



## USING THE VALUE CHAIN APPROACH TO DESIGN A COMPETITIVENESS STRATEGY

### INTRODUCTION

The value chain approach promoted by USAID’s Microenterprise Development Office is the direct result of nearly ten years of practice and research in the areas of global value chains, competitiveness and micro-, small and medium-sized enterprise development. Industry leaders from academia, development consulting and the private sector have been involved in developing this approach. This briefing paper, which is a product of these collaborative efforts, provides guidelines for USAID missions and development practitioners for working with the private sector to design programs that extend impact beyond individual firms to industry-wide competitiveness.

Designing strategies that target industries is essential to create systemic change. Firm-level interventions may improve the competitiveness of individual firms in the short term, but without addressing constraints in the value chain as a whole—including the enabling environment and supporting markets—impact is likely to be limited and of short duration.

### WHAT IS VALUE CHAIN COMPETITIVENESS?

Rapidly changing market conditions require that firms and other actors—whether competing or collaborating—share a common understanding of what is required to be competitive in an end market. Some level of cooperation is necessary for a value chain to achieve competitiveness and consequently firms need to have a shared vision for their success. Value chain competitiveness is the ability of actors within an industry to:

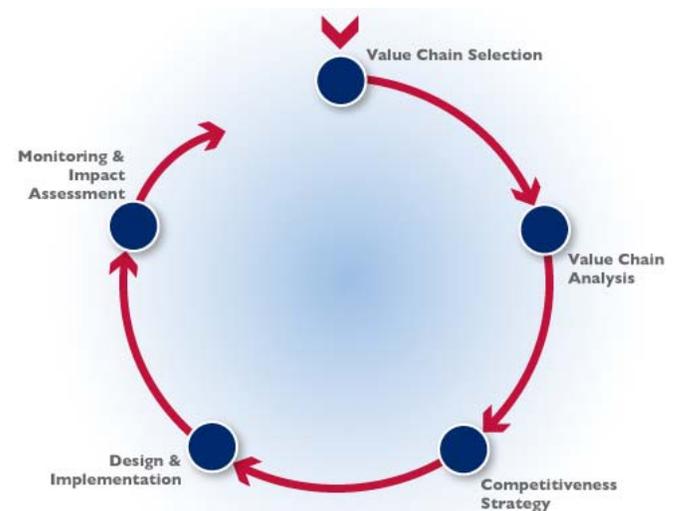
- Anticipate and meet buyers’ demands
- Identify and take advantage of end-market opportunities
- Respond to changes in market demand or the competitive landscape

### WHY IS A COMPETITIVENESS STRATEGY IMPORTANT?

A competitiveness strategy provides the roadmap to move an industry to sustained higher rates of growth. Without a strategy, it is difficult for firms to overcome the tendency to see each other solely as competitors, which hinders their ability to collaborate or take leadership to leverage resources, overcome common barriers and meet marketplace demand.<sup>1</sup>

For development professionals, design of a competitiveness strategy should be preceded by selection and analysis of the value chains with the greatest potential to contribute to sustainable economic growth (see figure 1). Value chain analysis is a critical prerequisite for strategy design because it identifies and prioritizes the constraints and opportunities that affect the competitiveness of an industry.

**Figure 1: Value Chain Project Cycle**



The objective of a competitiveness strategy is to use the findings of the value chain analysis to foster collabora-

<sup>1</sup> For more on inter-firm collaboration see *Groups, Associations and Other Horizontal Linkages* 2008 AMAP BDS Knowledge and Practice Briefing Paper

tion among firms in order to address shared constraints. By targeting the most promising end-market opportunities and the constraints that most limit the ability of the value chain to exploit these opportunities, a well-designed strategy provides incentives for firms to invest in its implementation. The perception that firms throughout the value chain will benefit is essential to attract and retain the private sector commitment necessary for the successful execution of the strategy.

## COMPONENTS OF A COMPETITIVENESS STRATEGY

A competitiveness strategy consists of three components:

- End-market competitiveness
- Upgrading requirements
- Plan for sustaining competitiveness

These components all rely on inputs from the value chain analysis and buy-in from the private sector in their design to produce a focused approach to improve and sustain industry competitiveness.

## END-MARKET COMPETITIVENESS

### Step 1: Determining Where to Compete

An end-market assessment is a necessary first step to determine where it is possible and most advantageous for a value chain to compete. Avocados from Kenya, for example, have a range of end markets including shoppers at the local weekly market and customers of international supermarket chains or gourmet grocery stores and restaurants in Europe. Avocados may also be processed to extract oil, which opens additional market channels within the cosmetic industry, or used as an ingredient in food products. In addition to existing markets, it is important to consider new market possibilities—in the case of Kenyan avocados, for example, there may be organic or fair trade niche markets—as well as the markets into which competitors are selling. From within this universe of market segments and locations, firms must use information from Step 2, below, to distill *where it is possible to compete* based on their supply capabilities and attributes—including access to inputs, proximity to markets, cultural distinctiveness and production capacity—and where they have or can create competitive advantage.

