

Compilation of insights
of the online debate
Value Chains in Rural Development (VCRD)

Up to February 2006

The role of donors in Value Chain Interventions

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Index

1	WHERE DOES THE COMMUNITY OF PRACTICE ON VALUE CHAINS FOR RURAL DEVELOPMENT COME FROM?	1
1.1	The objectives of the VCRD-COP.....	1
1.2	The working structure of the VCRD-COP.....	1
2	WHAT ARE VALUE CHAINS? AND WHY ARE VALUE CHAINS IMPORTANT?.....	2
3	SHOULD DONORS INTERVENE AT ALL? WHY (NOT)?	3
4	KEY ISSUES OF VALUE CHAIN ANALYSIS	5
4.1	TOOLS FOR ANALYSIS.....	6
4.2	ENTRY POINTS FOR VC ANALYSES AND INTERVENTIONS	8
5	KEY AREAS FOR DONOR INTERVENTIONS	10
5.1	WHEN TO INTERVENE AT ‘VALUE CHAIN ACTOR’ LEVEL AND HOW?.....	10
5.2	THE ROLE OF DONORS WHEN INTERVENING AT THE LEVEL OF LINKAGES AND RELATIONS	11
5.3	FINANCIAL AND NON-FINANCIAL SERVICES (SERVICE PROVIDERS).....	12
5.4	ENABLING ENVIRONMENT (LOCAL, NATIONAL, INTERNATIONAL)	14
5.5	VALUE CHAIN GOVERNANCE.....	14

Glossary

BDS	Business Development Services
CSR	Corporate Social Responsibility
Donor	The term ,donor’ in this paper includes bilateral and multilateral donor organisations, development agencies, NGOs implementing on behalf of a donor agency, consultants, etc.
EBS	Embedded Services
R&D	Research & Development
SSA	Sub Sector Analysis
SDC	Swiss Agency for Development and Cooperation
VC	Value Chain
VCA	Value Chain Analysis
VCD	Value Chain Development
VCRD	Value Chains in Rural Development – an online debate platform

1 Where does the Community of Practice on Value Chains for Rural Development come from?

The Swiss Agency for Development and Cooperation (SDC) emphasized in the past, and continues to stress, the importance of rural development and its close linkages to 'urban engines of development'. With the Community of Practice on Value Chains in Rural Development (VCRD) the Employment + Income Division of SDC wants to encourage a constructive exchange among practitioners and conceptualists, based on their personal experiences and the value chain issues they face in their ongoing work.

The initiative consists of a structured on-line discussion on an exchange platform combined with a website. Participants in the VCRD Community of Practice are people who are keen and willing to share their ideas, knowledge and experiences. Together they intend to explore how to improve their own competence in order to support the improvement of value chains for rural development. They typically work in development programs, implementing partner organisations, or in otherwise affiliated organisations and centres of competence. The organisations of the participants are typically involved in a) implementing efforts in promoting market access for rural areas, or b) researching and developing practical approaches for increasing rural income through market access.

1.1 The objectives of the VCRD-COP

We think that value chain approaches are helpful to generate added value, additional income and employment opportunities for small farmers and rural areas, and for other actors along a chain. Added value is not only to be understood as monetary. There are non-monetary benefits as well like for example, improved know-how, social cohesion and enhanced social standing.

With this VCRD-COP we want to achieve the following objectives:

- Explore on how development agencies can use value chain approaches to contribute to rural economic development
- Link key issues of value chain approaches to lessons learnt, good or bad practices, personal opinions, and new ideas for concepts and practical procedures
- Provide ideas for practitioners to increase the effectiveness of their work
- Provide orientation and inputs for conceptual guidelines.

This note is a first attempt of drawing conclusions and general guidelines for conceptual orientation from the exchange that has happened so far (November 2004 - February 2006).

1.2 The working structure of the VCRD-COP

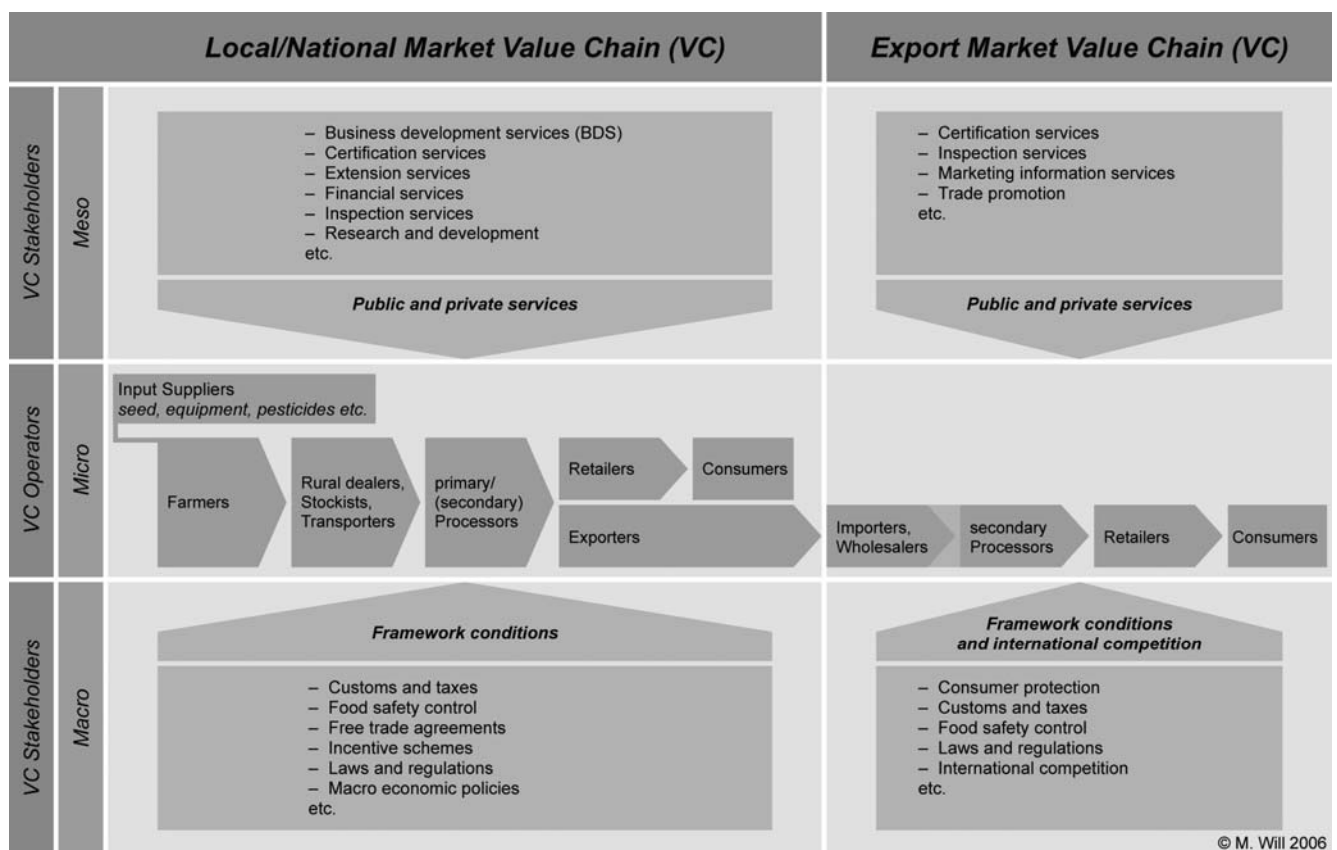
We structured the discussion in various cycles. In each cycle a set of questions and issues were debated, subsequently small syntheses were prepared and consensus achieved. The topics of the six cycles so far were:

