Approach to value chains

Giving Forests Value as an Alternative to Deforestation
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Introduction

In the last years in development circles the use of value chain approaches has grown and spread. However, it is important to understand the different approaches to the concept of value chains in order to use the concept in a manner that aids local communities and farmers to gain from the benefits of local/national/international trade.

Throughout this text we will present the ideas and approaches Forests of the World (FoW) works with and how they guide our work with our partners and beneficiaries. We will first discuss the concept of value chains from a theoretical perspective to then move to FoW’s approach to value chains more specifically. Then we will move on to how FoW applies the concepts.

What is a value chain?

The concept value chain was initially defined as an internal value chain, and described as: “A value chain is the whole series of activities that create and build value at every step. The total value delivered by the company is the total sum of the value built up all throughout the company (Porter. M.E. 1985).

This initial approach focused on a strategic analysis of procurement, manufacturing, sales, follow up as well as supporting activities for a product or service in order to reveal which proportions of an individual company’s organization contribute to the generation of profit margin. In addition, a value chain analysis reveals weaknesses in the production process. By eliminating these you increase your margin and secure an advantage over the competition (Porter. M.E. 1985).

Today the concept of value chains is also broadly used to describe a chain of value addition across companies in sectors; the entire range of activities required to bring a product from the initial input-supply stage, through various phases of production, to its final market destination (UNIDO 2009). According to UNIDO; “A value chain analysis is both useful to understand overall trends to industrial organization, but also a good tool to better target support and investments in enterprise competitiveness, income distributions and equity” (UNIDO 2009: 4).

By not only focusing on the internal value chain this analysis attempts to understand interactions and synergies among actors and between them and the business and policy environment. By revealing strengths and weaknesses, value chain analysis helps participating actors to develop a shared vision of how the chain should perform and identify collaborative relationships which will allow them to keep improving chain performances (UNIDO 2009: 4-5). We term this sector approach in this document.

Both approaches present possibilities to analyze and decide strategically on how to develop business in a sector. Therefore, FoW consider the two perspectives of analyzing value chains complementary, but not necessarily dependent. In general, the focus in our development work is generally on the internal value chain of an association/cooperative of farmers or foresters (women and men). This is due to the context in which FoW operate, where forest dependent people in general firstly need to organize around a common business interest and then secondly forms part of a supply chain.
The sector approach is, in the work of FoW, also used in advocacy, analyzing industries and identifying limitations for new actors such as community enterprises or for new products or services that can be inserted into these.

a. The Company Value Chain Analysis

The individual elements of a business' value chain can be divided into two areas: primary activities and support activities. Primary activities are all processes directly involved in the value chain, logistics, production and customer service. Supporting activities, however, are not directly linked to the production process, but provide the conditions for this. These are the infrastructure of the company, the employees, expenditure on research, development and procurement. Both direct and support activities can be subclassified for further analysis. For example, a coffee cooperative using a value chain analysis can detect inefficient work in certain sections of its production. This could be caused by the delays that arise e.g. when the coffee collection is not coordinated well. The delays then create a need for having more warehouse facility to stock the coffee production for a longer time both increasing costs and financing requirements. By eliminating this problem, the coffee cooperative might maintain or increase the level of coffee production in the same period of time and at the same time cut costs and thereby increase the profit margins as more coffee can be produced within a shorter time frame.

b. Broader Sector perspective

In addition to the internal (horizontal) value chain analysis that creates an overview of a single company there is also an external (vertical) value chain, which classifies the individual operating as part of an entire industry or sector.
In the above model the integrated function of a company is exemplified with the company being the manufacturing part of an industry’s value chain. And of course, there can be many manufacturing companies in an industry’s value chain. These are then competing against each other as exemplified in the below model:

Using the example of a coffee cooperative, the cooperative obtains individual material from local supply companies and implement them during the collection and drying of the coffee. The horizontal value chain in this case comprises from delivery of the material to the coffee cooperative to the delivery of the coffee from the cooperative to a client. The vertical value chain however classifies coffee cooperatives as part of an industry, which includes all steps from extraction of the
raw materials to the supplier companies through to local coffee shop in or outside the country of origin of the cooperative.

c. Product vs. demand perspective

One important distinction that needs to be made in relation to the production of any product, is the need for an established market demand for the product in order for it to be viable as an income source. Therefore, it is important to integrate a demand perspective to any value chain analysis.

