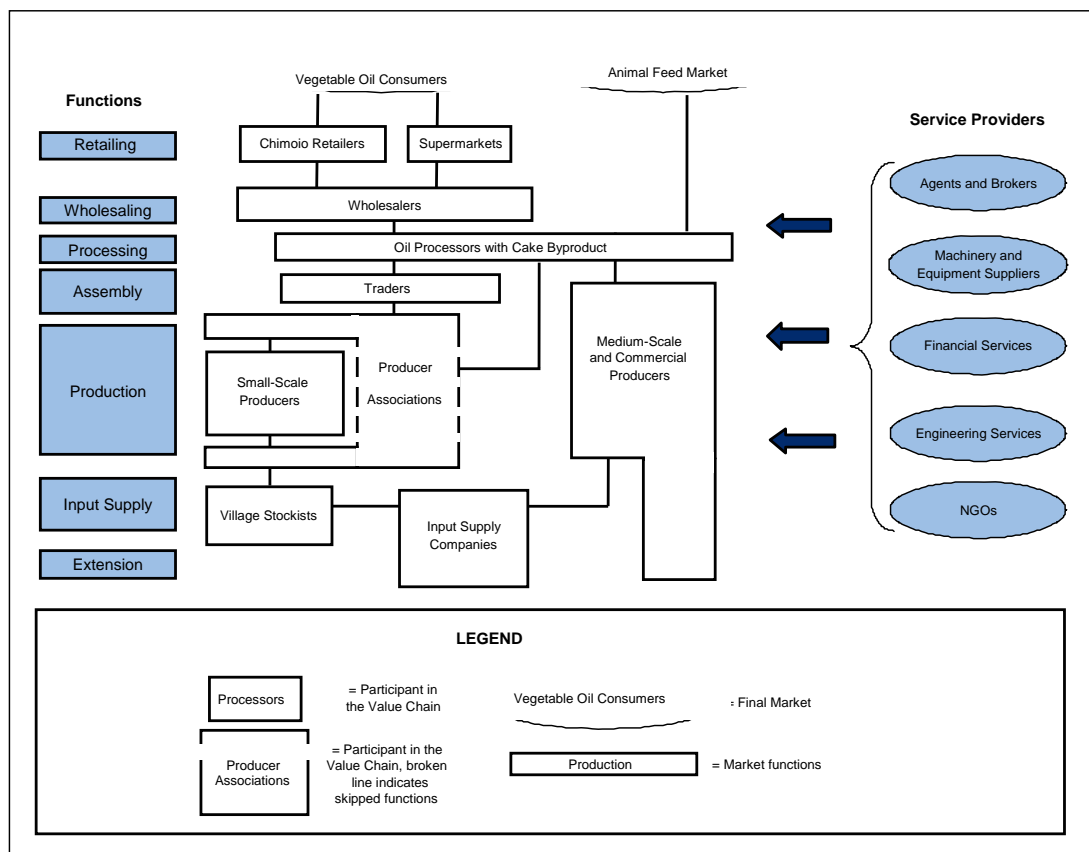
Survey instruments and interviews are designed to identify: (a) the structure of the value chain; (b) participant perceptions of the opportunities and constraints that they face; and (c) the extent of learning and benefit flows to participants in the chain.

2. VALUE CHAIN MAPPING

The value chain map is a graphic depiction of the structure and functions in a particular value chain and is useful in illustrating relationships between firms.

The value chain structure typically includes the industry's various market segments, their relative importance and growth rates, the channels (or supply chains) that serve these markets and the

Figure 5: Mozambique Oilseeds Industry—Basic Value Chain Map



value chain participants, including service providers, with particular attention to the how these relationships affect the distribution of and access to information, learning and benefits to firms in the value chain.

- Identifying **opportunities** for increased efficiency, improved product quality and differentiation and expanded demand for the product(s) or service(s) in the selected value chain.

number of different-sized firms in each channel. The value chain map can be used to display information on numbers of participants, employment by each participant group, gender disaggregation of employment and value added at each function.

Figure 5 above is a simplified value chain map of the Mozambique oilseeds industry that illustrates the key functions of the value chain, categories of participants and critical support services.

Once the preliminary data are collected and interviews with key participants completed, the analysis team can develop a preliminary value chain map illustrating participants and functions. After conducting additional and follow-

up interviews to fill any remaining information gaps, the analysis team should develop the final value chain map. The detail level added to the map depends on the audience and assessment objectives.

3. ASSESS CONSTRAINTS AND OPPORTUNITIES

The next step is to assess the constraints and identify intervention opportunities. This is the core of value chain analysis. It includes the following:

- Identifying the dynamic **factors and trends** affecting or liable to affect the industry's performance and competitiveness.
- An analysis of the nature and structure of **relationships** between

- Comparing a given industry/value chain against its **global competition** on efficiency, product differentiation and demand generation criteria.

The analysis is structured using the value chain framework; the factors and trends, relationships, opportunities and global competition are considered in the context of business enabling environment, end markets, supporting markets, inter-firm cooperation and firm-level upgrading—although, clearly, not all aspects of the analysis will apply to each of the elements of the framework.

In analyzing the relationship dynamics between the value chain participants, the assessment team needs to examine the power dynamics between firms as a

measure of who and how much control is exerted over the terms and conditions of trade; whether the relationships between firms facilitate learning and innovation; and how benefits are distributed, as measured by income and risks.

As an organizing structure for the analysis, the framework ensures both systematic and systemic analysis of the industry, i.e., systematic analysis of factors from the business enabling environment to benefit distribution, and systemic in that together the chain factors and relationship dynamics represent the market system or value chain.

4. VET THE FINDINGS

The utility of value chain analysis in an intervention design process is to assist in the development of a private sector vision for change that results in higher levels of firm and industry competitiveness. Achieving this requires active participation by stakeholders in vetting findings and in the intervention design process.

Once the analysis is complete the assessment team is advised to hold a workshop with value chain stakeholders who are responsible for critical market functions, service provision and the legal regulatory and policy environment.

A variety of participatory facilitation techniques can be used to vet the analysis with stakeholders, identify opportunities and constraints to increased competitiveness and begin to prioritize them. This workshop should also be used to facilitate the stakeholders' vision of a more competitive industry and the actions needed to realize that vision. The framework can be used to organize constraints and opportunities to ensure

that all factors potentially influencing industry performance are included.

5. IDENTIFY POTENTIAL INTERVENTIONS

Industries must be able to resolve key constraints and take advantage of opportunities if they are to make their comparative advantage pay off in terms of real growth. To accomplish this, industry stakeholders must be able to establish both firm-level and industry-wide solutions to those factors that constrain the industry from achieving an optimal strategy of improved efficiency, differentiation and new demand exploitation. These constraints are found in one or more of the following: weak connections to end markets, a business enabling environment that is not responsive to industry needs, inefficiencies in vertical or horizontal linkages between firms, and poor quality or a lack of critical support services.

