The risks of inclusion: shifts in governance processes and upgrading opportunities for cocoa farmers in Ghana
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2
UPGRADING FOR DEVELOPMENT

2.1 Introduction
The discussions on globalisation and its impact on development emphasise the challenges faced by entrepreneurs in developing countries, i.e. intensified competition and price-fluctuations. Since the late nineties, the focus has been especially on small and medium enterprises (SMEs) (Humphrey and Schmitz, 2000; Lambooy, 2002; Maskell and Malmberg, 1999; UNCTAD, 2001). Recently, with agriculture back on the development agenda as the ‘engine for economic growth’, the emphasis has shifted from SMEs to small-scale agricultural producers (EGFAR, 2003; World Bank, 2007). At the same time, these small-scale producers are increasingly viewed as independent entrepreneurs. In order to support sustainable growth and reduce poverty, these agricultural ‘firms’ have to improve their competitiveness (Wenner, 2006; World Bank, 2007).

In the literature on competitiveness, the concept of upgrading highlights the options available to producers for obtaining better returns. Historically this concept is linked to the process of shifting from ‘Fordism’ to ‘post-Fordism’. This change includes a shift in the understanding of the process of change, moving away from the idea that state driven interventions build-up capital and technological innovation towards the idea that upgrading is the outcome of organisational learning and inter-firm networking. This paradigm, which finds its origin in political economy and industrial economics, has been applied in various bodies of literature, from cluster studies to the value chain approach (Gibbon and Ponte, 2005: 87-8). Cluster studies focus on local level governance structures, which are viewed as the main facilitators of upgrading and innovation (Helmsing, 2002; Humphrey and Schmitz, 2000; Westen, 2002). Alternatively, the value chain approach concentrates on ‘global chain governance’, which views inter-firm co-operation within the chain as a competitive advantage (Gerrefi, 1999; Humphrey and Schmitz, 2000: 14; Vargas, 2001). Essentially the value chain approach proposes that inserting entrepreneurs in value chains offers the possibility to engage in learning processes and to acquire new knowledge from external buyers (Humphrey and Schmitz, 2000; Vargas, 2001: 5).

Several authors have highlighted the limitations of both approaches and the necessity to combine the ‘horizontal networks’ with the ‘vertical networks’ (see Giuliani et al., 2005; Humphrey and Schmitz, 2000; Lambooy, 2002; Palpacuer, 2000; Westen, 2002).

In addition to being complimentary, both approaches have some important similarities. For example, both approaches assign a limited role to public sector actors. The public sector is not perceived as active intervener but rather more as an
enabler (or hinderer) of economic development. Recently the role of the state has been re-examined (cf. Griffiths and Zammotto, 2005; Lall, 2005), emphasising that national governments and institutions did and continue to play an important role in fostering the competitive advantage of industries/firms. An increased focus on the state also follows from the recent trend to directly link upgrading to development goals. The link of upgrading to development originated from the recognition that globalisation knows ‘winners’ and ‘losers’ – the gains of globalisation are not distributed equally. In the agricultural sector the small farmers are seen as the losers; only those locked into larger farm production have a chance of making a profit (Kaplinsky, 2001: 127). This recognition of varied success in reaping the gains from globalisation opened another discussion on social ‘inclusion’ and ‘exclusion’ and ‘inclusive growth’ (Giuliani et al., 2005: 6; IDRC, 2006) and on the reasons behind unequal benefits that the different actors receive. The notion that ‘global processes produce different outcomes in different settings’ also opened space to discuss ideas on ‘structure and agency’ (Post et al, 2002: 1-4).

It seems worthwhile to investigate how different governance levels separately (and in interaction) contribute to creating the upgrading opportunities and to influence the upgrading outcomes. Therefore, in this chapter I will discuss these different governance levels and how they relate to the concept of upgrading and development. I will start by introducing the concept of upgrading, its different typologies and its relevance for agricultural commodities. In this section I will elaborate on the concept of ‘inclusive upgrading’. Next, I will discuss the potentials and shortcomings of the two conventional approaches for upgrading, the global value chain approach and the local clustering approach. I will continue with a discussion on the changing role of the state in development and its theoretical underpinnings by making use of the concept of ‘state governance’. Lastly, I will discuss the need to study the interactions between different governance levels to identify more inclusive upgrading.

