Discussion Paper, June 2008

Value Chain Governance

Is it "Supply Chain Management" vs. "Pro-poor Upgrading of Value Chains"?

Abstract

The basic assumption of the present paper is that the issue of "governance" (understood as the power to control, influence, set the modes and rules of interaction) in value chains is somewhat underrated in the implementation of upgrading strategies. The paper presents an overview of the variety of different economic development approaches influenced by the value chain concept and relates these to the governance issue. More in-depth, this relation is presented for "supply chain management as a business management tool" and "pro-poor upgrading of value chains as a development concept" as distinctly different approaches. Despite certain similarities, a clearer differentiation is advocated, notably for the context of international development cooperation. Based on the literature review and on lessons learnt in the field, a simplified model of value chain governance is derived. Implications for development practitioners are discussed which include that ODA programmes supporting private sector supply chain management are to be tied to a set of conditionalities which ensure additional development impacts (e.g. social and environmental standards) and prevent alliance partners from taking windfall profits. Finally, the concept of "Sustainable Development" is suggested as the ethical "Leitbild" (or guiding principles) that is needed to give value chain governance legitimacy and relevance. This implies by definition a holistic and process-oriented approach to value chain governance which lays simultaneous emphasis on i) economic growth and welfare, ii) equal access to and fair distribution of value-added as well as iii) ecologically sustainable use of resources.

The findings and opinions expressed in this paper are solely those of the author as a private person, and do not in any way imply policy statements of organizations the author is associated with. Remaining errors and misjudgements are solely the responsibility of the author. Comments on this draft are welcome and should be addressed to: hans-juergen@wiemer.com.vn

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List of Abbreviations

ADB	Asian Development Bank
BEM	Bordeaux Management School
COC	Chain of Custody
DC	Development Cooperation
DFID	(Britisch) Department for International Development
DIE	German Development Institute (GDI)
et.al.	and others
EIBA	European International Business Academy
GNP	Global Production Networks
GTZ	Gesellschaft fuer Technische Zusammenarbeit (German Technical Cooperation)
IDS	Institute for Development Studies, Sussex
ILO	International Labour Organization
LED	Local Economic Development
M4P	Project: "Making Markets work better for the Poor"
MDG	Millennium Development Goals
M & E	Monitoring and Evaluation
MIT	Massachusetts Institute of Technology
MNE	Multinational Enterprises
NGO	Non-governmental Organization
NIS	National Innovation System
ODA	Official Development Assistance
OECD	United Nations Organization for Economic Cooperation and Development
PACA	Participatory Appraisal of Competitive Advantage
PPG	Pro-poor Growth
PPP	Public Private Partnership
PPP	Power Point Presentation
PWF	Privatwirtschaftsfoerderung (Private Sector Promotion)
RD	Rural Development
SCM	Supply Chain Management
SCO	Supply Chain Orientation
SME	Small and Medium Scale Enterprises
SNV	Dutch Technical Assistance Organization
TNC	Transnational Corporation
UNIDO	United Nations Industrial Development Organization
USAID	United States Agency for International Development

1. Concepts of Value Chains and Governance

Over the last two decades, the value chain approach has emerged and developed into a research tradition with a large body of literature, originating from various disciplines. As yet, the approach is not a fully coherent theory, but carries different connotations in each discipline and even different ramifications within each of these disciplines. Disciplines, to name a few, include management sciences, innovation theory, transaction cost theory, industrial and trade economics, logistics, economic geography, sociology and – not the least – development economics. As Henderson et.al. stated: "although the approaches often overlap with one another, they derive from different intellectual domains and, therefore, carry with them different kinds of intellectual `baggage`".[1]

Attempts to define the value chain concept therefore depend on the background of the discipline and the purpose of its use. Most commonly accepted as the origin of the concept is management sciences; most prominently promulgated by Michael E. Porter (1985). Whereas Porter's early work focused on generic value chains within single companies in order to strengthen competitive advantages, his later work attracted attention to additional location-specific factors such as local demand patterns and rivalry, and focussed more on linkages between companies, thus optimizing "competitive forces that shape strategy" for networks of companies or production systems, and even for whole nations.[2]

Kaplinsky R., & Morris M. (2000) defined the value chain concept as "the full range of activities which are required to bring a product or service from conception, through the intermediary of production, delivery to final consumers, and final disposal after use". Elements of the chains include design, production, marketing, distribution, and support to get the product to the final user. The activities that comprise a value chain may be contained with a single firm or may embrace many firms. They can be limited to a single country or stretch across national boundaries. If firms specialise in a certain stage of the value chain and establish linkages with input providers (upstream) and processors or distributors (downstream), this is usually referred to as vertical linkages. At the same time, firms tend to be embedded in horizontal linkages, i.e. cooperative relationships with other firms at the same stage of the value chain. Moreover, firms are connected with non-firm organizations, e.g. employer's associations, trade unions, NGOs, universities and government agencies. Many of these relationships do not directly influence the process of value addition and should therefore be distinguished from vertical value chain links (Altenburg 2007, p.6).

Despite its complexities, the value chain concept can also be portrayed as a simple idea, which is a strong reason why the concept has become so popular with the mainstream of development practitioners. As Hubert Schmitz put it:

> School children know that their wooden desks started as a tree that had to be felled, transported to a sawmill and cut up; the planks of wood were then sold to carpenters who transformed them into desks that were then sold to shops or directly to schools. School children may not know about the numerous additional activities carried out along the chain, for example: drying of the wood, the certification that the timber comes from managed forests, the design of the desk, adding metal fixtures, painting, inspecting quality, etc. Adding these activities is merely a refinement of a simple idea. (Schmitz 2005, p. 4)

As Schmitz continued, the idea gets slightly more complex and starts to become useful for analytical and policy purposes, once three further features are included:

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

[1] At the 31st Annual Conference of the European International Business Academy" (EIBA) in Oslo on "Landscapes and Mindscapes in a Globalized World", Oslo December 2005, cross-referenced from Altenburg, T. (2007)

[2] See Porter (2008) and World Economic Forum (2007)

- some activities add more value and are more lucrative than others (the policy-makers' concern is to help local enterprises to move into these more lucrative activities);
- some actors in the chain have power over the others.

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

Schmitz' useful extensions to the simple idea introduce the concept of "governance" which is rooted in political science, and widely applied in development cooperation. The World Bank defines governance as "the exercise of political authority and the use of institutional resources to manage society's problems and affairs" (World Bank 1991). Based on their mission statements, other institutions use the terms "good governance" as a synonym to shape their strategies, such as DFID defines:

> Good governance is not just about government. It is also about political parties, parliament, the judiciary, the media, and civil society. It is about how citizens, leaders and public institutions relate to each other in order to make change happen. Elections and democracy are an important part of the equation, but equally important is the way government goes about the business of governing. (DFID 2006, p. 20)

Other organizations define governance as monitoring the achievements of the UN millennium goals (MDG).[3] Yet others limit their perspective on specific social and/or environmental concerns, including biodiversity. Most of these appear to be rather detached from economic performance or competitiveness. The need thus remains to link these perspectives into an aggregated vision and into common rules of governance.

As early as the 1960ies, "governance" has entered management science with the concept of "corporate governance" which relates to individual firms and describes a set of processes, customs, policies, laws and institutions affecting the way people direct, administer or control a corporation. In this understanding, corporate governance also includes the relationships among the many players involved (the stakeholders) and the corporate goals. The principal players include the shareholders, management, and the board of directors. Other stakeholders include employees, suppliers, customers, banks and other lenders, regulators, the environment and the community at large.