After vetting opportunities and constraints with industry stakeholders, the assessment team and stakeholders can develop a short list of those likely to have the greatest impact on industry performance and competitiveness. This step is the bridge between the industry analysis and the active participation of stakeholders in identifying strategies and action plans to increase industry performance and competitiveness.

Potential activities should be limited to those that can either be implemented by industry stakeholders, assumed by stakeholders after an initial facilitation period by an implementing agency, or "one-off" activities that may require some initial subsidy level, but will not

require an ongoing subsidy for its effect to be sustained.

It is tempting to move from identifying potential activities to direct implementation of those that the implementing agency has the capacity to address. However, it is not the implementing agency's responsibility to execute these activities. Doing so without the active participation of and ownership by key stakeholders will make it difficult to sustain any of the interventions' short-term benefits.

6. EXPECTED RESULTS

The value chain analysis provides the researcher with a clear understanding of the key participants, the structure and function of participant relationships and the factors influencing the industry's competitiveness. Sound and comprehensive value chain analysis combined with effective facilitation of participatory workshops will provide the analyst with a clear understanding of the principal constraints to competitiveness and the opportunities to achieve higher performance levels.

Once participant stakeholders have confirmed and prioritized opportunities and constraints, the value chain analysis team can facilitate the development by private and public industry stakeholders of a list of potential activities or interventions that address the opportunities and constraints with the greatest potential to impact the competitiveness of the selected industry and MSE benefits.

While it is clear that value chain analysis can identify opportunities, the private sector participants must drive and own the upgrading process. The firms must take the risks as they are the ones who

will gain or lose depending on the outcome of upgrading investments.

The content of a given value chain analysis will depend on the end user or client. Value chain analyses for policy-makers will weigh information differently than those used by value chain participants or organizations working directly with them. The World Bank and donors concerned with the policy implications of value chain analysis require rigorous quantitative information including costs, prices, value added at each step of the various channels, and returns to participants and investors. When the value chain analysis audiences are industry participants and donors whose agenda is to support industry competitiveness, value chain analysis will place more importance on qualitative information and the set of factors that influence stakeholder decisions than on quantitative rigor.

Industry stakeholders capable of exercising leadership of a value chain or industry are likely to be aware of the quantitative data collected in value chain analysis, but strong value chain analysis is built on a combination of quantitative and qualitative data.

As previously stated, competitiveness is a process, not a fixed point, and as such, requires constant revision and modifications as factors evolve and firms begin overcoming basic constraints to achieve higher performance levels.

7. TOOLS AND TECHNIQUES

A number of tools and techniques are used to conduct value chain analysis. Good analysis always begins with a solid review of existing information

including reports, available statistics on the selected industry, the legal, regulatory and policy environment, the extent and quality of critical public infrastructure, and support markets. On the foundation of sound desk research, interviews, survey techniques and focus groups are key information collection strategies.

Creating the value chain map draws from subsector mapping techniques. Organizing opportunities and constraints according to the value chain framework facilitates and ensures that both static and dynamic relationship factors are incorporated into the analysis. Researchers collecting data on factors and relationship dynamics rely on a range of techniques including, but not limited to, constraint or SWOT¹⁶ analysis.

8. CHALLENGES

Failure to Consider the End User's Requirements

The value chain analyst needs to be aware of the client's needs and objectives before organizing the analysis. Stakeholder participants will find highly detailed information on returns, costs and prices of little value since they are likely to know much of this already. Conversely, policymakers will be frustrated by a report that focuses on the structure of relationships among firms and areas where there are inefficiencies or failures in meeting the requirements of certain markets, without rigorous price and cost information.

Assuming a Fixed Industry Structure and Static Relationships among Stakeholders

The structure and organization of firms in an industry or value chain can change in response to perceived opportunities, the attributes of the products or services sold into the final market, external competition, or perceived opportunities to achieve higher efficiency levels by restructuring market relationships. Assuming a constant structure and relationships will obscure opportunities to increase the efficiency and productivity of a particular industry or value chain.

Inattention to Learning and Information Flows

Learning and information flows are key to the ability of value chain participants to respond to existing market opportunities, meet the requirements of higher value markets and achieve efficiencies. Key to increasing an industry's competitiveness is identifying value chain participants who have or could have incentives to increase learning and information flows through the value chain.

Missing Factors

A common weakness of many value chain analyses is the failure to systematically consider all the factors that influence industry performance and competitiveness. End markets, particularly if they are outside of the country where the study is based, are often ignored or inadequately investigated. Analysis that excludes the quality and quantity of services needed by firms to upgrade their products or services will not capture the extent to which weak service markets constrain industry performance. The value chain framework presented in this paper attempts to define the universe of factors that can influence firm and industry performance.

Inter-firm relationships and the distribution of market power and learning and benefit flows are the most important and challenging constraints to building more competitive industries.

Inadequate Attention to Relationship Dynamics

Industry performance is to a large extent a function of the relationships among firms. Competitive industries require efficient, accurate and rapid information and learning flows from consumer to producer. Participating firms must be able to benefit from investments in upgrading regardless of size. Power over the terms of trade in market relationships impacts learning and benefit flows. The assessment team needs to recognize that relationships matter and can change.

Failure to Verify Data

Value chain analysis requires collecting a wealth of information. In any exercise of this type there is much room for error. Incorrect data calculation or interpretation, or incorrect data provision by respondents (intentional or not) can lead to errors. Value chain analysis teams are strongly encouraged to submit collected data to plausibility checks throughout the analysis to avoid costly errors.

Failure to Filter Constraints

Long unfiltered lists of constraints provided by key informants in value chain analysis should be considered data, not information. Since the purpose of the analysis is to identify strategies to increase a particular industry's competitiveness, the researcher should filter

constraints by the extent to which they limit the factors that contribute to competitiveness, increased efficiencies, the ability to differentiate products in a market, and the ability to take advantage of new or increased demand. It is the filtered set of constraints that provides the basis for interventions that can have a significant impact on industry performance.

In addition to filtering constraints by their impact on competitiveness, additional factors can be included in the filter such as potential impact on a targeted beneficiary group.

Opportunities and Constraints are Identified that are Not the Most Important

The goal is to identify a set of proposed interventions that address opportunities and constraints with the greatest potential to increase industry performance.

Confusing What Needs To Be Done To Increase Industry Competitiveness with Who Has the Incentives and the Capacity to Do It

This leads to market distortions and sub-optimal use of a subsidy. Implementing institutions exist to implement; the temptation is strong to figure out what to do and then do it. This can result in diminished private sector buy-in of the process at best, and often results in donor subsidies of functions with little or no chance of becoming sustainable.

In the analysis phase it is important to identify what the constraints and opportunities are without addressing who will fix the problem. Private sector participants should be involved and, where possible, drive the intervention process.