2.2 Defining the concept of upgrading

In the discussions on how small and medium enterprises in developing countries cope with globalisation there is an apparent agreement and a clear preferred course of action. In order to remain competitive these firms should upgrade by learning and acquiring new knowledge (Humphrey and Schmitz, 2000; Gereffi, 1999, Schmitz, 1999; Vargas, 2001). There are differences in opinion on the exact definition, typology and use of the concept of upgrading. For example, there are different types of upgrading with particular categories, such as: product, process, functional and inter-sectoral (or inter-chain) upgrading (Gereffi, 1999; Humphrey and Schmitz, 2002). ‘Product upgrading’ refers to moving into more sophisticated product lines, with increased product value. ‘Process upgrading’ is defined as transforming inputs into outputs more efficiently by re-organizing the production system or introducing superior technology. ‘Functional upgrading’ can be understood as acquiring new superior functions in the chain, such as design or marketing, or as abandoning the existing low-added value functions in favour of higher value
added activities. ‘Inter-sectoral upgrading’ refers to applying the acquired competences in order to move into a new sector (Humphrey and Schmitz, 2002). Although recognised as helpful, this classification of upgrading has been criticised for several reasons. For example, Meyer-Stamer (2002) opposed this typology because it does not provide information about the direction upgrading takes (for example ‘downgrading’) and neglects the idea that the direction can be perceived differently. Smakman (2003) argued that the distinction between ‘upgrading as a process’ and ‘upgrading as an outcome’ is not always clear. Other doubts, raised by Gibbon and Ponte (2005: 88), criticised the difficulty of distinguishing between product and process upgrading. For example, in the case of agricultural commodities the introduction of organic processes of production generates a new category of products (for example organic coffee). Should this be considered product or process upgrading? Gibbon and Ponte also had a critique on the emphasis placed on functional upgrading, which implied that this type was more optimal than the other available upgrading options. Excessive emphasis on this option also overlooks key findings of various authors (e.g. Schmitz and Knorringa, 1999; Gereffi, 1999), namely that global firms can make it very difficult for local producers to progress in functional upgrading (‘lock-in’).

Because earlier studies on upgrading mainly concentrated on small-scale industries in developing countries, some adaptation is necessary in order to adequately apply the upgrading concept and its terminology to producers of agricultural commodities. Therefore, looking at upgrading issues for producers of this type of commodities, Gibbon (2001) proposed an alternative (provisional) classification: 1) capturing higher margins for unprocessed commodities, for example through higher levels of productivity; 2) producing new forms of existing commodities; and 3) localising commodity processing (2001: 352-4).

More recent work provides alternatives to unpacking relations between upgrading and governance in GVCs, which intentionally avoids using terms such as process, product, functional and inter-sectoral. Gibbon and Ponte (2005: 91) proposed a detailed empirical analysis (on a chain-by-chain basis) ‘that identifies concrete roles that offer suppliers higher and more stable returns, as well as the routes that they typically use for arriving at them’. Such an approach would make it possible to identify the returns that actors below the level of the ‘lead agent’ accrue. Studying the global coffee trade, Daviron and Ponte (2005) tried to avoid the vocabulary of upgrading and chose instead to focus on its components: ‘the ability of producers to create and control the value’ (2005: 30).

In my study the different views on the exact definition, categorisation and adequate use of the concept are not perceived as contradictory but rather as complementary to each other. I link the different types of upgrading (what?) to the process of upgrading (how?), to its main driving forces (by whom?) and its outcomes for producers (for whom?) (see Chapter 7). I question the validity of the identified ‘goals’ (competitiveness) and ‘means’ (learning) for upgrading for producers of agricultural commodities, despite the existing agreement in the upgrading debate. These notions seem to be grounded in two basic assumptions: 1) the presence of an open market system and 2) the absence of a limit to upgrading, as long as there is

27
access to new knowledge and technologies. But these conditions are not always ‘fully’ present for the producers. In some large sectors of several commodity producing countries, there are no truly ‘free markets’. Also, with respect to access to new knowledge and technologies, small producers often face serious constraints to apply the already existing knowledge/technologies let alone seek out and adapt new innovations. Nevertheless, I recognise the importance of learning, especially in light of the increasing demand for more sophisticated commodities (for example more sustainably produced commodities) that is likely to make learning more urgent for these types of producers. In this context, it is important to know the gatekeepers of knowledge and the channels for transferring this knowledge. It also requires the acknowledgement of other ‘non-economic’ indicators of success, for example improvements in process quality, and increasing concerns about safety, health, environmental and labour standards (cf. Barrientos et al., 2001; Laven, 2007).