Coming back to Schmitz' first extension of the simple idea (activities carried out in different parts of the world), value chain research in recent years has focussed on the evolution of global-scale industrial organization with a variety of network forms of governance situated between arm's length markets, on the one hand, and large vertically integrated corporations on the other.

For this general introduction of the basic concepts of value chains and governance, the question remains: What importance has "governance" (in the sense of networked governance, beyond the level of a single firm) in which concept of "value chains"? - Altenburg, 2007, gives a "state-of-the-art" overview of the analytical foundations and different connotations of the variety of value chain concepts in different disciplines. The table following on the next pages is an attempt to summarize the major characteristics of the different concepts of value chains and combine this with a first assessment of the relative importance of "governance" in each concept. In the next two chapters, this relative importance is discussed in more detail for two selected approaches: "supply chain management" as a business management tool, and "pro-poor upgrading of value chains" as a development concept.

[3] E.g. World Economic Forum (2006): Global Governance Initiative

Tab. 1: Overview: Economic Development Approaches influenced by the Value Chain Concept and their Relation to Governance

Econ. Dev. Approach	Discipline	Major Characteristics (selected References)	Importance of networked Governance
Supply Chain Engineering	trade economics, logistics	within single firms, corporations; technical in nature, concerned with optimization tasks in distribution and location, vehicle routing, production and demand planning, inventory management, international sourcing, compatibility in supply chain contracts (Rainbird, M. 2004; LINDO Systems 2006)	none
Supply Chains	strategic management science transaction cost economics	within single firms, corporations; core and non-core competencies, make-or-buy choices, in-house production versus outsourcing (Mentzer, J.T. et.al. 2001; Lynch, R. 2003; Gallis, M. 2006; Hill, w. et.al. 2007)	none
Supply Chain Management	management science, supply chain management	beyond company level, but strictly focussed on optimizing single company's interests; decisions on locational choice, logistics, outsourcing, just in time delivery, chain disintegration (Gibson, Brian J. et.al. 2005; Sturgeon, T. 2006; Bitran, Gabriel R. et.al. 2006; IKEA 2008)	so far only in the sense of "Corporate Governance"
Offshoring	management science, locational economics	strictly focussed on optimizing single company's interests; specific form of crossborder outsourcing (Peterson 2005)	practically none
Theory of Competitive Advantages	management science; M. Porter's value chain concept	initially limited to single company level, later focussed on positioning in networks, analysis of location-specific conditions and linkages with related and supporting industries and external economies; i.e. value chain integration from the perspective of individual operator (Porter, M. 1985, 2008)	potentially high, but effectively used to optimize power of individual operator
Linkage Approach	development studies, industrial economics	beyond company level; concerned with growth poles generating external economies for related industries; focus on positive spill-over of TNC on SME in developing countries (Altenburg. T. 2005; Downing, J. 2006; Ferriere, J. 2008)	high
Approche Filière	development studies, French school	vertical integration in agriculture, map actual commodity flows, identify agents within a filière; rather technical, criticized as static and neo-colonial (Raikes, P. et.al. 2000; Stamm, A. 2004)	low
Commodity Chains	development studies	used in earlier work of Gereffi et.al., initially similar to "approche filière" (Gereffi, G. 1994)	medium
Global Value Chains	development studies, Gereffi et.al.	In addition to the traditional notions of the input-output structure of chains and their spatial distribution, innovative contributions with focus on the governance structure of value chains (Gereffi et.al. 2003; Schmitz (ed.) 2004; Humphrey, J. 2004; Schmitz 2005; Altenburg, T. 2006)	very high
Subsector Analysis, Agrifood Systems	agricultural economics, agricultural marketing	Key concepts almost identical with value chain approach; highlights the importance of "coordination" of participants by mechanisms other than markets; lead firms as coordinators (Dolan 2004; Gibbon & Ponte 2005; M4P 2005; Humphrey 2006; Fromm, I. 2008)	high
Industry Level Analysis	industrial economics	based on industry studies by McKinsey; neo-liberal approach concerned with policy-based market distortions, aims to reduce government interference in markets (Altenburg 2007)	low
Global Production Networks	development studies, Henderson et.al.	GPN replaces the metaphor of a chain (as a linear process) and conceptualizes how inter-firm networks are embedded in societies, how firms and individuals are influenced by overall power relations and sociocultural patterns (Henderson, J., et al. 2002)	very high

Econ. Dev. Approach	Discipline	Major Characteristics (selected References)	Importance of networked Governance
National / Regional Innovation Systems	innovation theory	NIS has foci on innovation rather than production; national rather than global systems; institutions important in reducing uncertainty in the political, legal and economic environment (Lundvall, B. 1992; OECD 1997; Dornberger, U. 2003; UNIDO 2003; Downing, J. et.al. 2006)	high
Systemic Competitiveness	development economics	German Development Institute argues that competitiveness of firms is dependent on the quality of inter-firm relations and national systems of norms, rules and institutions that define economic incentives; mulit-level approach to interventions (Esser, K. et al. 1996)	high
Cluster	spatial economics, economic geography	Concept focusing on the spatial dimension, argues that values chains are sector specific and often spatially concentrated; geographic proximity facilitates "collective efficiency", sociocultural identity and embeddedness in local milieu facilitate trust (Fuchs, M. 2003; Fromhold-Eisebith 2005, 2007)	high
ValueLinks	development economics	GTZ approach to value chains; systematic compilation of action-oriented methods for promoting economic development, comprehensive manual with know-how on ways to enhance employment and the business income of micro and small-sized enterprises and farmers, emphasis is on those product markets that offer opportunities for the poor (GTZ 2007; Gibson, A. 2008)	medium
M4P	development economics	Making value chains work better for the poor; supported by DFID and ADB, toolbook for practitioners of value chain analysis, partly drawn from previous work of GTZ and SNV; manual not as comprehensive and more at grassroots practice; series of development bulletins (M4P 2007)	high
Local Economic Development	development economics, SME tradition	LED focuses on local economic development, produced a number of useful tools for participatory analysis in the initial steps of territorial initiatives (notably PACA); not yet a comprehensive approach (Meyer-Stamer, J. 2004)	medium
Sustainable Regional Economic Development	development economics, resource economics, rural development tradition	Based on vision of "sustainable development", takes a holistic and process-oriented approach to value chain governance and uses participatory methods of rural development, primary producers and SME in marginalized regions are integrated - to the extend possible - in local, regional and global value chains; focus on organizational and marketing aspects of collective action to strengthen bargaining position and to increase rural incomes while maintaining natural resources	high

Source: Most information drawn from Altenburg (2007).

Altenburg summarizes his assessment of governance in the value chain approach by quoting Kaplinsky (2000):

> The approach shows that power relations are crucial. The power relations between different actors determine how economic gains and risks are distributed among chain actors and to what extent dominant firms are able to set and enforce standards with the aim of raising entry barriers for competitors and to achieve market foreclosure. The concept of "governance of value chains" implies that "there are key actors in the chain who take responsibility for the inter-firm division of labour, and for the capacities of particular participants to upgrade their activities."

2. Supply Chain Management as a Business Management Tool

As argued by recent findings in the strategic management literature, there is no such thing as "a unified theory of Supply Chain Management" (Halldorsson, A. et.al. 2007). Depending on the concrete situation, one can choose one theory as the dominant explanatory theory, and then complement it with one or several of the other theoretical perspectives.