E. STEP THREE: DEVELOP AN INDUSTRY COMPETITIVENESS



The process of designing a competitiveness strategy for industries with high levels of MSE participation has three steps: 1) identify and establish competitive advantage; 2) develop a commercial

COMPETITIVE ADVANTAGE

Competitive advantage is created as a result of the individual and coordinated actions of firms in an industry to achieve:

- Increased intra- and inter-firm efficiencies and external economies.
- Successful product differentiation strategies that arise from:
 - Product uniqueness in terms of quality, price or unique attributes valued by the consumer
 - Unique product branding or management strategies, e.g., customer service, reliability or relationship management
 - Exploitation or creation of new demand through product development, promotion and marketing

upgrading strategy; and 3) create a process to sustain competitiveness. Maintaining a high degree of private sector and other industry stakeholder participation and ownership of the process is key to all three steps.

1. IDENTIFY AND ESTABLISH A COMPETITIVE ADVANTAGE

Consumer demand attributes of a particular product or service, and industry dynamics (leadership, organization, transparency, inter-firm cooperation) are the determinants of whether and how an MSE-dominated industry can create competitive advantage. Creating an industry competitive advantage requires investments in upgrading by individual firms and groups of firms. The development challenge is to identify industry stakeholders who have the incentives to create competitive advantage, while ensuring the participation of, and benefits to, micro- and small firms in the process.

When facilitating industry stakeholders in the process of identifying a competitive advantage strategy, it is important to use the industry as the unit of analysis, or at least those market channels with the greatest growth potential in productivity and competitiveness. This is often a challenge because the value chain participants' major investment of time, labor and intellectual and financial capital is in their own enterprise. The challenge is to convince participants, particularly industry leaders, that they alone do not have the ability to create competitive advantage even though they might be highly competitive and manage an efficient enterprise.

One of the most effective means of convincing participants of the importance of identifying and establishing industry-level competitiveness is involving them in the competitiveness analysis in which the industry is evaluated in the context of competitive threats, substitutes, market share, market size and industry trends (see step one: industry selection, above).

Effective presentation techniques can help firms recognize both threats to, and opportunities for, higher levels of industry competitiveness. One of the

GUIDING PRINCIPLES FOR PARTICIPATORY APPROACHES TO ECONOMIC DEVELOPMENT

When using participatory approaches in stakeholder meetings, several factors can help ensure a successful outcome:

- Include the participation of local leaders, sponsors and champions
- Keep the process short, simple and private sector-led
- Ensure viable markets are present
- Focus on activities with short-term results in a single subsector or value chain
- Undertake extensive advance preparation
- Plan for sustainability to ensure that long-term goals can be met

Source: Hatch and Kenman 2005

intellectual pioneers of value chain analysis, Hubert Schmitz, uses star plots, a graphical technique to illustrate the relative competitive position of an industry against its competitors.

The program design team is encouraged to make this process as participatory as possible including value chain participants from each function and support service providers, including input and other service suppliers, representatives of appropriate financial institutions and government officials in a position to influence the legal, regulatory and policy environment. Since an industry competitiveness strategy is not proprietary like an individual firm's upgrading strategy, broad participation tends to build buy-in of stakeholders and effectively demonstrates that the industry's success depends on the collaboration of all.

Because entrepreneurs lack the time and willingness to attend many meetings, this step can be integrated into the participatory workshop used to identify and prioritize constraints in step two, above.

2. DEVELOP A COMMERCIAL UPGRADING STRATEGY

Industries must have the ability to resolve key constraints and take advantage of opportunities if they are to make their competitive advantage payoff in terms of real growth. A commercial upgrading strategy is an action plan based on an understanding of the whole value chain. It is a vision of how to achieve higher levels of competitiveness by overcoming constraints in one or more of the factors that influence industry performance including end markets, the business enabling environ-

ment, inter-firm cooperation—both vertical and horizontal, and the existence and quality of critical support services.

Upgrading strategies are implemented at the firm and industry levels. The former tends to raise considerable proprietary concerns, while the latter does not. Industry upgrading strategies can be developed with broad participation of stakeholders or with smaller numbers around a specific constraint.

As an example, if a significant constraint to upgrading is the absence or poor quality of financial services, a participatory approach to drafting an upgrading strategy might include a small number of firms facing significant financial service-driven constraints and representatives of several financial institutions that could alleviate the constraint by developing new or improved financial products.

The development project may also assist individual firms, particularly lead firms, develop or strengthen their individual upgrading strategies, but it is important to recognize that these strategies are proprietary. The development agency that is able to honor the proprietary concerns of its private sector partners will be more successful at leveraging their upgrading investments to increase learning and benefit flows to participating MSEs. This can often be achieved by developing a clear memorandum of understanding (MOU) with the individual firm in question.

However, protecting private firms' proprietary information may run counter to the development agency's transparency policies that facilitate the achievement

of higher replication levels. Each development agency needs to weigh the tradeoffs between respecting a firm's proprietary rights and insisting on transparency from private sector partners.

Many MSEs tend to be highly risk averse and lack the capacity to make substantial investments in upgrading, especially if the payback period exceeds the MSE's carrying capacity. Nevertheless, MSEs do upgrade. While MSE upgrading may occur most frequently when they are provided with a guaranteed market for their upgrading investments, there is growing evidence that MSEs will invest in upgrading without an ensured market from a lead firm.¹⁷

3. CREATE A PROCESS TO SUSTAIN COMPETITIVENESS

To achieve and sustain growth, industry participants must be able to anticipate and respond to the changing market conditions quickly, efficiently and effectively. This requires a high degree of strategic cooperation among industry leaders.

Effective response over time requires a high degree of transparency and improvements in the nature and types of relationships among industry participants, the way learning and innovation are rewarded, and the ways that the benefits from upgrading are distributed to risk-taking firms, regardless of size.

Efficiency of industry response requires a high degree of inter-firm coordination and external economies generated in both vertical and horizontal relationships.

CREATING AND SUSTAINING COMPETITIVENESS

1. Participant stakeholders need to develop a shared vision of what their industry would be like if it were more competitive.
2. Private sector participants must drive this vision, not donors, NGOs or the public sector.
3. The vision must be linked to an action plan with short-term results that reinforce inter-firm cooperation to advance to an industry vision for competitiveness.

In open and therefore globalized economies, sustaining both firm and industry competitiveness is linked, and achieving it requires a high level of coordination among industry stakeholders.¹⁸ This is a challenging task.

First, developing a strategy to sustain competitiveness is an abstraction for many stakeholders, no matter the firm size. In many industries, the level of inter-firm cooperation is extremely low even around the most basic tasks that have a mutual benefit. Participatory facilitation techniques that emphasize short-term win-win activities for stakeholders and then build on these to develop an industry vision for competitiveness can be effective.

Creating and sustaining industry competitiveness is a process—and usually

not a short one. The following principles can be useful in the facilitating this process.

Build Trust by Rewarding Collective Action

Building trust by rewarding collective action among stakeholder participants is critical. Where there is a low level of collective action among industry participants, trust-building activities must focus on achieving very short-term results that benefit all participating stakeholders.