The idea that upgrading is not only based on better pricing and improved quality of products but that it is also important whether there is sustainable production within the chain is increasingly gaining ground (Abbot et al., 2005; Daviron and Ponte, 2005). This provides impetus and input for discussions on ‘inclusive upgrading’.

2.2.1 Inclusive upgrading

In most debates on inclusive upgrading the focus is still on insertion of the poor (in a chain or cluster). Insertion in a value chain or cluster does not automatically result in upgrading. Especially for weaker actors, upgrading can be enabled or hindered by more powerful players (including governments and NGOs) and by existing social structures. Also the gains that result from upgrading are often unequally distributed (Giuliani et al., 2005; Tiffen, no date). For example, fair trade organisations aim to pay poor farmers a fair price for their produce, but membership in such schemes is selective. Many development initiatives attempt to secure benefits for small producers by making the value chain shorter or by reconfiguring a chain. In practice this results in the exclusion of middlemen, who may also be poor and may have difficulty finding alternative employment.

As used by policymakers the concepts of social exclusion refers to a lack of material resources but also to a lack of rights. Inclusion was defined as a policy aim and a desired situation (Hospes and Clancy, 2009). Various scholars embraced the concepts of social inclusion and exclusion. In these studies it is increasingly recognised that ‘inclusion’ is not always a desirable aim and is not always wanted by the ‘excluded’ (Blowfield, 2003; Hospes and Clancy, 2009; Wennink et al., 2007). ‘Self-exclusion’ can be preferred by for example farmers that foresee too little profit and too many risks in the chain. But for ‘self-exclusion’, or inclusion under favourable terms, small producers need to be empowered to make their own informed decisions about their work and livelihoods (Wennink et al., 2007).

In value chain and cluster literature various authors took up the discussion on social inclusion and exclusion (e.g. Altenburg, 2006; Cortright, 2006; Gibbon and Ponte, 2005; Knorringa and Pegler, 2006; KIT et al., 2006; Nadvi and Barrientos,
In this study I make a distinction between a more general notion observed by Altenburg (2006) that 'value chains become more exclusive as small-scale producers fail to meet rising scale and standard requirements', and the idea of 'inclusive upgrading', whereby I refer to the outcomes and impact of interventions on weaker actors within a chain. In Chapter 7, I will further define and operationalise the concept of inclusive upgrading and highlight some of the different notions on its exact meaning.

Further in the next section, I will discuss different governance structures and will link these to the upgrading concept. The main question of interest is to discover to what extent dominant governance structures support or hinder 'more inclusive' upgrading.

2.3 Upgrading and governance
There are different possibilities of theorising governance. 'Governance' instead of 'government' implies a reduced role for the state in development. It also implies an increased role for other actors, and the configurations in the relationship between the state and these other actors (Nuijten, 2004). Although some authors asserted that the state continues to be one of the central actors in governance (e.g. Gibbon, 2001; Lall, 2005; Nuijten, 2004), others stressed that states primarily act as the facilitators of international capital instead of being the principal caretaker of social equity and well-being (Post et al, 2002: 2). This last observation, which views the state mainly as an enabler of economic development, dominates the discussion on upgrading approaches. The GVC approach focuses on global chain governance, where private actors are the main drivers in the chain. The cluster approach concentrates on the level of local governance structures, where firms and institutions compete and cooperate. While the government's influence on the 'determinants of regional advantage' is recognised (for example in Porter's Diamond Model, introduced in 1998) (Neven and Dröge, no date), nevertheless, the government is not regarded as a steering actor within a cluster. Recent debates on upgrading and development partially repositioned the role of the government, thus opening a debate on the role of the government in chain development and cluster development.

In this section I will discuss these different levels of governance and link them to the upgrading approach. I will look at governance from a wide perspective, including not only formal arrangements but 'any form of institutionalised practice' (Nuijten, 2004: 104-5), whereby governance will refer to 'both steering processes themselves and the results of these processes' (see also Kooiman, 1993; Rhodes, 2000).