On the other hand, it was already stated four decades ago:

> Management is on the verge of a major breakthrough in understanding how industrial company success depends on the interactions between the flows of information, materials, money, manpower, and capital equipment. The way these five flow systems interlock to amplify one another and to cause change and fluctuation will form the basis for anticipating the effects of decisions, policies, organizational forms, and investment choices.[4]

In business management, "Supply Chain Management" (SCM) is a discipline in the early stages of evolution, but gaining fast in strategic importance and popularity. For a number of reasons: Specific drivers may be traced to trends in global sourcing, an emphasis on time and quality-based competition, and their respective contributions to greater environmental uncertainty. Corporations have turned increasingly to global sources for their supplies. This globalization of supply has forced companies to look for more effective ways to coordinate the flow of materials into and out of the company. Key to such coordination is an orientation toward closer relationships with suppliers. Further, companies in particular and supply chains in general compete more today on the basis of time and quality. Getting a defect-free product to the customer faster and more reliably than the competition is no longer seen as a competitive advantage, but simply a requirement to be in the market. Customers are demanding products consistently delivered faster, exactly on time, and with no damage. Each of these necessitates closer coordination with suppliers and distributors. This global orientation and increased performance-based competition, combined with rapidly changing technology and economic conditions, all contribute to marketplace uncertainty. This uncertainty requires greater flexibility on the part of individual companies and supply chains, which in turn demands more flexibility in supply chain relationships (Mentzer, J.T. et.al. 2001).

Since the term SCM first appeared in the literature some twenty years ago, numerous academics, practitioners, and professional organizations have offered definitions. In fact, an Internet search (Google) for "supply chain management definition" in January 2005 yielded 2,360 possible sources (Gibson, Brian J. et.al. 2005). The same search repeated in June 2008 has revealed more than 560,000 sources.

SCM definitions are a disparate set of descriptions. Some definitions offer a narrow, functionally based perspective (e.g.: SCM is the management and control of all materials and information in the logistics process from acquisition of raw materials to delivery to end user). Others define SCM more broadly (e.g.: SCM is the integration of business processes from end user through original suppliers that provides products, services, and information that add value for customers). In general, academics have attempted to provide some structure to SCM by re-examining previous SCM definitions and offering more complete SCM definitions that include scope, functions and relationships (Gibson, Brian J. et.al. 2005).

To start off with the question of what is a "supply chain", Mentzer, J.T. et.al., 2001, define:

> A supply chain is defined as a set of three or more entities (organizations or individuals) directly involved in the upstream and downstream flows of products, services, finances, and/or information from a source to a customer.

Encompassed within this definition are three degrees of supply chain complexity: a "direct supply chain," an "extended supply chain," and an "ultimate supply chain." A direct supply chain consists of a company, a supplier, and a customer involved in the upstream and/or downstream flows of products, services, finances, and/or information. An extended supply

[4] Forrester 1958, p. 37, cross-referenced from Mentzer, J.T. et.al., 2001, p. 1

chain includes suppliers of the immediate supplier and customers of the immediate customer, all involved in the upstream and/or downstream flows of products, services, finances, and/or information. An ultimate supply chain includes all the organizations involved in all the upstream and downstream flows of products, services, finances, and information from the ultimate supplier to the ultimate customer (Mentzer, J.T. et.al., 2001).

Although definitions of "Supply Chain Management" (SCM) differ across authors, they can be classified into three categories: i) a management philosophy, ii) implementation of a management philosophy, and iii) a set of management processes. For the purpose of the present paper, the 2nd option (focusing on implementation) is seen as the one with the highest practical relevance.

The implementation of SCM needs the integration of processes from sourcing to manufacturing and to distribution across the supply chain. Integration can be accomplished through cross-functional teams, in-plant supplier personnel, and third party service providers. SCM is then defined as "integration of processes" in four stages:[5]

1) Represents the base line case. The supply chain is a function of fragmented operations within the individual company and is characterized by staged inventories, independent and incompatible control systems and procedures, and functional segregation.
2) Begins to focus internal integration, characterized by an emphasis on cost reduction rather than performance improvement, buffer inventory, initial evaluations of internal trade-offs, and reactive customer service.
3) Reaches toward internal corporate integration and characterized by full visibility of purchasing through distribution, medium-term planning, tactical rather than strategic focus, emphasis on efficiency, extended use of electronics support for linkages, and a continued reactive approach to customers.
4) Achieves supply chain integration by extending the scope of integration outside the company to embrace suppliers and customers.

Effective SCM is made up of a series of partnerships and, thus, SCM requires partners to build and maintain long-term relationships. Forming strategic alliances with supply chain partners such as suppliers, customers, or intermediaries provides competitive advantage through creating customer value.

The general motive behind the formation of supply chain arrangements is to increase supply chain competitive advantage (Porter 1985) in terms of cost leadership and differentiation. According to Porter, competitive advantage grows fundamentally out of the customer value a firm creates, and aims to establish a profitable and sustainable position against the forces that determine industry competition. Thus, it is proposed that the implementation of SCM enhances customer value and satisfaction, which in turn leads to enhanced competitive advantage for the supply chain, as well as each member firm. This, ultimately, improves the profitability of the supply chain and its members.

The specific objectives of SCM are then to improve profitability, competitive advantage, and customer value/satisfaction. For example, a key objective of SCM is to lower the costs required to provide the necessary level of customer service to a specific segment. Another key objective is to improve customer service through increased stock availability and reduced order cycle time. As such, SCM is concerned with improving both efficiency (i.e. cost reduction) and effectiveness (i.e. customer service) in a strategic context (i.e. creating customer value and satisfaction through integrated supply chain management) to obtain competitive advantage that ultimately brings profitability (Mentzer, J.T. et.al., 2001, p. 9).[6]

[5] Stevens, G.C. 1989, cross-referenced from Mentzer, J.T. et.al., 2001, p. 5

[6] For some practical examples in the German context, see: Behrenbeck, K. et.al. 2005; Brinkhoff, A. et.al. 2007; Thonemann, U. et.al. 2007

In summary: Despite all the variety of approaches and definitions referring to “Supply Chain Management” (SCM), there are at least two common features in the conventional approach of management science:

1) The focus of SCM is on optimizing the interests of individual players within the supply chain or supply network.
2) The perspective of “networked governance” (beyond the interest of individual players) is largely ignored.

Yet, in the conventional SCM literature, a predecessor of a governance notion can be found in the concept of “Supply Chain Orientation” (SCO) which Mentzer, J.T. et.al., 2001 illustrated with the simplified analogy:

> A supply chain is much like a river, with products and services flowing down it instead of water. Whether anyone recognizes the systemic, strategic implications of managing the water basin, the river still exists. Similarly, whether any company recognizes the systemic, strategic implications of the supply chain of which they are a part, it still exists. When one state through which the river flows recognizes the need for states above it in the water basin to conserve and preserve the water supply and recognizes its own need to do the same for states below it, the state has taken a systemic strategic orientation-the river equivalent of a supply chain orientation. However, without the cooperation of the states above and below it, there is little it can do about implementing this orientation. It is only when a number of continuous states adopt such a similar orientation and actively manage the resources of the river that we can say the water basin is managed. Similarly, supply chain management can only result in a managed supply chain when several companies directly linked in the supply chain have a “Supply Chain Orientation” (SCO) and actively manage to that orientation.