- Cycle 1: Analysis of value chains in rural areas
- Cycle 2: Identifying intervention and leverage points
- Cycle 3: Donor interventions in value chains
- Cycle 4: Value chains and poverty reduction
- Cycle 5: Embedded services and other services in value chain development
- Cycle 6: Enabling business environment for supporting value chain development

2 What are value chains? And why are value chains important?

The analysis of a value chain allows an understanding of a sequence of activities which are needed to bring a product from its conception to the final consumer. Looking at individual profit maximization at business level and interlinking these businesses does not yet make a value chain. The 'value chain view' implicates to look at a broad system of interactions and relationships between different actors and organisations. Understanding the mechanisms within the value chain system, allows distinguishing bottlenecks, failures and improvement possibilities within the system. The tackling of these constraints should in the long term assure a competitive advantage over other systems. Understanding a dynamic system is a challenging task – and trying to influence it in a way that the poorest are included, and positive outcomes for poverty alleviation are achieved, is a tricky issue. The intervening agency needs insider know-how and knowledge, fast reaction possibilities and a willingness to take risks. Are donor agencies the right organisations for such tasks? Before getting back to this question, let us have a look at a static picture of a value chain. We see that it includes usually more than a handful of producers and market stands. Business development services are as much part of it, as the enabling environment and as producers, transformers, retailers and consumers.

Chart 1: The value chain system



Globalisation does not only patch up market gaps and bring producers and consumers closer together; it also brings regional and international competition into local markets. For instance, any agricultural produce not consumed by the farmers' family is a product on the (local – international) market and competes today with products from close and far away regions. Therefore, farmers who are able to offer their produce for sale are instantly part of a value chain. So why should the international donor community bother to intervene? Why not leave business to business?

First, there are people left out of value chains, which depend on good value chains for their livelihood. They need support for becoming value chain actors. Second, it is not only a question of being inside a value chain system, but most important: what is the role you play (what is the power you have)? The poorest or smallest actors in the value chain need support for improving their position. Third, some value chains are exploiting low income possibilities. Actors who are stuck in such VCs will hardly escape the poverty trap. Fourth and last, improving the value chain system holds the possibility of creat-

ing competitive advantages for the whole system; a multi-win function for a big number of people competing in local, regional or global markets. Undoubtedly there is an interesting and important field for interventions for donor organisations concerned with poverty alleviation issues.

3 Should donors intervene at all? Why (not)?

From an economic perspective, donors should only intervene in VCs when there is some sort of 'market failure' – a lack of finance or information for example, and when the benefits of interventions to correct this market failure exceed the costs. A market failure, e.g. missing competition or unfair power relations, lack of access to information or finance, is easy to detect in many markets. But also functioning VCs with high potential impact on rural development are recognised targets for donor interventions. The economic perspective is not the only one. There needs to be a clear public interest for supporting existing or potential value chains. The benefits resulting from donor interventions should therefore be benefits with a public interest (i.e. food security, poverty alleviation).

Donor¹ interventions should always consider and be adapted to the situation and context of a specific region. Nevertheless, any intervention has to consider some basic intervention rules:

- VC – outsiders² should only intervene where they can add real value to existing capacities of VC players and VC service providers. The motivation and goals of VC-outsiders must be communicated clearly towards the VC-actors.
- Interventions from donors should support existing local actors, entrepreneurs or organizations having a potential to effect a change (change agents). Changes will only be sustainable if they are carried and implemented by local public bodies and entrepreneurs.
- VC development can be a commercial venture. Donors or public funded agencies should not play the role of enterprises and thereby sabotage the emergence of truly sustainable and viable enterprises.
- Participative approaches should be used when and where appropriate. Identifying the change agents and the business potentials does not always need a very participatory or bottom-up approach, but changes in the VC only occur by fully engaging the concerned actors.

Before intervening in any value chain, the donor must have a minimum understanding of markets, actors, informal rules and laws, embedded and other services, etc. . Donors have to understand what is going on in markets and within value chains, in particular, what constraints are undermining value chain performance. And understanding means being engaged and close.

Public interest in VC development

Donors represent the public interest of including disadvantaged people in commercial activities. A pro-poor or small farmer orientation is often not the main interest of entrepreneurs. While entrepreneurs invest in private interests, the donor should invest in enhanced pro-poor focus; e.g. mechanisms that foster the profit of the poorest in VCs – like fair-trade schemes, labour standards, corporate social responsibility, etc.

In the past, many donors and development actors have 'condemned' the private sector, the perception of exploitative traders was widespread. The way forward is to envisage new and creative partnerships, and create room for cooperation. Let both do what they are best at, with carefully linked and synergetic efforts.

Public interventions in markets lead inevitably to market distortions. The idea of neutral interventions is very idealistic and can not be achieved. In addition, donors do want to change market settings or as stated above, market failures. For instance, where no market for a specific product exists, or an exist-

¹ Please note, that the term 'donor' includes bilateral and multilateral donor organisations, development agencies, NGOs implementing on behalf of a donor agency, consultants, etc.