2.3.1 Global Value Chain analysis
Global value chain (GVC) analysis is an analytical tool used in a variety of domains. GVC analysis has its roots in world systems theory and dependency theory. The GVC approach first appeared in the literature under the term global commodity chain analysis, as introduced by Hopkins and Wallerstein (1986; 1994) and further developed by Gereffi and Korzeniewicz (1994). Originally, 'global commodity chain
analysis’ was concerned with agricultural products, but Gereffi was mainly concerned with industrial commodity chains and the development of a unified theoretical framework that would make it possible to identify upgrading strategies for firms and thus change existing power relations within a chain (DFID, 2004). A commodity chain refers to ‘the whole range of activities involved in the design, production, and marketing of a product’ (Gereffi, 1999: 38). The terms value chain and commodity chain are often used interchangeably. Using the term value chain reflects the understanding that value is added at each point of the chain (Smakman, 2003; Vermeulen et al, 2008: 14). Essentially the primary returns – economic rents – accrue to parties who are able to protect themselves from competition by creating entry barriers (Kaplinsky and Morris, 2003).

Gereffi distinguished between four dimensions in the value chain: 1) their input-output structure, or the sequence of interrelated value-adding activities (including product design and engineering, manufacturing, logistics, marketing and sales); 2) the geographical coverage, which refers to the spatial dispersion or concentration of activities within and across locations; 3) the global chain governance, which is defined as ‘authority and power relationships that determine how financial, material, and human resources are allocated and flow within the chain’ (Gereffi 1994: 9); and 4) the institutional framework that defines the local, national and international conditions and policies that in turn shape the environment where firms operate (Gereffi, 1994; Gibbon, 2001; Smakman, 2003). Because of the discussions on upgrading and its link to development goals, the institutional dimension has increasingly gained in interest (see Daviron and Ponte, 2005; Gibbon 2001; Tiffen, no date; Westen, 2002). It is essential to include the institutional framework in value chain analysis as it recognises that chains are not ‘closed systems’. They receive external inputs in terms of knowledge management (technical research institutes, extension services) and they are influenced by: advocacy movements (trade unions, NGOs) that work on environmental or social issues; policy priorities set by national governments or international organisations (e.g. World Trade Organisation, World Bank, or United Nations agencies), and by social structures (e.g. on the organisational level of producers or traditional hierarchical relations). Furthermore, the institutional framework is important because it either provides effective channels through which quality standards can be introduced as part of upgrading or it creates barriers that block this exchange. For example, sanctioning may also take place outside the chain (Kaplinsky and Morris, 2003: 16-8).

Although the importance of the institutional dimension is recognised in GVC analysis, institutions are not regarded as active actors with governing power. In the value chain literature there is a different ‘approach’ that looks more at ‘the totality of structures and relations around specific commodities, including relations of power’, namely the Francophone filière tradition (see Box 2.1). This approach was mainly used to look at the upgrading patterns in primary export commodities.

Despite the benefits of the filière approach and methodological similarities between this tradition and my study, I prefer the GVC approach. The main reason is that the
analyses of the filière tradition attach more importance to the technical side of the material flow than to the role of social actors. It has also been criticised for an excessively strong ‘quantitative tradition’ and its rather static analyses (Raikes et al, 2000).

The majority of studies that use a GVC perspective focus on labour-intensive manufacturing (cf. Humphrey, Knorringa, Morris, Schmitz). Cramer (1999) was the first to highlight the necessity for broadening the focus of value chain analysis to also include primary commodities. He stressed the particular importance that upgrading agricultural export commodities has for developing countries; it is their main link to the global economy. A number of authors have taken up this notion and analysed several agricultural commodity chains, primarily focusing on cocoa and coffee (see Gibbon, 2001, 2003; Fold, 2002, 2004; Gibbon and Ponte, 2005; Kaplinsky, 2004; Ponte, 2002; Daviron and Ponte, 2005) but also looking at cotton (Larsen, 2003) and tobacco (Vargas, 2001). Studies on these agro-based commodities tend to be more normative than studies on labour-intensive manufacturing, which seldom go beyond ‘observing’ differences in power. They reflect the initial thinking on global commodity chains, which has its roots in dependency theory.18

Development agencies and policymakers have also adopted GVC analysis, by employing this perspective as a point of departure for drafting international agricultural development strategies.19

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**Box 2.1  The filière tradition**

The filière tradition, influenced by studies on agriculture in the US in the 1950s and 1960s, was developed by French researchers at the Institute National de la Recherche Agronomique (INRA) and the Centre Internationale en Recherche Agronomique pour le Développement (CIRAD) as an analytical tool for empirical agricultural research. In contrast to the GVC analysis (which aims at developing a unified framework), the filière approach includes ‘several different schools of thought’, with the ‘common characteristic that they use the filière (or chain) of activities and exchanges as a tool to delimit the scope of their analysis’. The filière approach is more a ‘meso-field of analysis’ than a real theory. It is seen as a ‘neutral, value-free technique applied to analysing existing marketing chains for agricultural commodities’.