Move from Activities to Vision

As industry stakeholders recognize the value of strategic coordination even while they are competing with each other, the development agency or facilitator should encourage stakeholders to take on longer-term and more strategic activities including advocacy to improve the business enabling environment. By this stage, industry or trade associations will begin to represent the industry's collective interests.

Once inter-firm coordination results in reasonably strong associations or equivalent structures for collaboration, the facilitator is advised to use approaches that are more effective at generating a vision for change than merely activity based.

Continue to Address the Business Enabling Environment

Industries operate in a wide range of business enabling environments, from facilitative to hostile. In the short term, businesses and industries can grow even rapidly in relatively difficult business environments. Today in Bangladesh—with one of the least transparent business environments and high corruption

levels—the apparel industry is expanding rapidly. There is no evidence, however, that industry competitiveness can be sustained without a strong, supportive and transparent business enabling environment that facilitates investments in upgrading by the most efficient and innovative firms.

4. TOOLS AND FRAMEWORKS

The process of developing and sustaining an industry competitiveness strategy is based on sound industry value chain analysis, the use of a range of participatory facilitation techniques, and an appreciation of where to start based on an assessment of the degree of industry leadership and inter-firm coordination. The industry competitiveness assessment and analysis yield the information needed to develop an industry competitive advantage and upgrading strategies.

A number of participatory tools and strategies bring together individuals who have both common and competing interests to develop a shared vision or plan. Many focus on getting a group of participants to agree on identified opportunities and constraints to the realization of a common goal or purpose. The SWOT analysis and constraints analysis fall into this category.

Research into organizational dynamics has shown that constraints-driven analysis may be less successful in helping people develop a vision because it limits participants to a view of what is, rather than what could be. More vision-focused techniques like the appreciative inquiry approach have been used with stakeholders with some success to develop a common vision and action plan. Appreciative inquiry and similar frame-

LINKS TO THE POSITIVE

ACDI/VOCA's Linking an Industry's Network of Knowledge and Skills (LINKS) is a highly participatory approach to develop stakeholder dialogue. It creates a common vision from which concrete actions are determined in a short time period. As opposed to focusing on system breakdowns, facilitators instead lead interactive discussions with industry stakeholders to discover what works well in the industry and develop realistic action plans that build on present successes.

This process demonstrates that industry members have the knowledge and ability to implement the actions needed to improve their industry. The LINKS process provides an empowerment model and generates an ongoing, sustainable process of building linkages and strengthening an industry.

Source: Sparks 2005

works are based on the premise that a vision can be more effectively established if it is grounded in what is working now.

It is important to note that in many industries and value chains there is not enough inter-firm cooperation for participants to develop a shared vision to create and sustain competitiveness. In such a case, facilitation strategies should focus on very short-term results that are

oriented around quick win-win activities to create positive reinforcement for inter-firm cooperation.

There is no empirical analysis that favors one framework or approach over another. Multiple frameworks exist, and behavioral research is always suggesting new ones.

5. EXPECTED RESULTS

This step has three parts:

- 1) Identifying and establishing competitive advantage
- 2) Developing a commercial upgrading strategy
- 3) Creating a process to sustain competitiveness

All three require a high degree of private sector participation and ownership of the process. The third step, creating a process to sustain competitiveness is just that—a process. It may take years to unfold. The time required depends on the degree of leadership and inter-firm cooperation in the industry and the degree to which an implementing institution is able to facilitate higher levels of inter-firm cooperation and industry leadership.

Overall, the process of developing an industry competitiveness strategy will result in a set of interventions that stakeholders can undertake without and, when necessary, with donor support.

6. CHALLENGES

Failure to Ensure that it is a Private Sector-Driven Vision

This is most likely to occur in nascent industries with weak linkages, or in economies that are currently or were public sector-driven. In the weak or

nascent industry case, donors or NGOs are often tempted to “drive” the competitiveness strategy without buy-in from private sector stakeholders. While it is possible to kick-start industries, the lack of private sector buy-in will make it very difficult for the industry to continue to move towards the “vision” in the absence of continued subsidies. In the case of public sector dominance, the vision and priorities are unlikely to match marketplace requirements.

Lack of Consensus on an Industry Vision

Firms in an industry have both complementary and competing interests. In most instances they will be more acutely aware of their competing agenda. Creating a shared vision for what a more competitive industry would be like that is acceptable to those stakeholders is essential to creating a more competitive industry. It is a challenge requiring strong facilitation skills.

Overly Ambitious Action Plans that Leave Participants Discouraged

When the facilitator is aware that donor funding for industry interventions is time limited, s/he may propose unrealistic goals. Because building incentives for and rewarding inter-firm cooperation are so important to building competitive industries, it is essential to ensure that action plans are realistic and realizable with clear short-term gains. If short-term activities are successful, they will reinforce and reward participant stakeholders’ cooperative behavior from which longer-term activities can be developed.

NGO/Contractor Directly Provides Critical Services with Inadequate Attention to Exit Strategies

Though best practice guidelines indicate that NGOs and contractors should facilitate the delivery of services rather than provide them directly, there are a number of instances where it makes sense for NGOs and contractors to directly provide services. This is especially the case where service markets are very weak and the time it would take to build the capacity of local providers would significantly delay the industry’s improved performance.

Nevertheless, direct provision of services essential to the improved performance of an industry introduces distortions and in many instances will discourage private sector provision of the same services.

In the intervention design stage, NGOs and contractors should identify a clear exit strategy that ensures that critical services will continue after the project ends. In the case where an NGO is directly providing services, an exit strategy requires the parallel capacity building of private providers. Where donor projects directly provide services, in most cases it is important not to subsidize the cost of the provided service so that incentives are maintained for private providers to enter the service market.

Facilitation where Service Markets are too Weak

Conversely, it is possible for implementing agencies to tie themselves so strictly to best practice guidelines that they fail to grasp the extent, or lack thereof, of local service provision. Insisting on the facilitation of services where services are either absent or of extremely poor quality can diminish the confidence that value chain participants have in the program as implementers

encourage them to purchase or use poor quality services. It can also slow the realization of important initial successes.

In some instances it is acceptable for an implementing agency to “prime the pump” by directly providing services. Again, having a clear and plausible exit strategy can help an implementer determine under what conditions and for how long it may be appropriate to directly provide services.

Failure to Tap the Power of End Market Catalysts

In many value chains, particularly those with global end markets, there is a buyer or buyers with the skills and incentives to drive, or at least facilitate, upgrading investments by participants further down the value chain. This is particularly the case where end-market buyers are able to capture increased profits by ensuring that their suppliers invest in upgrading.

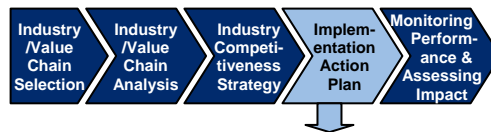
Where market catalysts exist, they can be a powerful means to develop and reinforce cooperative behavior by market participants in the short term. Conversely, if the participatory process to develop a vision and action plan for a more competitive industry does not include end-market buyers, the power of market catalysts to drive change will be lost.