² The VCRD debate defined actors that do not have any commercial stake in a VC, as VC-outsiders. Donors, as described above, are usually VC-outsiders.

ing market is monopolised by a single firm, the creation of a market, or the removal of a distortion can be the objective of a donor intervention.

Include the poverty reduction focus

Pro-poor economic growth and poverty reduction issues are a public interest. Entrepreneurs are by definition more interested in economic sustainability than inclusion of under privileged people. As donors have an interest in improving the quality of life of the poorest, it is the donor who has to be concerned about supporting pro-poor mechanisms. This can be done through supporting farmers directly (capacity building, trainings, organization development) or advocacy (for a fair pricing system that leads to a win-win situation) or through supporting a bigger company (manufacturer; exporter; out-grower-schemes).

This does not mean that donors should exclusively interact with the weakest actors. On the contrary, the poorest or most marginalized people are not the engine of VC development. VC development is usually done through entrepreneurs, business companies or associations. Therefore, donors should concentrate on change agents for VC development whose concepts and ventures have the best chances for a sustained effect on poverty. Creative partnerships and room for cooperation with the private sector is therefore crucial for VCD and poverty reduction.

The principles of many social or ecological production and trade systems are on achieving win-win situations, creating lasting relationships and with 'reasonable gains for all sides'. But, enforcing improved labour conditions or corporate social responsibility (CSR) can create undesired or unsustainable solutions; it can even put people out of business. Donors should help to establish a fruitful interaction and a balanced negotiation between the partners.

Demand-oriented interventions

Most people agree that a donor should formulate its intervention based on verified needs and real demands; this is contrary to a profit oriented business that does not care so much about needs, but about demands and willingness to pay. What happens if a demand is not need-based but donor-driven or a demand can not be formulated due to lack of knowledge or know-how? An interesting discussion about a project example in Tanzania shows some opportunities. The case description of Mali, however shows a limitation of demand orientation.

Box 1: Demands and reaction in the Tanzania case (Micro-irrigation)

Farmers don't demand micro-irrigation, simply because they don't know about it. Interventions: Donors cannot react to a demand. Donors can fund programs for experimentation with a potentially useful innovation to happen, so that farmers know what they can demand.

The markets don't demand the technology. Interventions: Donors cannot react to a demand. They can provide resources and expertise, so that the input-potentials and the follow-up marketing potentials are well understood, which will allow getting a better grasp of the business potentials.

Entrepreneurs demand resources to develop the technology, acquire the skills to install it and service it, and establish distribution channels. Interventions: Donors can react to this demand by providing the resources for business-oriented R&D by entrepreneur; and by entering into public private partnerships with them.

NGOs could demand funding of their efforts to introduce micro-irrigation for food-security reasons.

Interventions: Because micro-irrigation is expected to be a commercially viable venture, the NGO should only be supported if it is restricting itself to the R&D phase. Otherwise the donor risks distorting the emergence of a viable service market.

Box 2: Need and qualified demand in Mali

The idea from the donor is to gather the actors of a value chain so that they analyse the strengths and weaknesses of the chain. The expected result of the exercise is a concerted analysis that leads to a common and shared action plan (or a least agreed set of priorities). Then, when all actors expressed their needs, a common demand is articulated. In this ideal case, the stakeholders of the chain could now look for the appropriate responses for their demand. Experience shows that this is an ideal case, which does not always work. For instance, in Mali, farmer groups are very smart to profile their demands according to what they know the donor community finances! Therefore, donor agencies can easily get the perfect match between their demand and the own offer, but it might end up with very little effect on the value chain. This dilemma is occurring again and again – ideas for closing this trap are very welcome.

The facilitator role

Donors can enhance VCD through support and partnership at the micro, meso and macro level. A role that is often assumed by donor agencies is the one of a facilitator. During the online debates we found that a neutral outsider is often necessary for organising stakeholder meetings and trust building activities. An external facilitator seems inevitable in those VCs where mistrust is common and where learning processes should be facilitated.

But, should the facilitator be a VC-outsider who has no commercial stake in the VC or rather a VC-insider who does have a commercial stake? From the perspective of development agencies, an outsider is required to ensure the public interests in the success of the VC, i.e. poverty effects. Such an outsider is often necessary for organising stakeholder meetings and trust building activities. Additionally, VC-outsiders are best suited for facilitation in order to ensure transparency and neutrality. A private business would pursue its own agenda first. From the entrepreneurial point of view there is the concern that the VC actors need facilitation and support for networking, trainings etc. in the long term and not only during the initial phase to withstand competition. Therefore, the facilitation should be done from within the VC. Its organisation and financing is an issue that has troubled the online debate for quite some time. An idea is that the facilitation could be done by an agent who has a commercial stake in the success of all actors in the VC.

Furthermore, donor interventions can create local instability, mistrust and unequal competition. Publicly funded organizations act often as though they are enterprises, thereby sabotaging the emergence of truly sustainable and viable enterprises. Some actors may lose power, influence or simply drop out of an existing chain through a donor intervention. The most probable losers from increased information (access) are not the producers, nor the consumers, but someone among the established traders. These actors might become critical for VC success.

The VCRD debate did only raise these thoughts but did not achieve a final recommendation.

Leverage of donor interventions

If there is the choice between (a) VC development for organic or fair trade markets abroad with the potential of relatively large benefits for relatively few poor people and (b) interventions in local value chains with the potential of comparatively little benefits but for large numbers of people, donors should choose case 'b', because this implies a bigger contribution to their poverty alleviation goal.

The key issue is "leverage": How do we use systemic change to reach tens of thousands of people rather than apply direct assistance to help a few companies? It really comes down to a question of cost benefit. If strictly calculated with costs as money spent, and benefits as money earned by poor people, then systemic change (using a real subsector approach) will generally have the strongest impact if you target the right nodes that have the best leverage in fairly large sectors.

Another point to be considered may be the demonstration or learning effects. Thus to go from smaller to bigger may also be a time sequence, provided the scaling up mechanisms are explored and tested already in the "smaller" learning phase of the effort.

4 Key issues of value chain analysis

Working with value chains implies a minimum understanding of its mechanisms, processes and involved actors. The online debate concentrated on practical questions and cases that brought up a series of insights and recommendations; the most important issues are mentioned below.