The filière approach started in the 1960s by studying contract farming and vertical integration in French agriculture. It was soon applied to the analysis of the production and marketing chains for selected export commodities that were produced in France’s (African) colonies, such as: rubber, cotton, coffee and cocoa. Initially the studies mainly dealt with local production systems and consumption patterns, because state institutions controlled all trade and processing. The main focus was on the way in which public institutions affected local production systems. It has been argued that this type of analysis was used to justify the maintenance of interventionist systems (such as the price stabilisation funds) because the French research showed negative consequences of market liberalisation on developing countries. Recently, the filière approach has started to focus more directly on issues of trade and marketing.

One of the main traditions within the filière approach is its ‘empirical research tradition’, with its main objective ‘to map out actual commodity flows and to identify agents and activities within a filière, which is viewed as a physical flow-chart of commodities and transformations’.

So far GVC analyses have focused on global chain governance. However, the value chain literature can seem confusing as the concepts of ‘chain governance’ and ‘chain coordination’ are often used interchangeably. Because they are a central focus of this study, I will further elaborate on these concepts in separate paragraphs.

**Chain governance**

Value chain governance helps unravel the determinants of income distribution and opportunities for adding value, by highlighting the factors that determine the nature of the insertion of different producers into the global division of labour (Kaplinsky, 2001: 124-9). In discussions on chain governance, generally a distinction is made between two types of chains where the producers have different positions (Gereffi, 1999). Producer-driven chains are found in capital and technology intensive sectors. Technical knowledge and high levels of capital prevent new producers from entering these sectors. Multinationals are the central players in such chains, which are complex and multi-layered, often marked by international subcontracting of the more labour-intensive parts of the process. In contrast, buyer-driven chains are found in more labour-intensive sectors, where design and marketing are centrally controlled (such as garments and footwear) and in agro-commodity chains (such as cocoa and coffee).

Both producer-driven and buyer-driven chains are seen as vertical networks. In buyer-driven chains the so-called ‘lead firms’ include large retailers, branded marketers, and branded manufacturers. They act as strategic brokers who link producers and markets; their privileged knowledge of strategic research, marketing and financial services grants them this privileged position (Gibbon, 2001; Gereffi, 1999). Lead firms (as a group) control certain functions that allow them to dictate the terms of participation by other actors in different functional positions in the value chain. Lead firms use entry barriers to generate different kinds of ‘rents’ (Kaplinsky and Morris, 2003). Immediately upstream of lead firms, there are other powerful agents who do most, or at least a large share, of the day-to-day work of chain coordination. These firms are defined as first-tier suppliers and have their own suppliers, so-called second-tier suppliers, which can have their own suppliers, and so on (Gibbon and Ponte, 2005: 99-104).

This distinction between producer and buyer driven chains has been challenged from different perspectives, which questioned its relevance in analysing agricultural commodities. For example, it has been argued that this classification does not reflect governance patterns in agricultural commodity chains. According to Gibbon (2001), international traders govern a growing number of agricultural commodity chains (e.g. coffee, cocoa, cashews), for which he proposes to use the term ‘international trader-driven chain’. Fold opposes the distinction between buyer and producer driven chains from another point of view. According to Fold (2002: 230) this:

> crude dichotomy (...) fails to acknowledge the more complicated patterns of power relations between lead firms in global chains – or, at least those for agro-industries. (...) This distinction does not help specify the dynamics of ‘drivenness’ in certain global chains.
This idea of ‘degrees of governance’ is very relevant for a growing number of agricultural value chains that are becoming ‘increasingly buyer/trader-driven’ (Fold, 2002; Humphrey and Schmitz, 2000). The concept of chain coordination was introduced in this context; it focused on ‘inter-firm relationships and institutional mechanisms through which non-market coordination of activities in the chain is achieved’ (Humphrey and Schmitz, 2002: 7). Gibbon and Ponte (2005: 163-4) made a clear distinction between governance and chain coordination, arguing that ‘a GVC may be characterized by different forms of coordination in various segments, yet a relatively coherent form of overall governance’. In other words, a lead firm may control the value chain without controlling each segment of the chain.