Underutilization of Market Incentives

The underutilization of market incentives contributes to market distortions and the subsidizing of activities that market participants might undertake on their own. Competitive industries rely on incentives for all stakeholders—

private and public—to work towards and benefit from the factors contributing to increased levels of competitiveness, such as efficiency, product differentiation and increased demand.

F. STEP FOUR: DEVELOP AN IMPLEMENTATION ACTION PLAN



The implementation action plan is a road map or strategy to increase the competitiveness of industries with high MSE participation levels. Where the implementation action plan receives donor or private sector support, it serves as a project design document. Even without external support, the implementation action plan can function as an action plan for the industry stakeholders who participated in its development. Several principles guide the development of an implementation action plan or project implementation strategy.

1. KEEP INDUSTRY STAKEHOLDERS IN THE DRIVER'S SEAT

Clearly the process of establishing and sustaining industry competitiveness must be driven by industry stakeholders, principally but not exclusively from the private sector. (The critical importance of the business enabling environment requires both private and public stakeholder participation.) From the first participatory workshops through the project implementation

process, industry stakeholders should see themselves as the drivers of the industry competitiveness strategy.

2. START WITH WHERE THE INDUSTRY IS, NOT WHERE IT NEEDS TO GO

The most successful development programs take into consideration the capacities and incentives of their stake-

BUILDING AN INDUSTRY IMPLEMENTATION ACTION PLAN

Relationships matter. Increased transparency, creation of trust and a focus on industry level goals are critical to an industry's ability to respond and adapt to the dynamic nature of demand.

Value learning and innovation
Learning and innovation occur only when the incentives are in place to encourage firms to invest in risk-taking. When learning and innovation are not part of an industry's norms, the industry's competitive position cannot be sustained.

Benefits must be broadened and deepened. Benefits accrue in terms of increased incomes and reduced risk. An industry's competitive position depends in large part on the incentives to change behavior, enabling even the smallest participants to take on new risks and innovate.

Source: Field 2006

holders. As illustrated in the previous step, the industry structure and conduct drives the intervention strategy. Some programs will need to begin with critical business enabling environment changes before anything else can be achieved, others will begin developing strong partnerships with lead firms willing and able to drive upgrading investments throughout a value chain. Where no lead firms exist, other programs may need to focus on short-term win-win solutions that reinforce the value of inter-firm collaboration.

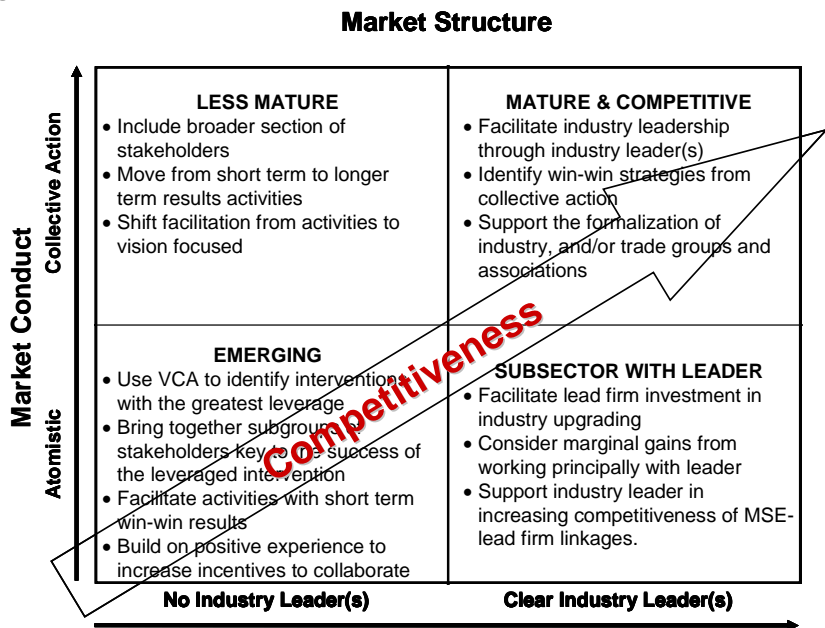
To illustrate, aspects of industry structure are useful in determining where to start in the process of facilitating and sustaining higher industry competitiveness levels. A well-executed value chain analysis will inform the practitioner about “where the industry is” in terms of its market structure and conduct. Particularly important to competitiveness are the following aspects:

- Whether or not there are lead or dominant firms willing and able to upgrade and drive upgrading investments
- Whether firm behavior is atomistic
- Whether a significant degree of inter-firm cooperation already exists

Figure 6 above illustrates how knowledge about market structure and inter-firm conduct help inform the practitioner approach to translating the value chain competitiveness strategy into action.

The top right quadrant illustrates a mature and competitive industry where lead firms are present and multiple firms have recognized the importance of at least some degree of collective

Figure 6: Market Structure Matrix



action around shared objectives. In industries fitting this profile, it is possible to bring together representatives of principal stakeholder groups to strategize about what it will take to sustain competitiveness over time in a dynamic and changing marketplace. Industry leaders take initiative and have the capacity to drive upgrading investments throughout the value chain. Countries and industries that fit this category have strong industry and trade associations and the capacity to analyze the market and help their members react to trends clearly.

The top left quadrant suggests a less mature industry where no single firm has emerged as a market leader, but where a relatively high degree of inter-firm cooperation exists. Because participants appreciate the benefits of working together, interventions should build on that, helping participants identify the threats to their industry, and developing a vision for how to sustain competitiveness.

Upgrading strategies at this point are less likely to be firm-specific. Interventions might include activities to support the formation, management or operations of industry and trade associations, advocacy or the deepening of service markets to reach smaller enterprise clients.

The lower left quadrant is reflective of emerging industries, transitional economies and those with weak or hostile business enabling environments. Weak supply chains and high-entry and -exit rates characterize these industries.

Entrepreneurial resources are devoted to keeping one’s own business afloat, rather than worrying about the whole industry. Because there are no lead firms, linkages to higher value end markets will be weak. Weak links to higher value markets and the absence of lead firms that can provide critical market information to small firms mean that there will be few incentives for individual MSEs to upgrade.

The lack of inter-firm cooperation suggests a strategy focusing on short-term, high-impact activities to increase the level of inter-firm cooperation (see “Clean the Beach” textbox adjacent).

This self-reinforcing process creates its own incentives for participants to move from concrete short-term results to more abstract long-term activities such as advocacy.

The bottom right quadrant describes industries where aggressive competition and innovation result in one or more

firms emerging as industry leaders. These can either be firms in the country in question or lead buyers in an export market country.

If a lead firm or firms can operate as a value chain catalyst by investing and driving upgrading investments by other firms in the value chain, the immediate impact and demonstration effect may produce more rapid change and innovation, leading to higher industry performance levels (see textboxes far left and next page).