Finding the right balance between ignorance and investigating every detail of a value chain is a key challenge for development programs. On the VCRD COP we decided that there needs to be a clear focus on going ahead without knowing everything. Even with the best analytical tools we will not have all the answers for planning interventions. In other words: there are no analytical tools or methods that lead to 'the' final picture of a VC. A 'learning by doing' process, which generates more informative data through experimental learning and action research, seems most promising. It may take only a

brief business talk with local entrepreneurs, or up to several months of investigation, networking and facilitation before the first VC development activities are implemented. In any case, a VCA includes to some extent following steps and will most probably face following key challenges:

Steps in VC analysis	Key challenges
<ul style="list-style-type: none"> - Get to know key actors and understand the (socio-economic) rationale of each one - Mapping the main functions in a VC - Checklist of critical success factors (including: Economic rent seeking; Governance; Potential for upgrading) - Leverage: What innovation from outside has the most effect on generating value in rural areas. - Consider all the competing market channels (Even when focused on a specific part of a country, you must follow the product through to its end markets and analyse the competition in those markets) 	<ul style="list-style-type: none"> - In most cases it is very difficult to get proper, reliable data, particularly in rural areas - A big challenge is to distinguish between non-sense and information that holds some truth (private entrepreneurs have better access and know better) - Building trust between the market chain actors - VCA must be done by VC actors

4.1 Tools for analysis

A value chain analysis (VCA) is about identifying the full set of economic cost along the VC, to determine where most value is added and what the relative importance of different actors is (i.e. the formal and informal governance structure)³. This includes a good look at the available services and the supporting institutional framework.

Value chain analyses include a wide range of different options; it can be done in a quick way through external experts (do they really understand the local realities?); or it can be done through an in-depth and participatory identification and reflection process (is it necessary to always include as many people as possible?)

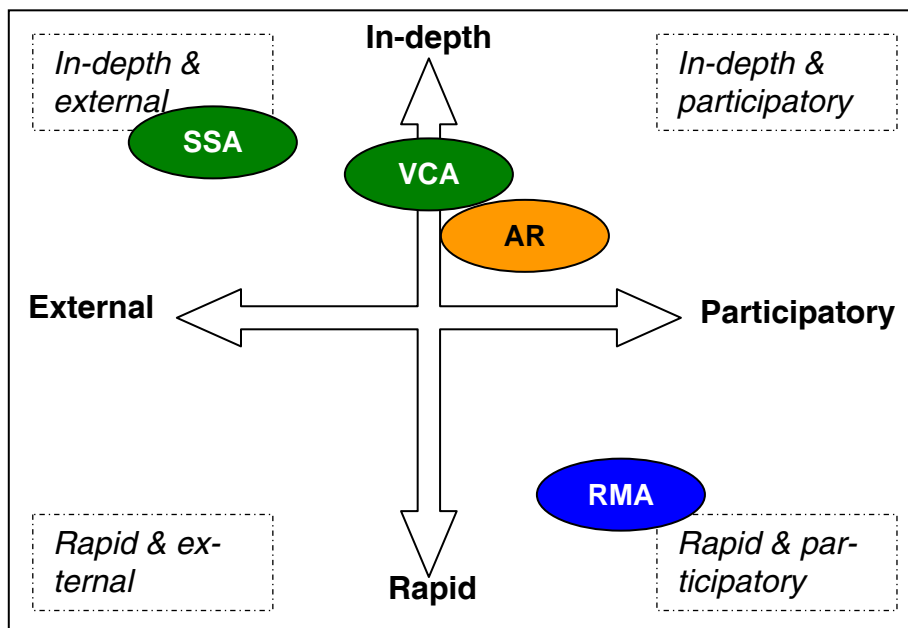
Two dimensions offer a grid for positioning the different instruments for analyses. The decision on what kind of VCA approach one chooses depends not only on experiences and thinking patterns of the user, but also on the institutional settings (mission, vision, interest). External experts with public funding are more likely to implement in-depth analysis; while NGOs or local consultants (mostly also financed with public money) choose participatory research appraisals; entrepreneurs would most probably do some action research (“just do it and you get to know very well the key actors, the governance structure and upgrading possibilities”).

Box 3: Rapid VC appraisal in Tanzania

In the forests of Kahama, people have been doing bee-keeping for many years, they keep literally thousands of traditional log-hives in the forest, but they don't have a market for their honey. Occasionally and very unreliably some buyers come along, but most of the honey ends up in making local brews. The rapid appraisal of the other end of the value chain helped us to realise that there is a potential for quality honey in the local market and even for export to Europe. Not surprising there were only few medium and large scale buyers of honey in Tanzania although some of them actually exported honey. We (a donor organisation) had a basic understanding of the costs and qualities of honey on which we could build and we realised that the beekeepers were more than interested in increasing their market. We knew for example that the practice of smoking out the bees would have to be changed in order to prepare quality honey; we also observed that the contamination of collected honey would have to be controlled; due to long distances transport had to be addressed in respect of cost and honey quality; finally the local and export market had to be further developed.

³ ‘Governance’ is a term used for describing the power-relation in a value chain. Governance reflects the fact that interaction between firms along a value chain exhibits some organisation rather than being random.

Chart 2: Two dimensions of value chain analysing tools (Please note: The different approaches can shift inside this frame, depending on their application.)



VCA: In depth value chain study & SSA: Sub-sector analysis
 RMA: (Participatory) rapid market appraisal AR: Action research / R&D

VCA / SSA: A traditional approach for knowing what is going on within a specific market is a combined sub-sector and value chain analysis. As this approach needs considerable amounts of time, money and particular capacities, this sort of VCA is often donor financed and implemented by specialized international or urban based organisations. Although a participation of local actors is sought for information gathering, it remains in most cases a typical externally led in-depth study.

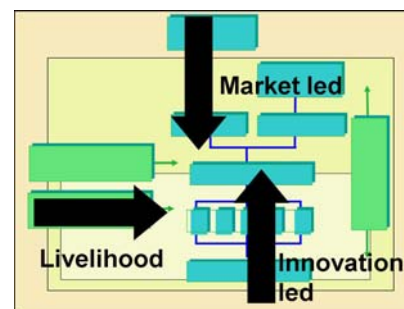
RMA: The RMA approach is based on findings in participatory rural or learning appraisals (PRA / PLA). Trust building and therefore including key actors from the very beginning lies in the center of this approach. The key criteria, available tools and sources of information are basically the same as in an 'in-depth-study', but the implementation practice is different: The information is generated and gathered through local stakeholders. One of the critical key challenges remains the same in both approaches: reliability of information.