### Step 2: Determining How to Compete

Michael Porter<sup>2</sup> defined three strategies for creating competitive advantage: efficiency, differentiation and market focus. Relying on USAID's on-the-ground experience, the Microenterprise Development Office and its partners have customized these strategies to reflect the challenges faced by value chains in developing countries as they position themselves within the global economy.

To compete based on *efficiency* a value chain must produce a good or service and deliver it to the end market at a lower price than its rivals in other regions or countries. Firms within a value chain must benchmark their costs of production against competitors; while as an industry, these firms must consider external costs such as tariffs, transport and communications. An industry perspective ensures that a strategy considers the competitiveness of firms, their enabling environment and support services.

To compete based on *differentiation* a value chain must market or add value to its product or service such that it is considered unique amongst its competitors. Differentiation through marketing can be achieved through branding or packaging, or simply by increasing spending on promotions. Differentiation through marketing alone, however, is a risky strategy that is unlikely to be sustainable without complementary investment in product or service improvements.

To compete based on *market focus* a value chain selects and targets a narrow segment within the end market. Niche markets may be defined by branding, such as designer clothing; social concerns such as fair-trade coffee or eco-friendly tourism; health considerations such as organic baby products or untreated wood furniture; specialty market channels such as museum stores and luxury spas; or timing considerations, as in the case of off-season fresh produce. Occasionally value chains can shape their end market and create demand for a product or service. One exceptionally successful case is business process outsourcing, where India's information technology value chain is continually identifying new areas where they can create U.S. demand for their services.

The challenge to developing an end-market competitiveness strategy rests on the ability of the industry to simul-

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<sup>2</sup> See for example, Porter, Michael E. 1980. *Competitive Strategy: Techniques for Analyzing Industries and Competitors*, The Free Press

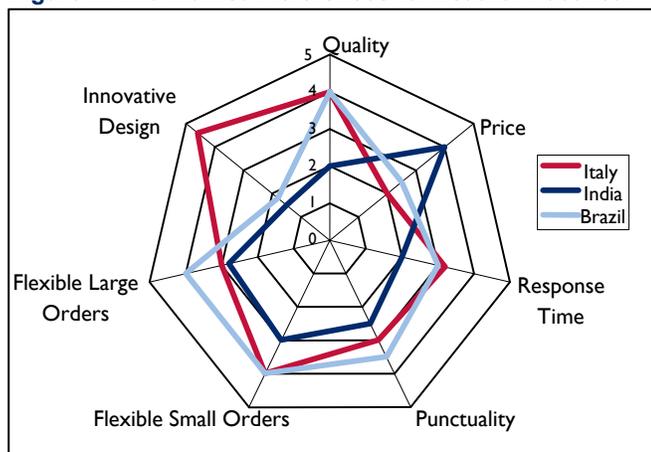
taneously *identify end markets* and *analyze the means to compete in those markets* considering their own and their competitors' advantages.

### Step 3: Determining the Products and Operational Characteristics Required to Compete

Having identified one or more market segments to target and a strategy to create competitive advantage, a value chain and its firms must adapt themselves to pursue the selected strategy. Research has demonstrated that turning competitive advantage into industry competitiveness is closely linked to the degree to which private-sector stakeholders drive this process.<sup>3</sup> Therefore, it is essential that actors along the value chain absorb the preliminary information produced by Steps 1 and 2 and proceed to learn more about buyer interests and requirements. The value chain must be willing to respond on a continual basis to the supplier attributes valued by buyers if it is to improve its competitiveness in existing markets or compete in new markets or with new products.

A spider diagram is a useful tool that allows competitiveness strategy designers and value chain actors to see how buyers rate a producing country in relation to its closest competitors in terms of required supplier attributes. Figure 2 shows buyer perceptions of the footwear industries in Brazil, India and Italy.<sup>4</sup> Firms in Brazil, for example, can observe from this spider diagram that to compete for market segments dominated by India, they should rely on efficiency since price drives buyers' decisions. To compete for Italy's share of the market where, the diagram

**Figure 2: End-Market Preferences for Leather Footwear**



<sup>3</sup> Kula, Olaf et al. 2006. *Globalization and the Small Firm: A Value Chain Approach to Economic Growth and Poverty Reduction*. AMAP BDS Knowledge and Practice microREPORT #42

shows, quality and innovation are highly valued, a differentiation strategy may be most advantageous.

When looking at the characteristics required to compete, firms may decide to reassess where they can create competitive advantage. Identifying the end markets in which to compete is an iterative process where the *where*, *how* and *what* must continually feed into each other.