Not surprisingly, as the first investor in an upgrading strategy, the catalyst will not want to have to share increased returns from upgrading with its competitors. This creates a dilemma for donors and NGOs that may be uncomfortable working with or subsidizing upgrading investments by a single lead firm.

There is not a clear answer as to whether and when a pro-poor NGO or donor should accord or support some level of exclusivity to a lead firm. Clearly in the long-term, MSEs participating in a given value chain will be better off if they have access to multiple market channels and the skills to enter them; in the long term, lead firm control of a market channel is not in the interest of MSEs.

In the short to medium term, however, exclusivity may provide a market leader the necessary incentives to invest in significantly upgrading a value chain. The direct results can be increased incomes for thousands of MSEs. As other firms begin to copy the initial firm’s upgrading strategy, the expected learning and benefits

LEAD FIRMS DRIVE UPGRADING INVESTMENTS THROUGH A VALUE CHAIN

- ITC India develops an Internet platform to improve small-scale grain farmers’ access to markets, information, and technical assistance.
- Starbucks invests in upgrading small-scale coffee growers in Chiapas, Mexico, while developing a proprietary brand in conjunction with Conservation International.
- Marks and Spencer, a UK supermarket chain, provides technical assistance to wholesalers and their MSE subcontractors to ensure quality supply.

Sources: ITC Limited 2006; Millard 2005; Kula 2005a.

CLEAN THE BEACH: A SMALL-STEP RESULT IN A FOCUSED STRATEGY PROMOTING INTER-FIRM COOPERATION

A consultant was working with small tourism firms in a region with considerable tourism potential. All the tourism enterprises saw themselves as tough competitors with one another. After numerous failures to get the tourism operators to think about how to make their industry more competitive, she focused on constraints to higher volumes of beach tourists.

One identified constraint was tourist complaints about feces on the beach—a problem affecting all beach operators that was even noted in a popular tourism guide. The consultant was able to convince the beach resort operators to collaborate to solve this particular constraint. Several hotel operators and tour guides came together to develop signs in the local language, hire unemployed youth to clean the beaches at dawn each day, and advocate with local community leaders to build latrines and enforce existing rules prohibiting defecation on the beach.

In a few months the change was noticeable. With the success of controlling a problem shared by all with a relatively quick and low-cost intervention, these same tourism enterprises began collaborating around a broader advocacy agenda.

Source: Value Chain Training Participant 2005

will reach even larger numbers of firms.

Conversely, there are examples where NGO insistence not to collaborate with a single firm has resulted in potential catalysts choosing not to collaborate

LEVERAGING STARBUCKS® IN MEXICO

Conservation International implemented a project that successfully leveraged Starbucks Coffee Company's ability to provide the incentives needed to encourage Mexican coffee growers in the Chiapas region to alter their farming practices.

The project introduced a set of best practices for coffee growers aimed at protecting the region's biodiversity and natural environment. The Starbucks agreement to purchase, at a premium market price, the coffee meeting their standards and the project's best practice standards served as the driving factors in encouraging the Mexican farmers to employ ecologically friendly farming techniques.

To assist the farmers in meeting the required standards, Starbucks also provided some of the necessary technical assistance that the farmers required to make the needed operational upgrades.

As a result, the farmers have realized not only a growth in income, but also improvements in the protection of their local environment.

Source: Millard 2005

with the implementing NGO on the joint objectives of increasing industry performance and learning and benefit flows to MSEs.

3. RELATIONSHIPS MATTER

An industry's ability to create value through increased efficiencies, product differentiation strategies and the exploitation of new demand depends on inter-firm relationships that are more transparent and trust-based, in which information flows facilitate rapid learning by essential participants and the distribution of benefits is a win-win situation for all parties. One of the challenges facing program managers is to work with stakeholders to establish this situation so as to lead to higher levels of competitiveness.

4. SMALL FIRMS CAN CONTRIBUTE TO AND BENEFIT FROM INDUSTRY COMPETITIVENESS STRATEGIES

Small firms can perform functions in which they have a comparative advantage. Projects should avoid maintaining high MSE participation in functions where MSEs have no comparative advantage. Conversely, through improved inter-firm collaboration, MSEs can both contribute to and benefit from higher levels of industry competitiveness.

5. FACTORS COMMON TO SUCCESSFUL PROGRAMS

Four common factors emerge in a wide range of successful programs where a key objective is the sustainability of results without an ongoing subsidy. These are not necessarily limited to value

chain based programs, but they are characteristic of the stronger ones.

1. Develop an Exit Strategy

Develop a clear exit strategy and periodically assess progress towards meeting it. With the importance often placed on quick results—when the project life is considerably shorter than the best estimates of how long it will take an industry to become globally competitive—there is a strong temptation to postpone discussion of an exit strategy and sustainability issues. However, failure to develop and integrate a clear exit strategy often results in industries incapable of sustaining life-of-project results after the project ends.

The project's exit strategy should be transparent to industry stakeholders so that they have the incentive to provide critical project services after the subsidy ends. Continual assessment of progress towards the project's exit strategy minimizes the risk that the industry will not be able to sustain key services without ongoing subsidy.

2. Remember the Framework

The framework of factors functions as an industry lens. It influences industry performance and identifies constraints to achieving higher levels of competitiveness. Using this lens to assess industry stakeholder progress in taking advantage of opportunities and overcoming constraints to competitiveness throughout project implementation helps ensure that no factor critical to industry performance is neglected.

3. Develop a Causal Model

Develop a causal model linking proposed activities to expected outcomes and results. In the past, USAID-funded

programs required that implementing partners develop logical frameworks (logframes) that linked identified constraints to activities, activities or outputs to expected outcomes or results, and results to anticipated impacts. The logframes could also be called causal models because they established a causality link between project activities and expected impacts. Causal models allow project managers to test the plausibility of proposed interventions in the context of expected impacts before they are implemented.

4. Maintain Flexibility

Maintain flexibility in a systematic program design process. As stated previously, the best program design is more of an art than a science. Systematic approaches can reduce the chance of serious error, but they can also introduce and magnify errors. The most successful projects establish a balance between the advantages of flexibility in project management and a more systematic program design approach.

6. EXPECTED RESULTS

The implementation of a successful value chain intervention should result in higher levels of industry competitiveness while creating a process that empowers industry stakeholders to ensure that competitiveness gains can be sustained over time.

7. TOOLS AND FRAMEWORKS

In addition to the causal model cited above, a number of tools and frameworks are useful for project managers who implement value chain based projects.

INDICATORS OF SUCCESSFUL VALUE CHAIN PROJECT IMPLEMENTATION

- Increased growth in incomes and employment in the selected industries
- Increased efficiency in the linkages between buyers and sellers throughout the value chain
- Improved delivery in the quantity and quality of supporting services
- An enabling environment that facilitates industry access to the highest value markets available
- Increased cooperation and coordination among stakeholders taking ownership of the competitiveness process
- Improved and accelerated learning and benefit flows to all value chain participants
- Improved benefit flows to the smallest firms in the value chain

Most important are regular discussions with stakeholders to ensure their ownership of the competitive strategy and to assess how the project is progressing. Regular site visits help ensure that even the smallest firms are benefiting from project interventions.