Action research: There is a good way the public can make good use of money earmarked for value chain enhancement in rural areas: Having a highly flexible action research program that allows placing small amounts of money for testing business ideas of various local and international actors.

In practice it is important to know what you must know, what you don't need to know and what you can not know. Checking the reliability of data and filtering of key information will be one of the main challenges of any practically oriented VCA.

4.2 Entry points for VC analyses and interventions

For donor organisations, there are many ways to explore and prioritize value chains. It is often the donors' mandate and (in)-flexibility that define where, with whom and on what to work. The listing of different entry points shows how different types of institutions (with their mission, interest and legitimacy) choose to start VC interventions. The type of tools and the problems an institution will face with its interventions will strongly depend from what angle the institution comes in to get a handle on all the key issues of a VC. The principal entry points are:



Please refer to Chart 3

Innovation led:

- **Commodity:** Choose a product or implement R&D for a new product or technology; Interest: to promote a commodity through better collaboration of market chain actors.
- **Technology:** Start with an existing technology or adapt / develop a technology; Interest: to promote a technology through its use in crops that achieve interesting income and allow recovering the investment.
- **Ideas:** Interests: Analyse and support ideas that were generated in a demand driven way from any VC actor.

Livelihood led:

- **Geography – Local:** Choose a region and concentrate on a livelihood system within a specific region and investigate on what this region could produce best for a) being marketed and b) for improving their livelihood.
- **Geography – National:** Choose a country; Interest: to promote products with good market potential and interesting economic (pro-poor) benefits.

Market led:

- **Business Opportunity:** Start with an existing chain; Interest: to create or expand a market for a specific product with high demand.
- **Consumer interest:** Choose a product with specific nutritious value or food safety problems; Interest: food security, food safety, consumer protection.

For any of these entry points there are key criteria that should be considered for deciding whether we do initiate a VCA or VC intervention, or not. In many cases, these key criteria are not (yet) known and are explored during the VC analysis.

Criteria of VC analysis

- | | |
|--|--|
| <ul style="list-style-type: none"> - Market potential - Potential of the selected commodity to increase the rural income in a sustainable way - Potential to alleviate poverty - Potential contribution to equity (including gender aspects) - The potential return on investment - Access to information - Scope of institutional network - Potential for upgrading | <ul style="list-style-type: none"> - Potential for growth (domestic or international market) - The size of the subsector / VC; with a fairly large subsector even a small positive change per person could lead to a large overall economic gain - The donors' ability to effect changes in the VC / SS. This is particularly relevant if it is government policy that is dictating the growth (or limiting growth) opportunities - Capacity of producer to fulfil specific standards (organic production, social standards) |
|--|--|

Box 4: Just Do It Approach – JDI

Why invest money and time in value chain analyses as an outsider? The JDI approach argues that real costs, problems and bottlenecks only appear when becoming active in a VC. So, you should simply:

- Set up a hypothesis on how the chain works and what leverages there might be; then make small deals with various people and see what happens.
- A simple survey with traders and producers; then support the sensitive parts and try to introduce a new product in a new market. The bottleneck is with the learning process and the changing of the mentality of a large number of small farmers.

The donors part can be to provide seed money for (i) legitimate actors that have a good business idea or hypothesis: The VCA will provide interesting data and insights, but the success of intervention is mainly in the hands of some key actors; and seed money for (ii) financing rapid market chain appraisals and stakeholder meetings resulting in a more solid “business plan”.

Arguments in favour of JDI:

- At an early stage, time-intensive research for micro-enterprises is too costly.
- Generation of more valuable data through experimental learning and action research.
- It fosters efficiency and the view is future oriented.
- Even with the best business planning efforts, the reality on the ground is something entirely different. So instead of investing too much into up front analysis better try it out and see what happens.
- Clear focus on going ahead without knowing everything; even with the best analytical tools we will not have all the answers for planning and interventions. Many new problems come up that need answers once you start to implement the discussed ideas.

Arguments rejecting the JDI approach:

- As long as I don't have the desire to be an actor in the VC I should leave the JDI to those who have a direct stake in the chain.
- JDI in the hands of nascent entrepreneurs can, and often does, lead to failure.
- JDI makes a lot of sense when generating and developing a (new) business venture together with committed and informed entrepreneurs. However, value chain development does not always imply a new business venture but could for example also be done through contract farming or franchising; in such cases a systematic approach is vital.
- Many of these market assessments are difficult to make, especially for small producers, but not trying could imply that small producers are exposed to enormous risks (of which they are not aware).
- Rural producers and micro entrepreneurs are not at all used to take business decisions and are not wealthy enough to take the risk of failure.

Two different cases (JDI and PCMA) illustrate the range of alternatives within rapid and participatory approaches.

Box 5: Participatory Market Chain Approach in Peru

The 'Participatory Market Chain Approach' (PMCA) approach is an explicit market chain approach based on three phases that seeks to achieve the following objectives to generate market chain innovations together with the market chain actors. It consists of three steps: (1) to get to know the market chain actors with their problems, ideas etc., (2) to analyse joint business opportunities, and (3) to implement joint market chain innovations. Innovations can be new technologies, new products or new institutions.

Our strategy is to do a diagnostic survey interviewing around 20 to 30 different market chain actors. These interviews help us to get to know the key actors of the chain and understand the (socio-economic) rationale of each segment?. We also learn about conflicts and opportunities etc. Since we invite all interviewed persons to a first event, where we present the results, this first contact is crucial to generate interest in participating in a process where joint market opportunities are discussed and analysed, within a setting that gradually generates a trustful collaboration.

Our experience shows that an institution, even with a very good survey, has a weak handle on the implementation of market chain interventions, because market chain actors themselves must do them. Accordingly, I don't believe in extensive surveys but rather in participatory processes that involve market chain actors who can make a difference. The institution's role must be to create a space for fruitful interaction, with a clear market oriented focus.