A customer driven value chain approach has been developed, basically building on the same elements, but with different sequencing:

The important difference is that instead of starting with the creation of the product and the perceived value that is being built into that product, it is suggested that the value chain starts with identifying the needs of the customer – or the value that the product has for the client. This approach gives a more market-oriented perspective to the product, which in turn should assure better opportunity to maintain competitiveness via a continuous understanding of developments in the market, which in turn should create more sustainable incomes for producers. This reflected in more detail in the model below.
Having this awareness as a supplier will also give you opportunities in relation to your position among other suppliers of similar products. But of course, such an approach, as described above, requires high capacity in the marketing department of a company, and it requires a certain presence in the end-consumer market, which is not always possible for all types of companies f.ex. community enterprises or farmers associations.

Therefore, if there is no understanding of the end market and how it works, the value chain runs the risk of becoming obsolete when the project intervention of FoW ends. The ability to act according to the market/customer needs are essential if we want to promote sustainable value chains. The first step is to form the understanding in local communities and cooperatives that they will have to continuously adapt to new market circumstances. This can be stressed performing the value chain analysis of a company starting with the customer needs and emphasizing the positive outcomes that come from having this approach.

d. Strategies and value considerations in value chains approaches
The internal value chain and the sector approach are not always in balanced and cannot necessarily be tackled all at once in a development project. F.ex.. we can support a cooperative to become FSC certified, but if the sector still consists of mainly non certified, it may be too expensive to be certified to compete in the market. The same applies to the product vs. consumer approach, we may see that the market wants a certain type of product, but the productive capacity or capabilities are not present to meet that demand. And in the case of the internal vs. the sector value chain approach there might be a need to enforce the payment of taxes to level competition among legal and illegal operating timber companies. Accordingly, possible contradictions need to be considered when creating a value chain strategy in a specific context and considering success criteria.

e. Local market vs. exports – depends on the strategy
Once the understanding of the customer’s needs and the market conditions for those needs, the necessary next step is to establish a strategy for development or improvement. Regarding the optimization of production processes, two major strategic routes can be chosen according to Michael Porter: The low-cost strategy and the differentiation strategy.
With the **low cost strategy**, the margin is increased by economization in the production process, checking the individual activities of the value chain and potential savings. However, the aim is not necessarily to reduce costs at any price because the savings should not affect the quality of the final product – unless you also shift your customer focus.

E.g. a Coffee Cooperative could try to buy his materials cheaper or make its production process more efficient, to achieve the same result with less costs and effort in terms of material and manpower.

In the **differentiation strategy**, a competitive advantage is sought by emphasizing special characteristics of a product or service that distinguish the product or services from those of the competition, in order to stand out. Here, individual elements of the value chain are analyzed in terms of differentiation potential as well as the cost required for this purpose. Based on the results of the analysis, a strategy is being developed which will result the greatest possible differentiation at the lowest possible cost.

A Coffee Cooperative could be distinguished from other manufacturers by the organic or natural origin of the coffee or the climate related adaption of mitigation effect the production has locally.

However, it is important to stress that in order to understand where your strategy can have the best impact, you need to understand the competition and the market, and to do this continuously. This of course requires more focus on how to get market information in order to define the areas of the company’s activities to improve, invest in or to market to potential clients, where to market it and of course to make sure that the product does not become too expensive in the process.

Irrespective of the type of industry and the size of the value chain project, success or failure will largely depend on the target market and demand factors, as well as the nature of the strategy adopted to confront potential competitors. We have, above, presented a walk-through of possible strategies and considerations to have in mind in order to improve the chances of success of a firm. However, FoW as a development organization can not only strive for profit maximization, our mission is to seek the optimal combination of all these technical and economic aspects in pursuit of long-term economic growth, poverty reduction and forest conservation.

In conclusion, in creating these strategies, FoW aids in creating milestones or expected changes in aspects of the chain such as technology and management, co-ordination among actors, changes in the incentives of key actors and the creation of new contracts. Furthermore, FoW can aid partners in doing evaluations of their business strategies and selecting the best opportunities and actions of improvement in their markets and relations to other firms. Below we will discuss more specific considerations we take in relation to the theoretical perspectives outlined above.

**FoW Value Chain approach**

a. **Other forms of value: Rights, Biodiversity, Climate, Sustainable Production,**
Reinvestment of Surplus, Certification, Gender.

As an NGO concerned with the conservation of the Forest and its communities, Forest of the World sees nature-based solutions and thus the sustainable forest management as an opportunity to create higher incomes for this communities and better standards of living.

At least a quarter of forests in the Global South are managed by different communities and this share is expected to increase the coming years. Even in regions where forests are officially owned by the national state, there has been a movement towards transferring management and land rights to traditional communities and indigenous peoples. As a result, local communities play an important role in the value chains of forest products and services and in the conservation of forests and the vast number of species living there.