However, ignoring the importance of governance issues in Supply Chain Management might not be an option for very much longer. In the opinion of the broader public, which is ultimately the customer at the downstream end of the chain, the role of major players in global supply chains, notably some of the “Transnational Enterprises” (TNC, or otherwise termed “Multinational Enterprises, MNE), lack legitimacy.

The private sector (and transnational corporations in particular) is often heavily criticized for exploiting Third World countries, for paying unfair prices, repatriating profits, evading taxes, bribing politicians, crowding out local competitors, etc. Criticism is especially heavy of potentially polluting (mining, chemical, pharmaceutical) and labour-intensive industries (garment, footwear, toys, coffee). It is no coincidence that these industries are particularly engaged in corporate social responsibility, especially if they are associated with brand names (Altenburg 2005). Global responsibility (for social and environmental concerns) has become the other side of the coin “global opportunities” for the major players.

Fig. 1: Multinational Enterprises

Source: OECD 2002

Although this challenge is increasingly reflected in “Corporate Governance” and various self-regulatory frameworks (e.g. Codes of Conduct), the conventional concepts of SCM do not yet fully appreciate this emerging threat. Instead, international organizations have stepped in with (non-binding) guidelines (see OECD 2000).

Improving domestic law in developing countries is, of course, an additional option. The limitations of both, international guidelines and domestic law, is the lack of enforcement and monitoring. In this context, business representatives often stress their view that corporate responsibility in the supply chain could not extend to "taking on" other companies' problems – in particular, their legal or regulatory responsibilities. Companies, they argue, exist as discrete units for reasons of economic efficiency and legal accountability. Therefore, it is not economically or logistically feasible for all enterprises to monitor and audit all their suppliers (OECD 2002).

In the personal view of the present author, this line of defence will not hold on the long-term, because market forces themselves will punish the non-compliance with minimum ethical standards of corporate responsibility.[7] In the light of more recent developments, therefore, the issue of Supply Chain Governance is seen as increasingly important, even in the self-interest of global players.

Consequently, the more recent research on Supply Chain Management reflects this trend: Modern organizations are analysed as more complex but less hierarchical than in the past, depending more on complex networks of alliances with business partners, suppliers, distributors, and customers to achieve their means. Understanding the ways in which these relationships work is vital to the effective management of modern corporations. Although governance issues are critical to the viability of supply chains, until recently these issues have been largely ignored outside the field of the strategic management literature. It is in this context that Supply Chain Governance, defined as the systems by which business networks are directed and controlled, has recently been studied. A central focus of the literature on supply chain governance is the analysis of the dyadic relation between buyer and seller. (Diaz 2006)

Selected examples of this new line of thought in the management literature of different schools include:

- Power Relationships and Their Impact on Competency Development (Halley, Alain et.al. 2006)
  Key findings: A central focus of supply chain governance is the analysis of the asymmetric relations between buyers and sellers.
- The Impact of Supply Chain Applications Announcements on The Market Value of Firms (Chávez, Gonzalo et.al.)
  Key findings: Effective integration of suppliers is not only vital for operational purposes, but increases shareholder value.
- Creating Competitive Advantage Using Non-Equity Strategic Alliances: A Small Company Perspective (Defee, Clifford 2006)
  Key findings: Smaller firms can leverage on proper Supply Chain Governance to expand into global operations, normally reserved to larger firms.
- Project Configured Supply Chains: Governance of – and Failures in – Operations (Koch, Christian et.al. 2006)
  Key findings: Governance issues in the management of project supply chain can determine success or failure.
- Exploring New Competencies in the Logistics Industry: The Intermediation Role of 4PL (Fulconis 2006)
  Key findings: Logistics outsourcing and the intermediation role of integrated logistics providers is an emerging trend in supply chain governance.

The latter finding on emerging trends in supply chain governance is shared by Bitran et.al.[8] in a report that merits more detailed presentation. Bitran observes and argues that the last few

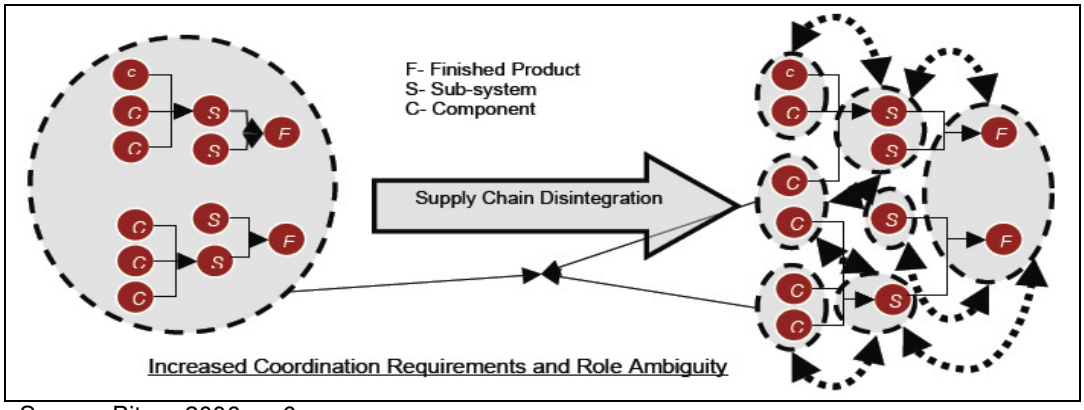
[7] This view is shared by numerous NGO initiatives; see e.g. Blowfield, 2001

[8] Bitran, Gabriel R. et.al.: Emerging Trends in Supply Chain Governance, Working Report of Sloan School of Management, MIT, Cambridge 2006

decades have witnessed a dramatic shift in the manner in which business is conducted around the world. Firms have shifted away from a hierarchical, one-dimensional supply chain entity to a fragmented network in favor of strategic partnerships with external entities. This global phenomenon causes ripple effects throughout the old supply networks. The phenomena of disintegration of supply networks have an impact on the network players with many businesses struggling to compete in this new landscape. On the other hand, the fragmentation creates opportunities for a whole new set of supply chain services.

The disintegration leads to a much more complicated network configuration. Even though the number of layers in the supply chain (from component to finished product) can remain the same, the level of interaction and coordination increases dramatically with the fragmented supply chain. In addition, the ownership and control of assets and functions in these supply chains have also changed hands, in many cases leading to a significant sub-division, or redistribution of the responsibilities of handling, material transformation, and of delivering end products to the customers.