5 Key areas for donor interventions

Depending on the key area of intervention donors play different roles and use different methods. In the next chapter it will be discussed how to identify the most promising entry point. The Key areas identified during the VCRD debate were the following:

1. Individual actors
2. Linkages / relations between these actors
3. Services
4. Enabling environment
5. Structures of governance

Except the rare situations when a value chain is induced from scrap by donor interventions, there are always actors, structures and processes in place. Between these actors, business relationships with embedded services, formal and informal laws and rules of behaviour and prevalent power relations (governance structure) exist. Donor interventions should be based on/ start with understanding the existing system and actors, and carefully consider possible interventions. Mostly it is preferable to work on enhancing existing commercial initiatives and market structures and refrain from establishing new channels, which may offer fairer terms (for some actors) but are not sustainable.

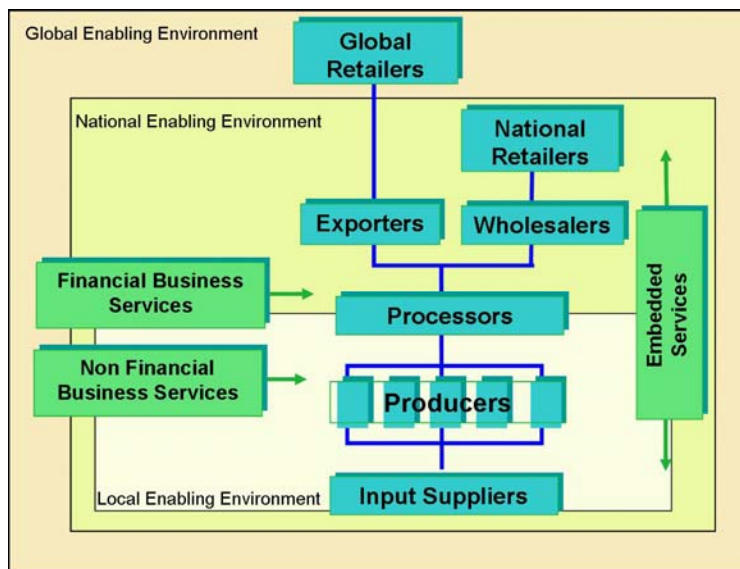


Chart 3: Intervention points (adapted from L. Goldmark, 2005)

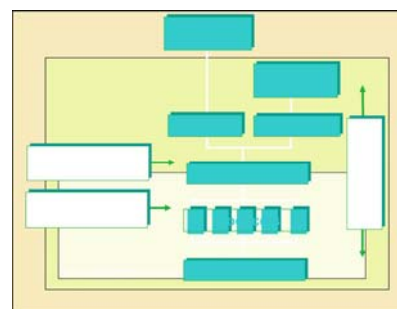
Where and how a donor intervenes depends on different factors: • identified bottlenecks in the VC • interest of the donor • capacities of the donor and • the existing relationship between the donor organisation and the various actors.

Depending on the challenges a value chain is facing, a development agency chooses the intervention level(s). It has proven successful to intervene at several levels at the same time. Of course, different levels are targeted with different strategies, as different outcomes are expected. One limitation of being engaged on several levels is the force and plausible influence of the donor interventions. For instance, a donor can initially concentrate on promoting private sector involvement in the major activities of the chain while substituting for the private sector in other activities (training, market information). The private sector has a greater chance of making these supporting activities commercial once a minimum critical mass of demand for them has been built up/developed.

5.1 When to intervene at 'value chain actor' level and how?

Many interventions in the past concentrated on directly supporting the target group, i.e. poor rural producers. When the bottleneck lies within a production or transformation step involving few VC actors this is still a legitimate area of intervention.

Any technical or financial assistance for producers, supplier or processor should include a discussion with indirectly concerned VC actors. For instance, if a seed producer manages to improve the quality of his seed through a donor intervention, the donor should also support the transfer of this information to the buyers and suppliers of the seed producer.



Large lead firms tend to be more forward thinking and take longer-term perspectives while smaller businesses often are unable to take a long-term view. For this reason it is often easier to work with

the lead firms to achieve positive outcomes for small (poor) producers (the example from Morogoro shows the importance to work with small farmers and the lead firm). On the other hand, this kind of intervention often leads poor small businesses to drop out of business. Donor interventions have to carefully consider with which VC actors to work for optimal broad and deep impact on poor people and pro-poor rural growth. Some general recommendations from the VCRD debate are:

- Trust building activities are crucial when working on a business to business level. The outsider or neutral position of a donor allows creating new working/interacting mechanisms.
- Donors should care about the public interest of functioning value chains. This means, leaving the commercial development to private entrepreneurs and supporting pro-poor and socially oriented mechanisms. A transparent and agreed public-private partnership (PPP) seems most appropriate.
- The clear distinction between public and private interests and roles minimises the danger of undermining the emergence of truly sustainable enterprises through entrepreneurial donor actions. It is crucial that VC actors obtain the capacities to introduce and manage changes.
- When directly supporting entrepreneurs, the donor should only provide assistance (technical and financial) for start-ups
- Providing start-up advice and financing is the most important task in direct support from donors. Once the enterprise is on the move, it should be able to present a concise business plan and get commercial credits and BDS. If such services are not available, the donor should get involved at the service level.

Box 6: Local value addition, Tanzania

Parts of Morogoro region in Tanzania are known for their fruit production. These fruits are mainly sold as fresh fruits to traders who in turn sell the fruits in Dar es Salaam or other towns. The small farmer does not get a good return on his fruits and on top of that about 60% of the fruits are actually rotting because of a lacking demand. An investor has now started to establish a fruit juice concentrate factory and is willing to buy all the fruits for a reasonable but fixed price. Although the price per orange might actually be only fair, the fact that 100% of the harvest is bought, increases the income of the farmers substantially.

Where does the donor come in? There are several entry points:

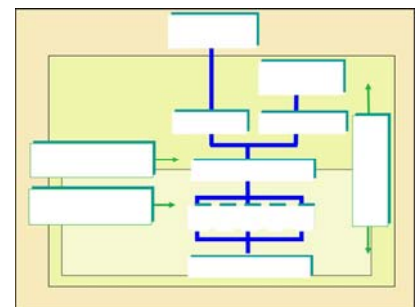
- Helping the farmers to get organized (in groups) and establish a collection system for the fruits with the company and the farmers.
- Work out with the investors and farmers a pricing system creating a win-win situation for both parties.
- Introduce savings and credit groups to ensure that income is being used to create additional assets (the company is in this respect an agent for the groups).
- Facilitate market research for the company and assist with organic certification.