The interdependence of local communities and forests is seen as an opportunity for forest conservation, because it often motivates rural households to maintain at least some forest cover and to look for alternative income from more sustainable sources. However, to be successful, the sustainable production of forest products and services is required to have a reasonable relation between labor input and improvement of livelihood. Therefore, it is crucial to adapt the added value and business capacity development to local conditions.

FoW considers sustainable value chains as a means to give the forests an alternative value to the deforestation. In several countries, land areas with forest are often cheaper than land without forest, and local traditions and knowledge often indicate that economic prosperity requires deforestation. Thus, FoW’s involvement in value chains and sustainable production is often motivated by a direct revenue-generating value as well as a subsistence economic value, while the overall goal also relates to the forest's not-always-monetary values, such as climate, water, air, recreation, religion and culture.

As we mainly work with indigenous and traditional communities, it is important for us to understand the household and community dynamics in relation to the productive processes they support. Therefore, when we attempt any value chain intervention, we also have in mind the household economy, its main activities throughout the year, the main activities they depend on, the arrangements around household work? Also, important to consider is the role of age and gender in these arrangements (Bolwig et al. 2010).

At the community level, similar questions of resource allocation and access are important, who controls aspects such as land or water is key, but also who has political control and patronage in the community. Elite capture is a risk to be considered, but in some cases also an opportunity in the short run, due to the resources and connections “elites” might have in a community. Furthermore, how are conflicts solved within the community is a key aspect in understanding general relations of employment among members of the community and will affect the organizational capacity of the firm (Bolwig et al. 2010).

Another potential key aspect of FoW value chain projects is its environmental sustainability and certification. We consider that sustainability can be achieved balancing the social, environmental and economic benefits together. Thus, it is crucial to protect producers by understanding risks
involved in the process to a more sustainable production. To sustainably create added value to a product (new or old) through performance improving and unified actions, can be conducted by e.g. joint marketing, establishment of associations and joining a sustainable standard scheme, such as FSC where FoW is directly involved in its governance.

Lastly, FoW has one requirement to be fulfilled, if a value chain initiative is to be established, which is that at least 10% of profits (not income) is to be re-invested into the community or territory which where the resource management is based. In a community or territory, it is most likely a group of persons that participate in a value chain initiative, but they can only do that because of their relation with the community, Therefore, a part of the profits is reinvested in the community, which strengthens the relation between value chains, the community and the forest they are dependent upon.


FoW has chosen to work with sustainable value chains related to timber, agroforestry products (e.g. shade coffee and cocoa), NTFP (e.g. medical and cosmetic plants/products), as well as locally rooted sustainable tourism. These forest products and services require a sustainable management of forest resources in order to survive in the long term.

FoW has chosen these particular value chains because of their potential, since wood products made from tropical wood, coffee, cocoa, oils and experiences related to the flora and fauna of the rainforest are already in demand and are being sold. The major challenges in this regard is partly a restricted supply, and the quality of end products. Therefore, they are excluded from participation further up in the value chains and are often watching from the sidelines when value is added f.ex. in the transformation of wooden product, or when an external guide shows tourists around in their village or forest areas.

Forest of the Worlds CSR-strategy provides the basis for collaboration with companies in development projects such as with the forest community cooperatives like COATLAHL (Honduras), achieving FSC certification while still protecting and managing the forest in a sustainable manner. Also, coffee production with the German company Lebensbaum and cocoa production with Dutch company Original Beans are examples of value chain creation involving private sector partners demanding sustainably produced products. Furthermore, we always looking out for new opportunities for our partners.

One of the main aspects of the work with do is on product development and market access. In doing this, we work specifically with:

- Training in sustainable forestry, sustainable agroforestry, sustainable tourism
- Transfer experience and knowledge to other producers in their own and other communities.
- Introduce and elaborate processed versions of local NTFPs and Agroforestry crops.
- Development of wood products including design.
• Promotion of intensive and permanent agroforestry systems in order to reduce the felling and burning of forests for perspiration while reducing the need for agricultural land.
• Introducing highly profitable crops such as coffee, cocoa, vanilla and nuts, adapted to local conditions to increase revenue.
• Capacity building in business plan development and product marketing
• Identify and develop markets for cash crops.
• Organization development to provide quality processing of various forest products.
• Development of administrative capacity
• Strengthening certification as a marketing tool.