Fig. 2: Supply Chain Disintegration



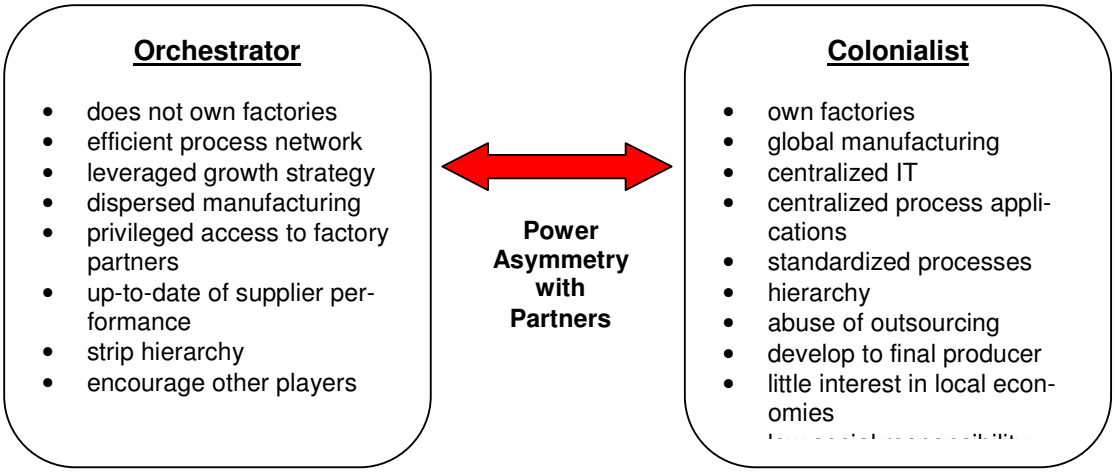
Source: Bitran 2006, p. 6

This process of disintegration has a huge impact on all the players in the network, but most of the negative effects are felt by the smaller entities in the lower tiers of the supply chain. Their size and distance from the end customer subject them to a great deal of variability. As a result, the smaller players in the network find themselves pushed to the edge of the network and losing their footing in the middle of the disintegration process. Smaller companies, located at the fringes, are forced to absorb this bullwhip effect. These companies, being less sophisticated than their larger counterparts, end up living through feast and famine cycles. When viewed in this context, one begins to understand the reasons which cause the SMEs to be willing to impart intimate knowledge about their own capacity, inventory positions and capabilities and allow a third party to assist with the coordination, sourcing and selling process. However, due to the sensitive nature of the shared information, this brings a third party into play which needs to be neutral and unbiased; e.g. a logistics provider (LP).

Bitran hypothesizes that the state of disintegration is not sustainable and will be followed by an eventual reintegration. Presenting evidence from a field study that was conducted to understand the impact of disintegration on original equipment manufacturers and on small and medium enterprises, he introduces into the governance discussion the so-called “aggregate player”, whose role is to provide the required services, assume control and govern a portion of the supply network. From this, he derives the so-called “mini-maestro” model of supply chain governance, which is characterized by varying degrees of power and control of aggregate players, ranging in roles from “orchestrator” (loose coordination of networks) to tight control (colonial style full vertical integration).

Butran continues to argue, supported by case studies of two successful Asian companies, that successful "mini-maestros" will develop into "maestros" which have considerable influence on (large numbers of smaller) suppliers and eventually become veritable "Aggregate Players" which can even become a real threat to previously powerful international buyers. However, the strategies guiding this path may be rather different, depending on factors such as corporate culture, the nature of the "social contracts" with network partners, etc. He broadly defines two extreme types of "aggregate players" which are positioned at the poles of a continuum of asymmetric power vs. other supply chain participants. The players of the poles have the following main characteristics:

Fig. 3: Types of Aggregate Players in Supply Chain Management



3. Pro-poor Upgrading of Value Chains as a Development Concept

In development studies, the debate over the last decades has been strongly influenced by the distributional, socially inclusive or pro-poor aspects of economic growth, production patterns and trade relations. In the literature on international Development Cooperation (in short DC) and its implementation by Official Development Assistance (ODA), "Value Chains" carry - by definition, strategy and instruments – a clear connotation of a holistic approach. While this might not even be accepted as a distinctive feature to the "Supply Chain" concepts presented in the previous chapter, the difference becomes more evident by considering the DC vision of "socially inclusive development" and notably by strategies of "pro-poor growth" in favour of the weaker operators in the chain (usually primary producers and SME in the developing countries). A clear distinction also stems from DC being part of the public sector, being financed from tax payers' money and thus equipped with a mandate (or corporate responsibility) to act on behalf and in the interest of the wider public, and not (such as management consultants) in the interest of a selected clientele.

The conceptual differences between SCM and upgrading of value chains gets sometimes blurred in practice, and might even be considered by some as splitting hairs, by others seen with deplorable ignorance. To polarize the points: The benefit sharing arrangements that business management strategies pursue on the one hand, and the "equal opportunity – fair distribution" vision of DC on the other hand, are a world apart. The present paper therefore

strongly advocates a clear differentiation of the concepts and related terminology of SCM on the one hand and those of the value chain approach used in DC, on the other.

And yet, there is the need and the interest from all sides to bridge this gap, to encourage collaboration between the public and the private sectors, to enter in or to promote alliances in the better interest of all stakeholders in the chain (or network). The question is: On what terms and conditions? - In this context, the dimension of "governance" could and should be developed into an even stronger tool in the analytical stage (the positioning in power asymmetries), in the implementation (who invests and who benefits on the basis of what contractual arrangement) as well as in impact monitoring (what is the additional net contribution to development, what is gained by the private partners).

In the introductory chapter of the present paper, some definitions and explanations on "value chains" have already been presented. They all originate from the development literature and therefore do not need to be repeated here. Simply for the clarification of terminology, some additional definitions are listed below (GTZ 2007: ValueLinks, Glossary):

A **value chain** is

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

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

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

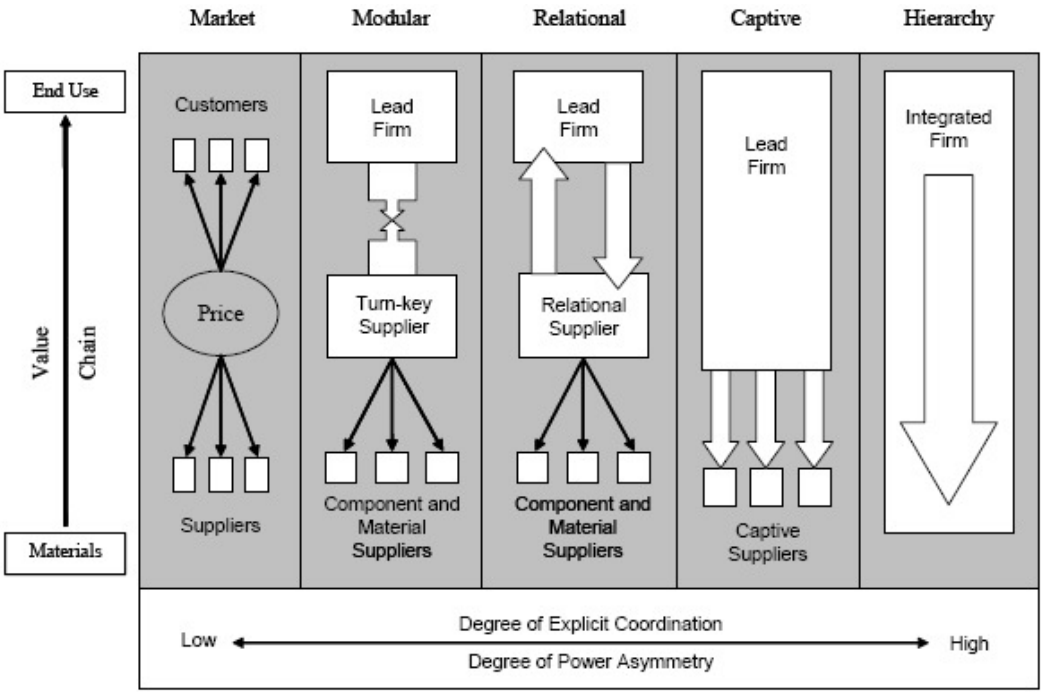
Governance in value chains refers to the way business activities in a value chain are vertically coordinated. Following the terminology defined by Gary Gereffi, we distinguish different forms of governance, of which the most important are markets, modular value chains, captive relationships and vertical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

The debate on governance in value chains, and more precisely the question how value chains can be steered into the direction of pro-poor growth has gained momentum over the

last years with numerous research papers and documents of DC organizations.[9] Some of these reports rather contribute to the polarization of the discussion (Pro-poor Growth versus Private Sector Promotion; (e.g. Kappel & Dornberger, 2005), while others aim to blur all the differences of interest by proclaiming a "New Generation of Private Sector Development" in which governance is not an issue and by which windfall profits for the private sector are programmed (e.g. Downing, J. et.al. for USAID, 2006).