5.2 The role of donors when intervening at the level of linkages and relations

VC outsiders can create a space for fruitful interaction, but the action has to be done by VC actors. In some cases these actors have been competitors for a product, market or market share, so trust building activities are crucial for a successful collaboration of VC actors. In situations where the VC actors lack the necessary knowledge, experience and instruments for VC analysis or development, donors assume additional roles: facilitators, supporters and advisors.

Donors can initiate and facilitate the getting together of VC actors, support the development of innovations and improvements, and the building of trust. Especially for trust building activities, a neutral outsider is essential. Some key elements for trust building interventions were identified on the online debate:

- Facilitation through neutral outsiders is accepted and often needed.
- Aiming at win-win situations is not a 'natural' behaviour and needs special attention from the facilitator.
- The VC actors have to stay in the 'implementation-seat'; co-driving leads to the risk of taking over business activities, so donors should only facilitate linkages and support with advice when de-



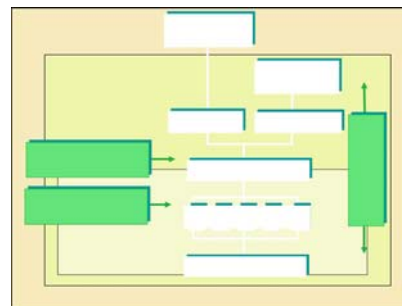
manded. In many cases, a clear statement of donor interest (i.e. public interest) will loosen the stress and open doors for transparent public-private partnerships.

- The VC interventions should stop when the actors are not ready to move by themselves.

Linkages and relationships are closely linked with access to information and knowledge management within a VC. Many rural markets lack appropriate information systems. Input suppliers, producers, traders, service deliverers and buyers would profit from access to important information. VC outsiders – donors, NGOs – should always consider the issue of access to information and knowledge management within value chain development as crucial.

5.3 Financial and non-financial services (service providers)

The establishment or development of BDS providers and financial services can have a great leverage effect for different value chains. The existence of a critical mass of customers is important, so that the BDS providers can survive on a commercial level once the donor withdraws his support. For instance, access to information for value chain actors is crucial. The donor can support the establishment of an independent business information service.



During a whole cycle we discussed the importance of embedded business services (EBS), since a large part of the critically important services come in form of EBS. Embedded business services are typically not as visible or as tangible as other service delivery mechanisms (such as fee-for-service, public services, social networks or media) and therefore have received less attention. EBS are services packed in or bundled around commercial transactions between a buyer and seller. EBS are increasingly considered important; particularly for the poor and people in remote areas, because the limitations of other mechanisms become clear. However, EBS should not be considered as just a stopgap if no other ways of service provision are feasible, but rather as one of the options for service provision along value chains, which is suitable in some cases and not in others.

EBS may not appear as the most desirable option, but they often are the only one with good chances for longer-term viability. Furthermore, most buyers would prefer not to have to provide EBS to producers, but they are willing to do so if it helps their business adequately.

Some key issues for donors when engaging in EBS were identified:

- Do not set up interventions which compete with existing EBS and other services, unless you are very sure about their viability and sustainability.
- Do not think that commercial VC actors are generally nasty but assume that they are willing and can be motivated and supported to improve their practices in ways that are compatible with the profitability of their business.
- The available actors can be supported in developing better practice and behaviour. This needs arrangements which provide incentives in the right direction. As mentioned, a transparent PPP agreement can be a good basis for cooperation. The public- and therefore donor-interest is to fund the building up of (EBS and other) services which help to get poor people into the VC; or to directly fund services which are required only for a limited time.

Box 7: How to set up a rural business information system?

An information system that allows identifying opportunities is vital. First identify the (broad) opportunities in an area and then adjust the information system to promote these. Obtaining real insights (information that matters) in a few commodity lines is challenging enough, i.e. to update it with (international) market developments. Do not 'water down the wine' by trying to be too broad.

The business information system should be an independent service paid for by its users. Trend information etc. can only come from engaged value chain actors and can be made available for others, i.e. producers, traders, processors, customers. This is what many rural producers lack: information that goes beyond a limited content the intermediary tells them.

The donor can support the establishment of such a service and facilitate the engagement of lead firms, supermarkets or governmental agencies.

Box 8: Embedded services in the date sector, Iran

The main problem appeared to be that there is a rather opportunistic behaviour of traders who went for quick profits, buying when and where possible, pushing most risks and costs to the farmers. However, one exporter provided a number of embedded services to his suppliers (farmers) such as training in a new harvesting method which improved the quality of the dates, as well as pre-financing the harvesting costs for the farmers. He takes a considerable risk yet he still continues (for some years now) whereby his reasoning is that he can afford these extra costs and risks as he is able to negotiate a much better price with his customers (quality, continuity) and can pass part of that on to his suppliers. Other farmers had started to copy the new harvesting method and other traders thus benefited also, but of course they also had to pay a better price – so win-win for both. As a result it is expected that the entire sector will one day raise its standards and I doubt if government/donor extension workers could have achieved something like that. The lesson learned: it takes always a few chain actors to actually get things done. There isn't much you can or should do as a donor if these 'change agents' are not there. You can enable some things, but it is the market opportunity and the risk taker who actually 'does it' and we can only support and should avoid disturbances.

New ideas for **rural business development services include the** rural business incubation centers. These centers could seek out ideas and support innovative ideas; they provide a space and meeting point for rural entrepreneurs.

Box 9: Rural Business Incubation Tank - an idea from the VCRD discussion

A rural business centre operates like an "incubation tank" for rural business ventures that would impact on income through VCs.

What are its activities?

- Hunt for good and even "crazy" ideas among the local population that want to earn money, and outsiders interested in investing money or buying specific goods (i.e. money from migrants).
- Get the two together, combine them, interact and build ideas worth testing.
- React immediately on ideas. Coach these ideas to the point where they may be tested. Fast and constructive reaction is essential.
- Fund the testing of technologies, marketing procedures, information flows with "rural venture capital" to do the R&D. These must be small projects. Venture capital means, if it works: pay back with interests. If it doesn't work, the investment is lost.
- Build business plans of successful ventures, and then coach the owners of the idea to approach normal finance sources (credits, investments).

Who operates it?

This must be operated by people who combine two sets of skills: Hard-nosed enterprising skills, and an intimate understanding of and skill in interacting with a rural population and particularly with the poor and *remote people*. *The incubation tank should be operated like a commercial venture.*

How to fund it?