Chain coordination

Humphrey and Schmitz (2000) distinguished between three types of coordination: 1) ‘network relationships’ based on co-operation between equals; 2) ‘quasi-hierarchy’, or ‘captive relationships’, combining cooperation with asymmetrical power relationships in which buyers dominate over suppliers; and 3) ‘hierarchy’, associated with vertical integration, where the buyer takes direct ownership of the operations. When buyer and supplier do not need to collaborate in defining the product, because either the product is standard or the supplier defines it without reference to particular customers, the term ‘arm’s-length market relationships’ is used. In the literature, the arm’s-length market relationships are often considered a fourth type of chain coordination.20

According to Humphrey and Schmitz (2000: 15), the buyers’ (traders) risks for losses from the supply chain failure is a factor that determines the type of relationships between local producers and external buyers. According to them due to ‘the increasing importance of non-price competition based on such factors as quality, response time and reliability of delivery, together with increasing concerns about safety and standards’, buyers have become more vulnerable to shortcomings in the performance of their suppliers. Different studies in developing countries have demonstrated that in response to the upgrading challenge, the relationships between local producers and their external buyers (traders) change (e.g. Gereffi, 1999; Nadvi, 1999). In addition, there are also changes in the relationships between other actors, for example between manufacturers and retailers (Gibbon and Ponte, 2005). However, the reasons for the types of shifts differ greatly. Humphrey and Schmitz (2000) expected that increased risks of supplier failure would result in a shift from arm’s-length relations to more active forms of cooperation between buyers/traders and suppliers, such as network and quasi-hierarchical relations. But, according to Gibbon and Ponte (2005: 163), this shift towards so-called ‘hands-on’ forms of coordination does not necessarily occur. They argue that ‘if economic actors are able to embed complex information about quality in standards, labels and certification procedures, they may still be able to operate with more hands-off forms of coordination’ (ibid). Also, it is not clear how the specifics of the value chain (‘tight or loose’ organisation) are linked to a particular outcome for producers (see also Kaplinsky, 2000; Kaplinsky and Morris, 2003). These uncertainties imply that there are power relations in a chain that have to be unravelled, as poor producers run up
against them (see also Kaplinsky, 2001: 140). They also indicate that besides risks for buyers there are other risks involved, namely for producers, who are generally not the main drivers in a chain.

In recent debates on upgrading and social in- and exclusion an important question was raised: how can ‘the poor’ enter global chains? This emphasised the risks for small-scale producers to remain (or become) excluded from these types of chains. However (as already argued in Section 2.2) including the poor in value chains does not automatically result in upgrading. Inequalities that exist in a society – endorsed by social and political structures at local, national and global levels – largely determine who will benefit from inclusion. In this study I chose to focus more on the changing conditions under which producers are inserted in global value chains, what I call ‘the risk of inclusion’.

**Limitations of the GVC approach**

Notwithstanding its potential use, the GVC approach has some limitations. Despite its institutional dimension, it has the tendency to ignore the importance of local governance structures, the role of the government and international regulation (Gibbon, 2001; Humphrey and Schmitz, 2000; Smakman, 2003; Vargas, 2001). Although the influence of public regulation and trade policy instruments is acknowledged (e.g. by Gibbon and Ponte, 2005) it does not recognise that institutions can play a steering role in value chain development and upgrading issues. Another observation is that in studies that apply a value chain approach authors who incorporate the institutional dimension tend to focus only on formal arrangements (e.g. Daviron and Ponte, 2005). They leave out the influence of informal institutions, such as the existing social structures in which local producers are embedded.

The tendency to focus on ‘lead firms’ is another limitation in the discussion on GVCs’ impact on development and on their potential to become more inclusive in the context of liberalisation. As lead firms are the main coordinators of agricultural value chains, their decision-making patterns have been extensively reviewed (cf. Altenburg, 2006). But, in order to obtain a full understanding of GVCs and their links to development, in addition to lead firm also attention should be paid to the suppliers/producers in the sector (i.e. agricultural export commodity sector) and the observed heterogeneity among them. I think that upgrading strategies should intentionally address different types of producers. Not only do these suppliers form the large majority of all the actors who are involved in the production of agricultural export commodities but they also are the weakest ‘link’ in the chain; they do not control their own upgrading agenda. Leaving them out makes the case that there is an inherent bias in existing studies that use GVC analysis. They focus on parts of the chain where upgrading is more manifest and ignore the actors/parts of the chain where upgrading is marginal. I assert that in order to link upgrading to development it is important to focus on the heterogeneity among suppliers (see Chapter 6 for more details).