Ground-breaking work in this field was first presented by Gary Gereffi, John Humphrey and Timothy Sturgeon in 2003 with a theoretical framework providing a better understanding of the shifting governance structures in sectors producing for global markets.

Fig. 4: Five Global Value Chain Governance Types
Source: Gereffi, Humphrey, Sturgeon (2003), p. 9



Gereffi et al. build on the distinction in organization theory among markets, networks and hierarchies. Between the two extremes of "markets" and "hierarchies", they distinguish three intermediate forms of "networked" governance.

1. Markets: Market linkages do not have to be completely transitory, as is typical of spot markets; they can persist over time, with repeat transactions. The essential point is that the costs of switching to new partners are low for both parties.
2. Modular value chains: Typically, suppliers in modular value chains make products to a customer's specifications, which may be more or less detailed. However, when providing "turn-key services" suppliers take full responsibility for competencies surrounding process technology, use generic machinery that limits transaction-specific investments, and make capital outlays for components and materials on behalf of customers.
3. Relational value chains: In these networks we see complex interactions between buyers and sellers, which often create mutual dependence and high levels of asset specificity. This may be managed through reputation, or family and ethnic ties. Many authors have highlighted the role of spatial proximity in supporting relational value chain linkages, but

[9] To name a few: Kaplinsky, R. 2000; Gereffi, G. et.al. 2003; Humphrey, J. 2004; Stamm, A. 2004: Schmitz, H. 2004,2005; Altenburg, T. 2006

trust and reputation might well function in spatially dispersed networks where relationships are built-up over time or are based on dispersed family and social groups

4. Captive value chains: In these networks, small suppliers are transactionally dependent on much larger buyers. Suppliers face significant switching costs and are, therefore, "captive". Such networks are frequently characterized by a high degree of monitoring and control by lead firms.
5. Hierarchy: This governance form is characterized by vertical integration. The dominant form of governance is managerial control, flowing from managers to subordinates, or from headquarters to subsidiaries and affiliates.

To further categorize the above types of governance, Gereffi et al. used three key determinants of value chain governance patterns: complexity of transactions; codifiability of information; and capability of suppliers. In doing so, they arrived at the model presented above.

For the purpose of the present paper, it is argued that in the governance theory of Gereffi et al., the extreme cases are of highest practical relevance when it comes to promoting improved access of primary producers and SME from developing countries to global value chains. At the one extreme, the governance structure driven by the "market" is an ideal case in which suppliers are provided with an equal share of power compared to the buyers. Prices and other parameters in the relationship are formed by negotiations on a "level playing field". To illustrate this scenario, it is re-labelled with the term "**Fair Trade**".

At the other end of the power continuum, Gereffi et al. present the governance type of "Hierarchy" as an extreme, which is debatable. Even more extreme, and not unheard of, is the fact that some Transnational Corporations (TNC) strongly influence the power structure of whole nations in the developing world. One does not have to go back to colonial times to illustrate this neo-colonial governance structure. There are numerous present-day examples where TNC exercise their influence on host countries in a way in which mainly the TNC set the rules of the game, and mainly they (plus the ruling elite of the host country) reap the lion share of the benefits.[10] To simplify the terminology, this worst case scenario of asymmetric power distribution is re-labelled "**Banana Republic**".

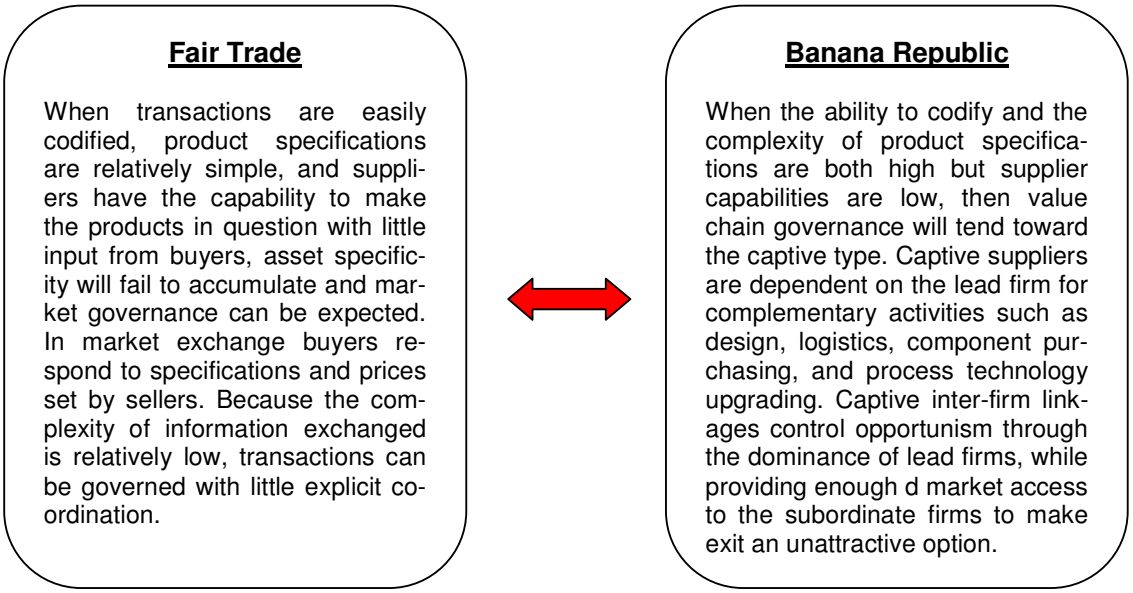
In terms of practical relevance in development cooperation, the case of complete vertical integration; i.e. the governance type of "Hierarchy" can safely be excluded, because it will in no way be supported by DC programs. More relevant in the typology is the case of "Captive Value Chains", which sufficiently expresses the power asymmetry between (mostly) large-scale international buyers and (mostly) small-scale local suppliers. For practical reasons, the term "Banana Republic" is therefore applied to the content and structure of what Gereffi et al. categorised as "Captive Value Chains".

Apart from the poles of the continuum, the typology of governance relations suggested by Gereffi et al. might be useful to explain some specific cases, but as Gereffi et al. illustrated themselves with a number of case studies to support their theory: "The case studies ... highlight the dynamic and overlapping nature of global value chains. Value chain governance patterns are not static or strictly associated with particular industries." This would imply that operators in the value chain – over time - might shift their positioning in the power continuum upwards (become more influential in setting the rules) or be pushed downwards, thus losing influence, becoming more dependent or – at the extreme – lose the ability to participate altogether.

Again for reasons of simplicity, the other continuum used by Gereffi et al. (the degree of explicit coordination) is rather seen as a dependent parameter; i.e. if power is available to an operator in the chain he is very likely to actually use it for explicit coordination. Thus, the newly defined poles of the continuum are:

[10] There are, of course, also numerous "good" examples of spillovers for and learning effects by SME where TNC hand on market requirements of OECD countries, such as compliance with social and environmental standards, certification and chain of custody (COC), etc. on to the host countries. As one recent example of this type, see IKEA 2008.