The first processing of raw materials - timber as well as others - begins in the forest. Here, producers' training is supported in responsible extraction and recollection, with a focus on product quality and sustainability. In processing, we seek to create capacity among manufacturers to ensure quality and improve design targeted to focus markets. Whenever appropriate, serial production is also planned and implemented in order to benefit from economies of scale. In addition, producers and partners are supported in seeking funding for basic processing equipment and working capital.

Furthermore, we mostly start out locally. Because if a company or organization cannot manage the promotion of goods and services at local level, it’s hardly going to be able to do it at national or international level. Therefore, FoW support the training of local business managers and administrative personnel to provide them with tools for successful processing and marketing of their products.

However, products produced by sustainable local forest management are often not required locally, or do not have sufficient quality for the next step in marketing. Therefore, the World Forests aim to support the development of aspects such as production volumes, quality, cost, and image / marketing to offer the products on various markets applying the relevant strategies to enter the market.

FoW also facilitates information work, advocacy and promotion at international level to help increase the demand for the various forest products, which is profitable to manage and exploit. It is expected to increase revenue among producers who will be able to continue their productive and commercial activities on their own when cooperation with FoW ends.

The below figure exemplifies intended value chain development we aim to do in relation to forest products and our level of expertise or involvement at each step of the production process depending on the product:
Of course, as the image shows, we do not work with all products at all levels, but we try to focus in the products and processes we are highly qualified in and if we are not we.

**C. Critical Areas of Attention in Value Chain Creation.**

Expression of local interest in developing a value chain initiative. This is important, due to the fact that it takes time to develop a business and a value chain, and the effort should be constant.

Also, as was already emphasized above, by focusing on value chains and not only on production, we take a more holistic approach to economic development projects. Also, in our experience, much of the product experimentation and innovation created tends to not take the market seriously, threatening the sustainability of the initiatives. The ability to act on the market/customer needs are essential if we want to promote sustainable value chains. Therefore, FoW emphasizes knowledge creation in relation to clients and end-markets as an important step to any product involvement and value chain intervention.

However, this can be bridged if a relevant company can enter early and provide the insights necessary. Such a company of course need to be patient and accept the process and time it takes. If they can they are considered part of the process and benefit from the support of FoW and the local partner.
Furthermore, any value chain intervention that FoW participates on needs to also comply with our criteria in relation forest conservation and re-investment of surplus as discussed above.

**Conclusions**

Throughout this text we have mapped the theoretical insights and practical approaches FoW takes to the use of value chains in the benefit of forest communities and with the objective of giving the forest a value that does not lead to deforestation and that increases the income opportunities of people living in and around forests.

The point of departure are of course the possibilities in the communities. The interest of community groups is important in order to assure longevity of the initiative. Market demand and access are other areas of investigation in order to assess the feasibility of a value chain.

As FoW sees nature-based value creation as a strategic opportunity we are willing to take risks alongside forest dependent communities. And we are aware of the time and resources it takes to develop value chains under difficult circumstances and with people who have not managed business before. Therefore, we build the process gradually and facilitate various important processes during the development of the value chain.

The need for enterprises to take their costumer’s desire and needs seriously in order to understand their possible strategic advantages of product quality and market potentials.

Of course, this process of strategy creation needs to be done taking into consideration our other objectives, as we are not an organization looking for a maximization of profits only. However, the need for a more sustainable income for communities is real, and FoW is ready and capable to support the creation of sustainable products and value chains as a path to the conservation of the forest and its peoples.
References:


Appendix: Tools for analysis.

After having discussed the different considerations, approaches and specificities of FoW’s approach to value chains we will now discuss some specific tools other than the value chain that are useful as additional methods to illuminate some of the points discussed above.

- Five forces
- Swot-Tows
- Process analysis matrix
- 4 Ps
- Blue Ocean strategy
- Benchmarking
- Market Analysis
- Firm survey

Why use value chain analysis?

The relevance of agro-chains for pro-poor growth:

Furthermore, in relation to FoW own objectives. Agro-industry, or in this case Agro-forestry, offers much better growth prospects than primary commodities. In addition, the market trend to break down production processes into specific tasks opens new opportunities for countries and communities to specialize and take a more profitable part in global trade, provided they meet the increasingly stringent market requirements (UNIDO 2009: 5), an aspect where FoW could be a key supporting partner.
At FoW, both the narrow and broad sense of a value chain are used to understand and tackle the main problems surrounding our projects. The broad approach is used to understand issues at the level of the communities we work with and the markets we are trying to enter and external companies we work with, while the narrow sense is used to aid the different cooperatives and enterprises we partner with to streamline their production processes.