Ensuring that project implementation continues to reflect the project exit strategy and to apply plausibility tests to project activities will increase the likelihood that activities will generate the expected results.

Finally, a strong monitoring and evaluation (M&E) system is essential to monitor project performance and assess impacts (see section 5, below).

8. CHALLENGES

Several common problems emerge in the implementation of value chain and industry competitiveness projects.¹⁹

The Private Sector Does Not Take or Loses Ownership of the Process

Where markets are very weak, or in transitional economies where the private sector is weak, the public sector or donors tend to drive the competitiveness agenda. As a result, private sector stakeholders choose to focus their energies on their own firms. This delays the emergence of industry leaders; it blocks incentives for increased inter-firm coordination and for greater transparency.

Failure to Build from Where the Industry Is

The establishment of an industry competitiveness strategy must take into consideration the capabilities and motivations of its stakeholders to ensure that the starting point is well within their reach. The level of inter-firm coordination—both horizontal and vertical—and the presence or absence of industry leaders should shape the competitiveness strategy. Failure to do will result in stakeholders' losing interest in and ownership of the strategy.

Lack of a Systematic Approach to Identify the Constraints to Competitiveness

The principal rationale for taking a value chain approach to design economic growth with poverty reduction programs is to ensure a systematic approach to building and sustaining competitiveness. However, strong and systematic analysis is only useful if that same analysis is carried through each step of the designing for competitiveness process, from industry selection through project implementation.

Forgetting the Small

Many economic growth and industry competitiveness programs focus on industry leaders and their relationship to buyers in final markets. These projects either emphasize deal making or lead firm capacity building.

While both of these are important, if the relationships between lead firms and the small firms from whom they purchase products are not addressed, lead firms and the industry will not be able to achieve the efficiency and product differentiation required of its buyers. The result will be suboptimal levels of competitiveness, growth and poverty reduction.

G. STEP FIVE: MONITOR PERFORMANCE AND ASSESS IMPACT



The new generation of private sector development projects that USAID and other donors have launched aims to

implement strategies that will help MSEs increase their participation in, and benefits from, the ongoing globalization process. Performance monitoring and impact assessment seek to measure the extent to which these interventions are achieving their desired effects.

Conducting such evaluation processes is important because improving our understanding of what works, and in what settings, will enable USAID and other donors to strengthen their promotion of economic growth with poverty reduction. USAID has conducted few impact assessments and other project evaluations since the early 1990s, but is now attempting to revive the culture of evaluation in the Agency.

Performance monitoring and impact assessment are based on a **causal chain** that indicates exactly what activities the project is undertaking and what the hoped-for results of those activities are at several levels.

Figure 7 on the following page gives an example of a causal chain for two smallholder tree fruit projects in Kenya. The causal chain (or logframe) stretches from left to right. In the second-from-left column is a list of **project activities**, often involving facilitation of organizations that provide business services in market-friendly ways.

The third column lists target **outputs**, which are often measures of service delivery by project-facilitated providers. In the fourth column are the more immediate project consequences, known as **project outcomes**. The fifth and far-right columns list expected **impacts**.

Typically, a project will try to increase the competitiveness of the whole value chain and the participation of MSEs in various subsector activities. It may also aim to expand employment or reduce the number of people living below the poverty line. In value chain projects, impacts are often sought at the value chain (subsector), enterprise and household levels.

1. PERFORMANCE MONITORING

Performance monitoring tracks what happens as the project is being implemented so that interim results can be fed back to project management to permit them to make mid-course corrections, as needed. Development program managers should establish performance monitoring plans near the start of project implementation so that the variables to be tracked can be defined and their baseline values measured.

Performance monitoring usually emphasizes the project activities and project outputs links in the causal chain. That is, it usually follows project activities and service delivery (the types of results most directly under the control of project management) to determine whether things are going as planned. Performance monitoring can also be applied to project outputs and impacts.

USAID's Performance Management Plan (PMP) system requires Missions to define and track key indicators related to strategic objectives (SOs), intermediate results (IRs), and sub-IRs.

2. IMPACT ASSESSMENT

Impact assessment tries to develop information that will both prove that the project achieved at least some of its desired results (thus strengthening future claims on resources), and to improve approaches to private sector development programming.

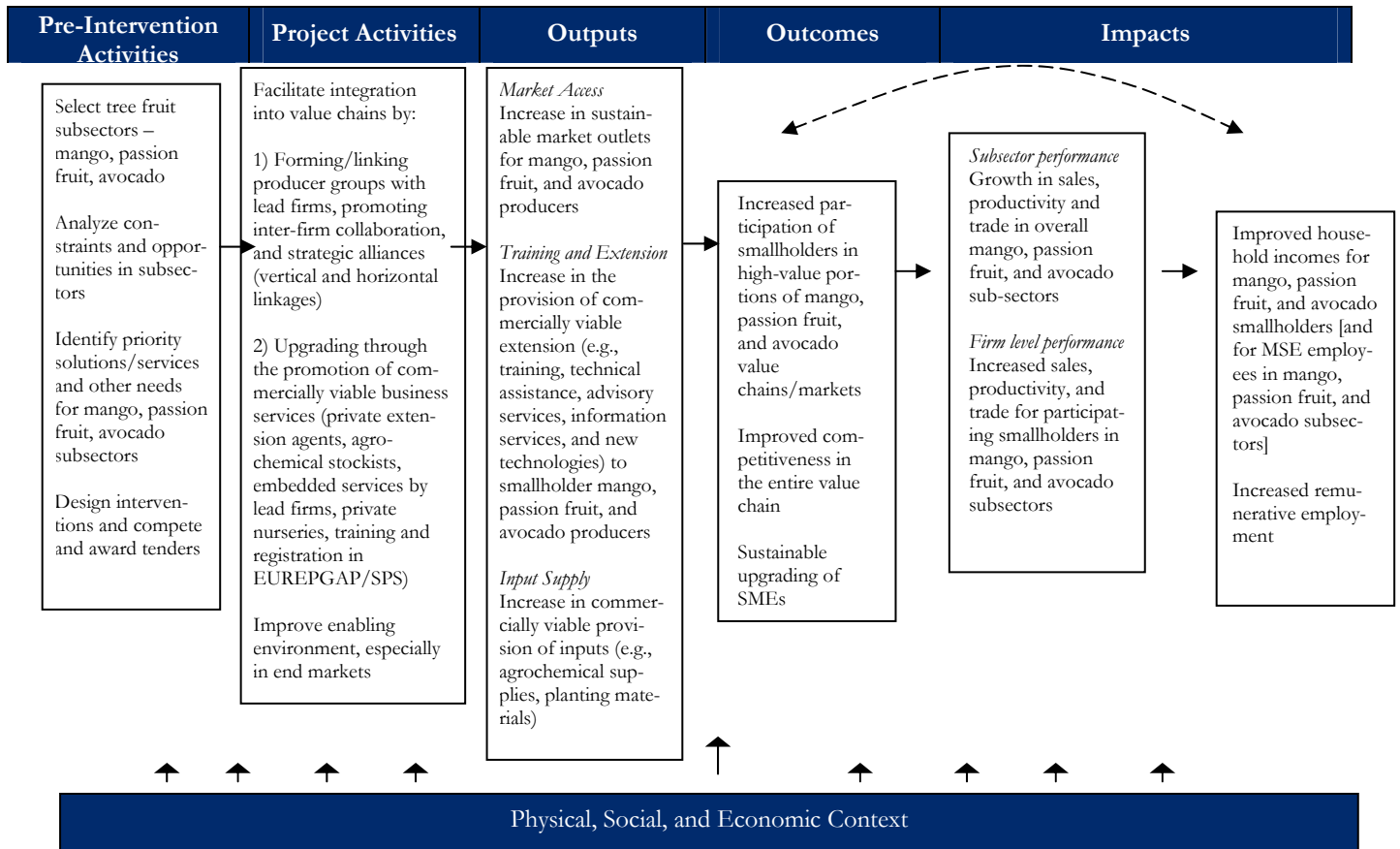
pendent body (albeit in close cooperation with project management), so as to achieve objectivity.