Regarding the differences among producers, generally a distinction is made between large and small primary commodity producers (Gibbon, 2001; Kaplinsky,
2004), which neglects non-economic factors (e.g. social position, gender, regional backgrounds). This excessive focus on vertical relationships in a chain constrains the analysis further as it does not capture more local inter-firm relations, for example joint actions among producers. The clustering approach addresses this shortcoming.

2.3.2 The clustering approach

In contrast to the value chain literature, the cluster literature views inter-firm cooperation within a single geographic area (rather than within the chain) as the source of competitive advantage (Humphrey and Schmitz, 2000: 14). This body of literature suggests that local level governance – by networks of public and private sector institutions – facilitates upgrading strategies (Helmsing, 2002; Humphrey and Schmitz, 2000). Having relationships in a cluster facilitate the creation of new products and services.

Despite a growing body of literature on clustering the concept is still rather vague offering multiple versions of a comprehensive definition (Boschma and Kloosterman, 2005; Cumbers and Mackinnon, 2007: 959-60; Guiliani et al, 2005). Simply defined, clusters are ‘agglomerations of firms operating in the same or in interconnected industries, within a spatially bounded area’ (Pietrobelli and Rabellotti, 2005). Other scholars consider the presence of institutions and of linkages between institutions and firms as a minimal requirement for defining an economic locality as a cluster (cf. Porter, 1990). Porter, who is regarded as one of the most influential geographical economists (Cumbers and MacKinnon, 2007), introduced the cluster approach defining clusters as,

‘geographical concentrations of interconnected companies, specialised suppliers, service providers, firms in related industries, and associated institutions (for example universities, standard agencies and trade associations) that compete but also co-operate’. (Porter, 1998)

The cluster approach has been widely adopted in developed countries, focusing on small-scale industries in Europe. Building upon these experiences (in particular from Italy), an agenda was set for research in developing countries (Knorringa, 1999; Schmitz, 1989; Schmitz and Nadvi, 1999: 1503-4). When looking at clusters in developing countries, the emphasis tends to be on ‘industrial upgrading’ and the rise of specialisation (Ceglie and Dini, 1999; UNIDO21, 2004; McCormick, 1999; Humphrey and Schmitz, 2000; Lambooy, 2002; Maskell and Malmberg, 1999; UNCTAD22, 200123). A number of case studies, looking at clustering in developing countries, concluded that in these countries clustering: favours incremental innovation, does not appear spontaneously (as was the case with Italian clusters) and often depends on external interventions (Knorringa, 2002; Cegli and Dini, 1999). There are some interesting examples of successful interventions aimed at fostering co-operative relations within SME clusters drawn from the experiences of Brazil, Mexico, India (by Nadvi, 1995) and Chile (by Humphrey and Schmitz, 1995).

Two frameworks are widely applied when studying clusters in developing countries: flexible specialisation (by Piore and Sabel in 1984) and collective efficiency (by
Schmitz in 1995). Both models have been criticised for their shortcomings. The framework of flexible specialisation could not be applied to many developing countries, because it made unrealistic assumptions on the availability of machinery, skills and trust in clusters. The framework of collective efficiency was criticised because it missed critical elements like external linkages (Neven and Dröge, no date: 5-9). In 1998, Porter introduced a new framework, the ‘Diamond Model’, which alleviated some of the limitations of the existing frameworks. This model proposed four interrelated factors, each representing a determinant of regional advantage: 1) firm strategy, structure and rivalry; 2) demand conditions; 3) factor conditions; and 4) related and supporting industries. Two additional factors, ‘chance’ and ‘government’, complete the model. These two factors are not determinants but influence the first four factors. Together these six factors form a system that differs from location to location; thus it can explaining why some firms (or industries) succeed in a particular location while others fail (adapted from Neven and Dröge, n.d.: 4). In recent work, Porter (2008) conceptualised the relationship between clustering and competitiveness by taking into account the role of the macroeconomic-context (see Figure 2.1).

Figure 2.1 Conceptualising clustering and competitiveness

![Diagram of diamond model](source: Adapted from Porter, 2008.)