Fig. 5: Poles of the Power Continuum



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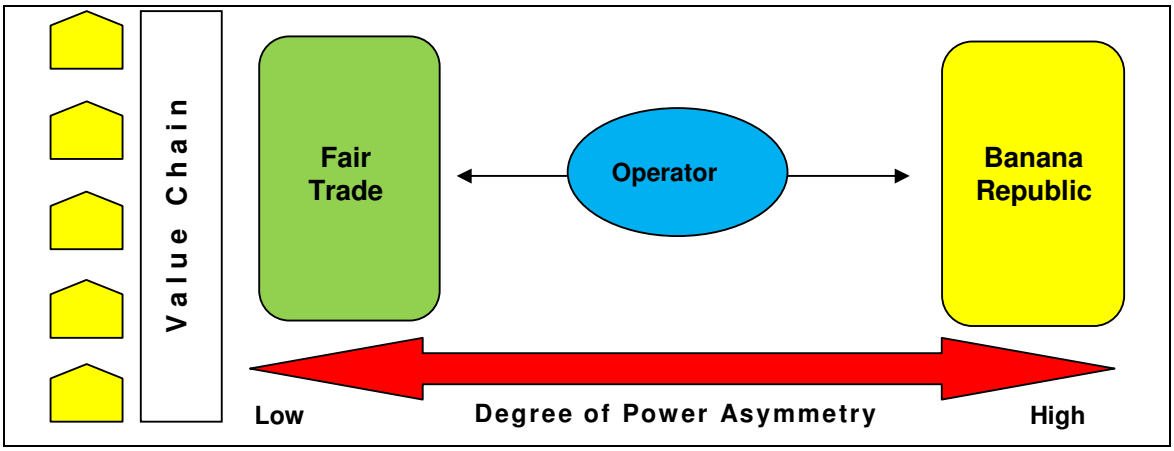
Gereffi’s typology as such is thus more of academic value. In practical terms, operators in the value chain would continuously aim to optimize their positioning in the power continuum which in many cases would mean to get more control over suppliers (upstream) and distributors (downstream) by way of increasing vertical integration. However, as is amply shown by the vertical disintegration of Transnational Corporations (TNC, see Chapter 2 of this paper), redefining their core competences and outsourcing non-core functions, the opposite might also hold true. What remains then is for any operator (in particular primary producers and SME as suppliers) to carefully analyse his current position in the continuum, define a strategy where to shift over what time, and carefully balance the trade-offs of gaining against giving away influence in the governance structure.

For reasons of analytical simplicity and practical relevance, notably for the application with primary producers and SME, a simplified dynamic model of value chain governance is suggested and presented below.

Whereas this simplified model includes economic and social aspects of development (economic growth, distribution of value-added) as well as the dynamics of change in relationships, the ecological dimension is not yet fully integrated, and largely neglected in the academic debate on governance structures. Examples of why environmental concerns do matter stem from numerous cases of TNC shifting their production lines (or outsource part of the production) to countries for the main reason of much more liberal pollution or emission standards. Evidence of extreme consequences of such moves is also well known; see Union Carbide and the so-called “Bhopal Tragedy” of 1984.

Fig. 6: Simplified Dynamic Model of Value Chain Governance



In the introductory remarks to the present chapter, we have mentioned the need for cooperation between the public sector (DC) and the international private sector. So what could the above governance model mean for this cooperation?

In conventional DC approaches[11], it is argued that between the spheres of influence and interests of Development Cooperation (including the interests of developing countries) on the one hand, and the interests of the international private sector (mostly TNC as international buyers) on the other, there would be a common ground of overlap, which represents a "win-win" constellation for both sides.

Notwithstanding a more critical assessment of the possibilities of creating such "win-win" constellations (see below), it is agued here that the perspective on two partners only (DC and TNC) entirely leaves out the interests of the local suppliers as a third party. As illustrated in Chapter 2 of this paper, in fact the "real world" of global value chains (or supply chains in the perspective of TNC) are much more complex with many more actors and intermediaries. But again for reasons of simplicity, we suggest to expand the two-party model into a three party model, which then offers more room for analysis and strategy development.

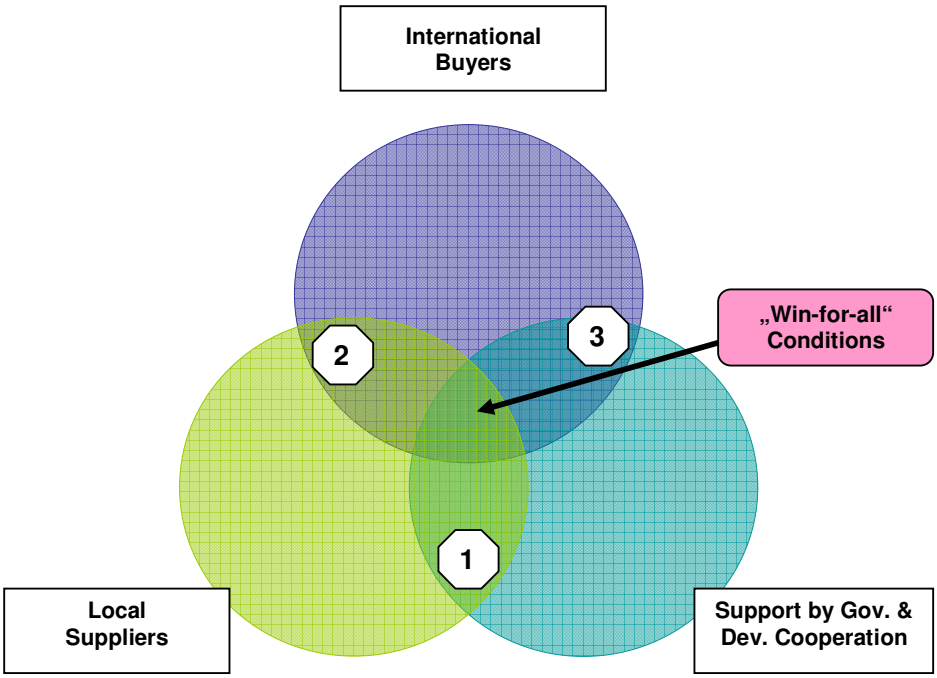
For the reasons outlined below, it is argued that cooperation agreements should include all three parties DC, TNC and the local suppliers), and that the basis for any such agreement should only be the rather narrow "**win-for-all**" constellation of common ground among all three parties concerned.

As illustrated with the model below, the **Area 1** representing the overlap of interests between Development Cooperation (including the interests of national and decentralized government structures of the host countries) with those of the local suppliers (primary producers and SME) is the field of day-to-day business in development cooperation. The instruments applied are certainly not limited to direct support for individual local suppliers, but cover the full range of advisory on the macro and meso levels, creating a more favourable business environment, BDS in cooperation with associations, SME promotion, rural development and specific support to certain value chain initiatives.

The **Area 2** strictly refers to the commercial relationship among local suppliers and international buyers in the "Supply Chain" approach, as described in Chapter 2 of this paper. As has been argued, the common ground (or the size of overlap) depends on the governance structure in the chain.

