

Chapter 2

The Global Value Chain Approach

The GVC literature that emerged in the 1990s was motivated by the need to better understand how producers engage with the process of globalisation and the resultant implications for the development of production capacity and capabilities. A number of value chain studies across sectors, including agriculture and light manufacturing, acknowledged and discussed changes in global production and methods of co-ordination, and explored what this means for firms and labourers.¹

The literature continues to develop, both conceptually (e.g. by recognising global production networks) and empirically (e.g. by employing more robust research methods). The building blocks generally remain the same, consisting of an understanding of the appropriation of rents within a given chain, which indicates economic power, and the governance structures that help to secure them. The methodology tends to take a more vertical approach towards tracing the relationships between producers and buyers.

2.1 Methodology

There are a range of research methods to measure participation in GVCs. These have different research objectives. They require different types of data and information, and vary in terms of their demand for complexity. Overall, the generation of GVC-related case studies is considered to be both the most complex and the most accurate approach to the measurement of GVC participation. In comparison, the collection of data related to trade in intermediate goods, such as parts and components, is quite straightforward.

In recent years, the use of trade in value added – net exports – has become a proxy for measuring participation in GVCs. However, the analysis of trade in value added captures predominantly vertically fragmented trade. For these reasons, this handbook advocates the use of a type of causal chain analysis that identifies buyers, sellers and the intermediate actors that link the two as the preferred approach to GVC analysis, because it can be applied across sectors: from light manufacturing to commodity-driven value chains.

2.1.1 Identifying GVCs: case-study analysis

Essentially, the GVC approach requires us to consider the market structures in which trade occurs and market dynamics. The approach focuses on the dynamics of inter-firm linkages and international industrial organisation,

as opposed to considering the production and export of goods in isolation from these structures.

The building blocks

Within the context of LDC graduation, the economic rents under consideration are the tariff rents, that is, the difference between MFN rates, applied to all trade partners, and the preferential rate conferred on LDC producers. However, prior to this approximation (which requires trade data analysis) it is important to understand how value added accrues and is distributed along actors within the value chain. This requires:

- identifying actors within the value chain that benefit from the tariff rent.

In order to derive this:

- unit costs can be proxied for producers and production costs analysed alongside sales data;
- this approach can proxy the potential economic margin (or profit).

This approach can derive a proxy for value added derived at each sequential stage of production. However, its drawback is that detailed information on sale prices must be obtained. This is not always possible when products are transported and sold overseas. Nonetheless, even beginning this process of mapping out the actors involved, identifying lead firms and buyers, and understanding production costs and sales prices can assist in identifying the drivers of the value chain.

Value chain drivers

Value chain drivers typically capture the largest share of value added. Therefore, the identification of value chain drivers through the approximation of value added and its distribution across actors within a given value chain is a good start in GVC analysis. However, in addition to shares of value added, Gibbon and Ponte (2005) presented lead firms in selected value chains with their market shares. They did this because the term 'lead firms' refers not only to firms that have the largest market share (in comparison with other firms in the same functional position), but also to the fact that, as a group, lead firms control certain functions that allow them to dictate the terms of participation to other actors in different functional positions in the value chain.

This means that approximating the market share of different actors within the value chain also becomes necessary, for example as follows: Firm A accounts for the largest value of production, and derives the largest margin based on estimates of production costs and sales price; it also accounts for 20 per cent of retail sales, based on the information derived from purchases made by Buyer B. Obviously, this approach could become complicated as

corporate strategies begin to be deciphered, as explained in more detail in the following subsection.

Market shares, buyers and structure

An understanding of how firms compete leads to a greater focus on specific product attributes. Kaplinsky and Morris (2001) described how dominant firms, and those with the market edge, gain economic control through the development of intangible competencies such as research and development (R&D), design, branding and marketing, which are characterised by high barriers to entry and which command high returns. In the case of particular retailers, these factors may include the development of a strategic end-market share on the basis of economies of scale, marketing and product differentiation.²

What all of this information suggests is that market share analysis should be supplemented with information on the major buyers in order to get an understanding of the GVC in which producers operate. Information on firm size and firm ownership structures, including shares of Foreign Direct Investment (FDI),³ should be used to supplement market share analysis in order to provide further insights into the determinants of competitiveness and the nature of relationships between firms. Although obtaining such information can be challenging because detailed firm-level surveys are not always available, beginning to qualitatively map out the different actors within the value chain and considering their relationships can be instructive.

Notes

- 1 For such studies, see Cramer (1999), Daviron (2002), Dolan et al. (1999), Dolan and Humphreys (2000), Gereffi (1999), Kaplinsky and Kaplan (1998), Navdi and Thoburn (2004) and Ponte (2002).
- 2 Other factors also noted by Gibbon and Ponte (2005) include political connections, and/or locking in on new locational advantages that arise from geopolitical changes. Although these are discussed with particular reference to sub-Saharan Africa, they are factors that are arguably relevant to most countries and regions.
- 3 However, there are constraints as to data availability and the mandate of the United Nations Industrial Development Organization (UNIDO), although secondary data sources such as World Development Indicators (WDIs) could be drawn on.

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