The third distinction is most important; while performance monitoring tracks what happens as the project is being implemented, impact assessment tries to

3. IMPACT ASSESSMENT CHALLENGES

Estimating the counterfactual is at the heart of the impact assessment process. The best way to do it is to compare changes over the course of the project for a sample of project participants with

Figure 7: Causal Model for Kenya BDS and FINTRAC HDC Projects



Source: Sebstad and Snodgrass 2005

Impact assessment differs from performance monitoring in three important ways. First, as the name suggests, it emphasizes higher-level results—especially impacts, but sometimes also outcomes.

Second, whereas performance monitoring is best done as an integrated project management function, impact assessment is better conducted by an inde-

measure the difference between what happened and what would have happened if the project had not been carried out—in other words, what difference the project made. Therefore, impact assessment compares the observed outcome with a counterfactual—an estimate of the unobservable output in the project's absence.

changes for a sample of comparators who are as similar as possible to the participants, except that they did not take part in the project.

Unless project participants are chosen at random from a defined population of eligible firms or individuals (which is usually not practical), project participants are likely to differ from the com-

parison group in relevant ways other than their project participation. Data from baseline and follow-up surveys must be analyzed carefully to take account of these differences, which are known as selection bias.

Another issue involves benefit spillovers from participants to non-participants as good news about ways of increasing productivity and profits spreads by informal means. Such spillovers increase the project effectiveness but make its impact harder to measure.

The approach just described is feasible at the enterprise and household levels, but it is much harder to apply at the value chain (subsector) level because there is no really appropriate comparison group. One can define various measures of the growth and competitiveness of the value chain, but how much of the observed change can legitimately be attributed to the project?

Comparisons across regions, subsectors, or countries may give some idea, but the project impact at this level may be difficult to determine. Measuring impacts on markets, (e.g., the market for business services of different kinds), poses similar difficulties.

Other challenges involve the political economy of impact assessment and cost management. Although the development community as a whole can derive great benefit from the impact assess-

ment of private sector development projects, managers of the specific projects to be assessed may resist the impact assessment, fearing that negative findings will weaken their ability to compete for scarce resources in an environment in which claims for rival uses of funds rest on claims that are unsupported by hard facts, yet may be hard to refute.

A common objection is that conducting impact assessment is too expensive. Indeed, conducting a full-scale impact assessment of every project would not be a good use of funds. Instead, full studies should be conducted on a limited number of the larger and more innovative projects so as to improve the understanding of what works.

This is the approach being followed under the AMAP BDS, which in addition to developing concepts and methodology will conduct impact assessments of projects in Azerbaijan, Brazil, Guatemala, India, Kenya, Uganda, and Zambia. Some of these studies are trying out lower-cost methodologies to see what can be learned from studies involving far smaller expenditures.

¹⁶ Strengths, Weaknesses, Opportunities and Threats.

¹⁷ Dunn and Villeda 2005

¹⁸ In closed economies in which local industries are effectively protected, at least in local markets, from external competitive threats, the notion of industry competitiveness is less important than firm or market channel competitiveness. Even in the case of market channel competitiveness, multiple firms will have to coordinate their activities around a shared vision for making a particular market channel more competitive through increased efficiencies, product differentiation or the ability to capture or create new demand.

¹⁹ Mitchell Group 2003; Hatch and Kenman 2005

¹⁵ Because competitiveness is not a discrete point but rather an ongoing process of identifying opportunities for upgrading in a constantly changing market, this last question is key.

V. CONCLUSIONS AND CHALLENGES

There is considerable anecdotal evidence that demonstrates that small firms can benefit from market globalization, that they can upgrade and be important players in many industries and value chains, and that they can benefit from their participation in these markets. This paper suggests that there are both static and dynamic factors that favor small-firm participation in a number of industries as part of an overall competitiveness strategy. At the same time, we recognize that small firms do not always benefit from globalization, and there may be many cases where market globalization will force small firms out of those industries.

This paper posits that large numbers of small firms in a wide range of product and service industries can both contribute to and benefit from overall industry competitiveness. It further asserts that in those industries, industry competi-

tiveness and participating small firms go hand-in-hand.

The challenge is to test these hypotheses and the limits of strategies to achieve significant economic growth and poverty reduction.

The strategy addresses issues of inter-firm behavior and incentives that are often missing from analyses and project designs. It articulates an approach to assessing relationships and incentives and to intervening in them to improve competitiveness. It posits that projects can intervene in relationships just as they have in the past intervened in the more tangible factors that contribute to market failures.

A challenge for agencies engaged in project implementation is identifying creative strategies for moving from win-lose to win-win relationships and from a skewed distribution of benefits to one

that creates incentives for small-firm upgrading and risk-taking.

Learning how to improve the competitiveness of industries with large numbers of small firms is an ongoing process. There is a growing body of evidence suggesting ways that this can be accomplished. Some strategies are completely private sector-led; others are led by some form of public (including donor) and private sector partnership. The field will evolve, and as it does, we will learn more about what works best.

If this paper functions as a starting point, a basis for rethinking how best to move forward, or a rationale for a new direction for industry leaders, donors and practitioners as they test private sector market-based approaches to accelerate economic growth and poverty reduction, it will have served its purpose well.

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Accelerated Microenterprise Advancement Project (AMAP) is a four-year contracting facility that USAID/Washington and Missions can use to acquire technical services to design, implement, or evaluate microenterprise development, which is an important tool for economic growth and poverty alleviation.

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