11 see, e.g., Downing, J. 2006, and Kuesel, C. 2006 at the Seventh Annual ILO Seminar on Business Services, Chiang Mai, September 2006

Fig. 7: "Win-for-all" Conditions of a Strategic Alliance



The **Area 3** is then what is described as the "win-win" constellation among DC and TNC, as mentioned above for the conventional viewpoint. - Analysing the lessons learned from leading donor programs, Altenburg[1] assesses the respective interests of the two sides in a somewhat more critical way. His answers to the question why donor agencies should cooperate with private companies can be summarized as follows:

1. The internal production efficiency of private companies is usually higher than that of public enterprises. Public service providers often lack customer orientation as well as incentives to improve performance, especially if they are fully publicly financed and not subject to competition.
2. Involvement of private-sector companies leverages additional capital for development financing. Private-sector capital may substitute for official development aid in countries and sectors with access to international capital markets.
3. Complementarities between public and private actors may create productivity gains. Development agencies may build on existing private initiatives, e.g. support spillovers from private investment projects.
4. Cooperation between development agencies and the private sector may contribute to mutual appreciation and learning. It may raise awareness for development issues within the private sector, while it may provide development administrations with a better understanding of international competition and certain management aspects.

Answering the corresponding question (What's in it for the private sector?), Altenburg points to the fact that many companies are not willing to engage in cooperative arrangements with government institutions, because of the high transaction costs involved[12]. Those companies that do cooperate[13] advance three main arguments:

[12] see, e.g. UNILEVER Vietnam, 2008, with their strategy of Supply Chain Management
[13] see, e.g. METRO Vietnam, 2008, with their Supply Chain Strategy

1. Cost sharing. Public co-financing may cut the costs of necessary or at least desirable investments in a firm's business environment, e.g. improvements to the value chain or the health and education of the local workforce.
2. Legitimacy. The private sector (and transnational corporations in particular) is often heavily criticized for exploiting Third World countries. Working together with public development cooperation is seen as a mark of confidence and as increasing the legitimacy of the companies concerned.
3. Complementary specialization. Among the specific competences attributed to development agencies is their experience in dealing with governments and certain stakeholders (e.g. farmers or trade unions) and in supporting organizational development in different cultural settings.

From the perspective of development agencies, however, entering cooperation with the private sector (in the form of strategic alliances, "Public Private Partnerships", PPP, or other) is bound up with some risks and additional costs which need to be kept in mind. In some cases the private partner's interest may not be in line with the public interest in the host country, e.g. firms may try to misuse their market power to prevent local firms from upgrading into strategic business fields or to crowd out local competitors. In case of such essential conflicts of interests it is obvious that there is no room for cooperation. More importantly, however, some risks and limitations remain even if public and private partners pursue complementary goals, namely (Altenburg 2005):

- If obligations, cost-sharing arrangements, etc. are not well defined, public-private alliances entail risks that public resources may be misused or wasted, especially if substantial public subsidies are involved. Even if corruption can be excluded, there is always a considerable risk that windfall gains will accrue to the private sector (and taxpayer' money may be wasted), i.e. if the private partners receive public support for activities which they would have performed in any case.
- Public-private agreements require additional processes involving transaction costs, e.g. for awarding projects, negotiating services, performance indicators and tariffs, managing partnerships, and monitoring performance. These costs may in some instances exceed the benefits of public-private cooperation.

From the point of view of development agencies, therefore, partnerships with the private sector make sense only if the public contribution triggers an **additional development impact** that goes beyond the impact that the private partner – in pursuance of his own interests - would have had anyhow, or that he is legally obliged to provide. If a firm receives public financial support for activities that are not additional in this sense, this represents a windfall profit for the firm and a waste of public resources, taking into account the fact that the subsidy would not have been necessary to catalyze the outcome achieved – irrespective of the size and quality of this impact (Altenburg 2005).

In practice, many public-private partnerships are criticized for allegedly violating this principle of additionality. The present paper therefore strongly advocates that the analysis of governance structures in value chains is applied to define the "win-for all" constellation, and that the results of such analysis are used to define a set of conditionalities which ensure additional development impacts (e.g. social and environmental standards) and prevent private alliance partners from taking windfall profits.

Recent years have seen numerous examples of presentations by practitioners of the value chain approach which in itself is ample evidence of the growing popularity of the concept and its application. The smaller part of these presentations do include analyses of errors in strategy and implementation of value chain initiatives, including the lack of governance analysis and strategy, the sometimes sub-optimal choice of implementation partners, etc. – And this is

the area where the most useful lessons can be learned it terms of avoiding typical deficiencies, traps and loopholes.[14]

Very little can be found so far in terms of a systematic assessment of the variety of value chain approaches across the board of different donor organizations, or in terms of impacts on structural changes in host countries deriving from value chain initiatives, nor impacts on the income situation of primary producers and SME, and/or in terms of optimizing intervention strategies. In fact, nothing can be found so far (at least by the research of the present author) on lessons learnt from the application (or non-application) of governance issues in the promotion of value chains.

The recently published discussion paper of GTZ may therefore be seen as a pioneering work, attempting to fill a white spot on the map.[15] The paper aims to examine and compare experiences made in the last few years with differing approaches across a region. Focusing on five countries in Asia - Bangladesh, Nepal, Sri Lanka, Thailand and Vietnam - it outlines the main characteristics of GTZ's value chain work and identifies the key challenges emerging from this. In doing so, it seeks to contribute to learning in the wider donor community.

The paper is built on one key premise: that in working in value chains GTZ's interest is to achieve impacts that are large-scale and sustainable, requiring systemic change beyond individual firms. It is structured around a framework of issues and criteria for describing and assessing work in value chains and the four key stages in value chain development work: initial selection and analysis, strategies, detailed interventions and monitoring and evaluation.

The conclusion and suggestions of the working paper include:

- to build on the positive programme experience, such as their strong process orientation to analysis, interventions guided by key principles and a process of engagement that is close to the private sector – and more recent innovations in, for example, impact assessment
- to recognize that the value chain framework offers more potential to identify systemic constraints and to consider sustainability in a detailed manner. These (and other) factors need to be addressed if work in value chains is to be developed as a coherent approach that can achieve genuine lasting development.

To systematically include governance considerations in concepts, choice of strategic partners, implementation and monitoring of programmes remains a major challenge ahead. Best practice can be found in the field, but is not yet documented. It includes participatory analysis of governance structures by major stakeholders within a given value chain with the objectives of maximizing pro-poor growth and monitoring the dependence on lead firms. To evaluate the inclusion of governance in the current practice would be a major empirical undertaking in order to get a representative view on strategies, impacts and contributions to structural change from all major DC organizations in different regional settings in Asia, Africa and other parts of the developing world.

Finally: "Sustainable development" implies by definition a holistic and process-oriented approach to value chain governance which lays simultaneous emphasis on three pillars: i) economic growth and welfare, ii) equal access to and fair distribution of value-added as well as iii) ecologically sustainable use of resources in the interest of future generations. Even though this concept remains a vision, it is a vision worthwhile pursuing. It also provides for the ethical "Leitbild" (or guiding principles) that is needed to give governance legitimacy and relevance. Both in the literature as in the operational context of value chain programmes, this is still in its infancy, and thus remains a challenge.

[14] To name just one outstanding example: Sadruddin Imran (2007) presents the experience of KATALYST in a fishery value chain in Bangladesh, assessing strategy and practice, including loopholes and sustainability of the approach after phasing out of support.

[15] "GTZ's experience in value chain development in Asia: an external perspective", Eschborn, May 2008; author: Alan Gibson, Springfield Centre

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