The incubation tank operates as a business, but at present such companies don't exist. The reason is that the transaction costs are far too high due to the typical dilemma of 'rurality', i.e. distance, markets. So this kind of incubation-tank-company would have to be financed like this:

- The company itself invests in those ventures that turn out to be successful and thereby recovers some of the venture capital.
- Donors provide funds for specific efforts aimed at particular sectors of the rural population.
- Topping up by donors for successfully achieved business plans that allow increasing the added value within rural areas.
- Large trade companies may invest in the incubation tank because they are interested in getting enough raw or semi processed products of superior quality.

So the income streams are actually:

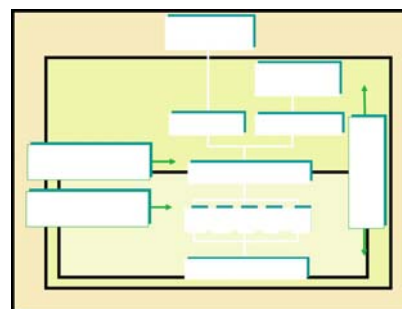
- Directly from the successfully incubated ventures. The incubation tank does not own the emerging businesses; it is simply a shareholder and business-coach.
- Backup funding by Donors, wherever possible tied to the success of the work of the incubation tank.
- Through contracting by companies operating on the large markets.

Legal status:

The incubation tank has a commercial licence. It could also operate as a foundation. This may actually be easier for funding agencies to work with, and may be more consistent with the activities of the tank.

5.4 Enabling Environment (local, national, international)

An important influence on enterprise growth is the quality of the business environment, which may either further or hinder enterprise creation and growth. The business environment is the product of many factors, including infrastructure, human and physical capital, macroeconomic policies, and microeconomic regulations. A favourable business environment provides economic and political stability, offers low costs for business transactions, and allows for efficient business operations, which lead to greater innovation and creativity. For a single business as well as for value chains, an enabling environment is crucial.

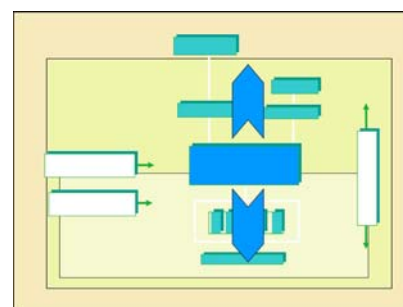


The VCRD debate identified four different ways in which donors can influence an enabling business environment for VCD:

1. Enable local actors (VC actors and supporters) so that they can lobby at the policy level through the local government or civil society (chambers of commerce, for example).
2. Support or enhance changes at a local / de-central level. Conducive policies should be based on regional characteristics. Donors can try to influence both public and private actors to define a regional policy favourable for VCs operating in their area.
3. Support governmental agencies with technical assistance, so they are able to offer a demand-oriented and efficient service to rural entrepreneurs (bureaucracy can be a business killer). Enable policy makers and public servants to act more private sector oriented by facilitating change management at local, regional and national policy and administration levels.
4. Gain experience through small field-level projects and use the lessons learnt for direct policy dialogue. Medium- and long-term projects have shown a pivotal role in the formulation of policies; for instance in an agriculture and education project in Kosovo.

5.5 Value chain governance

'Governance' is a term used for describing the power-relation in a value chain. Governance reflects the fact that interaction between firms along a value chain are ruled by some organisation rather than being random. Governance involves the ability of one actor (or of several actors) in the chain to influence or determine the activities of other firms; i.e. the determination of: • What is to be produced, • How is it to be produced, • When is it to be produced, and • How much is to be produced. It is crucial for any intervention to know the actual governance structure and to identify the central actor(s).



The conclusion of VCRD is to separate two types of Governance:

- Intrinsic governance is about power relationships between the stakeholders acting within the VC. For example, due to its (monopolistic) position, an importer defines the quality standards the producers must meet if they want to stay in business.
- More exogenous governance deals with actors influencing the 'framework condition'. Specific examples are laws and regulations for the use of timber and non-timber products, or the certification schemes for organic and fair trade products.

Therefore, at the top of the governance structure can be an actor from within the value chain (producer, trader, exporter, wholesaler, etc.) or from the outside of a specific chain (governmental agencies, NGO or private enterprises, i.e. for certification standards).

The choice of donor interventions may depend on VC governance structures. We have listed a set of such interventions possibilities in the following box.

Box 10: Governance structures and donor interventions

Governance structure	Intervention possibilities
<p>VC led by large national firms / global value chains Large firms and multinationals take the lead role and set-up up-stream linkages, perhaps private certification and branding schemes; they organise for up-stream extension services and quality assurance schemes; sometimes they are interested in joining forces with donor organisations in countries, in which they see an added value in doing so.</p>	<p>Public-private-partnership projects with lead firms. Financial / technical assistance; shared investments & risks for public interest purposes. Advocacy and lobbying for corporate social responsibility and accountability.</p>
<p>VC led by medium (to large) domestic firms medium-scale firms are interested to improve performance / profitability /quality assurance along the chain by (i) improving up-stream and down-stream flows of products and (ii) framework conditions under which they operate.</p>	<p>Facilitation and moderation between actors; fostering the network and the VC actors-relations. Public-private partnership with key actors (shared investments & risks, guaranties for credits) Fostering qualified demands (need-demand-response) Purely business-oriented and demand driven interventions Strengthening the lobbying power Supporting or lobbying for improved framework conditions R&D fund for business ideas (new products, new technologies, new market)</p>
<p>Small firms and farms intending to join an existing VC or initiate VCD In contrast to the two preceding examples, there is no bigger player involved who is interested in improving up-stream VCD and thus pulls or pushes VCD.</p>	<p>Identify change agents / innovative / entrepreneurial small scale rural producers who are capable to PUSH VCD. Assist the emergence of sustainable VC structures. R & D funds for action research on VC development or initiation possibilities (business plan). Capacity building for engaging in existing VCs on favourable terms.</p>

What follows? This note is like a snapshot of the state-of-art of the ongoing VCRD debate. The online discussion will start again in March 2006, and will dig into more detailed experiences and cases from participants. Several themes or issues need further exploration, new aspects will be highlighted for the first time. An overarching focus will be questions related to ‘*how to*’ intervene, support, develop etc. as a donor in value chains for rural development.

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