## UPGRADING REQUIREMENTS

Having identified a target end market and an approach (a combination of efficiency, differentiation and market focus) to competing in that market, firms in a value chain must strategically assess what product or process improvements are required to compete. Competitiveness strategy designers in collaboration with private-sector stakeholders must review the prioritized list of opportunities and constraints generated by the value chain analysis to prepare an upgrading plan (see text box). Upgrading plans describe how industries and firms within these industries will take advantage of opportunities and resolve key constraints to enhance their competitiveness.

### HAITI HANDICRAFTS INDUSTRY<sup>5</sup>

The first step in developing an upgrading plan is to prioritize the opportunities and constraints identified through value chain analysis in light of the selected end-market competitiveness strategy. In Haiti, AMAP team members helped handicraft industry stakeholders to prioritize six opportunities and constraints from an extensive list generated by end-market buyers and industry experts; Haitian micro-, small- and large-scale craft producers; and other value chain actors. Through a participatory value chain analysis and structured discussion, it became clear to the stakeholders that a differentiation strategy would enable them to enter and compete in the high-value U.S. home accessories market, but only if intermediaries could be found to facilitate sales. Therefore, stakeholders defined their upgrading strategy around two pillars: (1) improved information flows from end markets to enhance market responsiveness in product design; and (2) identification of existing and potential agents to fill a market intermediation role between producers and buyers.

<sup>4</sup> Schmitz, Hubert and Peter Knorringa. 1999. *Learning from Global Buyers* IDS Working Paper 100

<sup>5</sup> See Derks, Eric et al. 2006. *Haitian Handicraft Value Chain Analysis* AMAP BDS Knowledge and Practice microREPORT #68

The goal of an upgrading plan is to create an action path that actors in the value chain follow to collectively address constraints to competitiveness over time. To develop a shared upgrading plan, strategy designers and their private-sector counterparts should prioritize interventions that i) foster incentives for change, ii) begin with small steps with manageable risk for actors involved, and iii) offer benefits in the near term to maintain stakeholder commitment.

Unlike upgrading at the firm level, which emphasizes the ability of individual firms to adapt to changing market conditions, upgrading at the value chain level must also focus on interventions that will affect the behavior of the industry as a whole:

- Understanding value chain *governance* means understanding how relationships between actors are structured and knowing which actors have the capacity to generate change.
- Strategy designers must identify *actors with influence* along the chain, such as the only successful exporter in a value chain or a chief in a rural community.
- Similarly, *points of aggregation* should be identified, where interventions can lead to systemic change—for example, one bank that provides most of the lending to the agriculture sector or one processing firm that buys from large numbers of producers.

Interventions designed for particular firms should be avoided unless these firms have the potential to have a catalytic impact on their value chain.

## PLAN FOR SUSTAINING COMPETITIVENESS

The above guidelines to develop an end-market competitiveness strategy and plan for industry upgrading serve to foster competitiveness at a point in time. True competitiveness requires continuous adaptation to changing elements—buyer preferences, availability and scope of supporting markets, competitor capabilities, enabling environment regulations, etc. Hence, an approach to maintaining competitiveness over time must be woven into these strategies so that they are dynamic and adaptive. Monitoring changes in the following areas and integrat-

ing sustainable responses to these changes is essential to sustainable competitiveness:

- ***Changes in the end market***—Required supplier attributes may change: The iterative process that determines where and how to compete must be ongoing. Value chain actors must establish multiple sources of market information that include feedback from end markets and proactive market research so that they can adapt their strategies as market demands change and new market opportunities arise.
- ***Systemic constraints and opportunities***—As key constraints are addressed and a value chain upgrades, new constraints may arise as well as new aggregation points or sources of leverage. To enable continuous responsiveness to changes in the market, strategy designers can help prepare industry organizations, lead firms and other catalytic actors to adapt incentives, shift relationships, and foster organizational and institutional innovation.
- ***Business enabling environment***—The added costs, risks and diminished competitiveness associated with an unfavorable enabling environment must be weighed during the value chain analysis and the design of end market and upgrading strategies. Similarly, opportunities provided by a stable enabling environment should be considered. To maintain competitiveness, private-sector actors must understand and utilize their collective capacity to lobby for trade reform or improvements in the business enabling environment while staying focused on the opportunities and constraints that will have the greatest impact. Sustainability will reside in the ability of the industry to affect change on an ongoing basis.

Achieving sustainable competitiveness rests on an industry's continued ability to identify, prioritize and act on opportunities and constraints that are *external*—in end markets, the enabling environment, etc.—as well as *internal* to the industry, such as inter-firm cooperation and transaction costs, predatory behavior and the exchange of information.

**Please send comments and suggestions on this brief to Jeanne Downing ([jdowning@usaid.gov](mailto:jdowning@usaid.gov)) and/or Ruth Campbell ([rcampbell@acdivoca.org](mailto:rcampbell@acdivoca.org)).**