Over the years various scholars have emphasised the importance that external linkages to the cluster have for enhancing competitiveness and reducing the possibility of negative lock-in (e.g. Bell and Albu, 1999; Guerrieri et al., 2001; Humphrey and Schmitz, 2001; Neven and Dröge, no date; Schmitz and Nadvi, 1999). Nevertheless, these linkages are still largely ignored and weakly theorised. This limitation does not pose a problem for my study, as I intend to combine this horizontal approach with the global value chain approach. The consideration of the interactions between these approaches incorporates the importance of external linkages within the analysis. The clustering approach complements the GVC approach and generates some new insights regarding the local governance structures and the facilitators of competitive advantage.
An associate problem with the clustering approach is its over-emphasis on industrialisation and SMEs in development debates, while paying little attention to other ways of adding value and to other actors. This focus has unfortunately shifted the attention away from agricultural sectors, where poverty still is concentrated. In the cluster literature the recent shift back to agricultural development is reflected in the growing attention paid to agro-food clusters, for example fishery, tobacco, diary, and others (Porter, 2008; Visser, 2004). Viewing these types of ‘clusters’ mainly from a value chain perspective has produced limited effects. It chiefly examines inter-firm cooperation within the chain as the source of competitive advantages while neglecting the added value of the spatial approach and local-level governance processes.

In this study, I will explore the added value of the cluster approach in analysing upgrading strategies for small-scale producers of agricultural export commodities in developing countries. I will concentrate on some of the central concepts used in the cluster literature: ‘collective efficiency’, ‘joint action’ and ‘embeddedness’.

**Collective efficiency, joint action and embeddedness**

A central hypothesis is that ‘upgrading [which is] necessary to respond to the new pressures[,]requires a greater joint action by local firms’, which can be facilitated through strategic intervention in areas such as technological development or environmental upgrading (Kennedy, 1999). Joint action is perceived as a way to overcome problems of size, dependence on buyers and lack of knowledge and capital. ‘Collective efficiency’ and ‘joint action’ as a more ‘deliberate force at work’, introduced by Schmitz in 1995, have become central concepts in the cluster literature. ‘Collective efficiency’ is defined by Schmitz and Nadvi (1999) as the ‘competitive advantage derived from external economies and joint action’. External economies (positive or negative externalities) are seen as a passive component of collective efficiency, while the intended effects resulting from joint action are perceived as the active component (Neven and Dröge, no date: 5). Nevertheless, joint action and collective efficiency do not automatically take place. Different studies have shown that specific conditions are required, such as the existence of effective sanctions and trust (both within clusters and within their trading connections). In this context, clearly the existence of a shared language, culture and norms are important factors. Trade networks are another key precondition for collective efficiency (Schmitz and Nadvi, 1999: 1506-7). For joint action to take place it is important that there are incentives to work together, as joint action can involve opportunity costs (see also Deven and Dröge, no date: 5).

Joint action as a potential way for upgrading is a relevant strategy for small producers of primary export commodities. Individually, these suppliers have little to no bargaining power. This disadvantage is especially worrying for producers who have to negotiate directly with big buying companies. Also for the buyers joint action is important and they even may exert pressure on their producers to cooperate, for example for quality reasons or for requested volumes. In a recent trend, buying from producer groups has become a kind of marketing strategy for buyers to demonstrate that they source their cocoa in a socially responsible way (‘Fair Trade’ products are a clear example). The farmers can achieve economies of
scale by cooperating and working together. It can also contribute to time-efficiency and learning. Before promoting joint action, it is important to consider the existing extent of joint action among producers, in case it is absent, why it is lacking. If joint action is desirable, the relevant questions are who can facilitate such a process and what type of organisation, if any, is required?

The cluster literature uses the concept of ‘cluster governance’ to refer to the intended, collective actions of cluster actors aimed at upgrading a cluster (Gilsing, 2000). Gilsing warned that clusters can have very cohesive and integrated structures but may not be very inclined to adapt when circumstances change. As a consequence, firms can lose their competitive advantage because of emerging weaknesses in their environment. Westen (2002: 51) was one of the authors who pointed out that clustering does not automatically favour innovation or help local firms to compete globally. Advantages from clusters usually derive from an ‘optimal mix between cooperation and competition among its members’. When this balance is disturbed clustering can jeopardize competition. Understanding the conditions under which such an optimal balance can occur requires insight in the level of ‘embeddedness’ of economic activity. In this study, I will follow the version of Mark Granovetter, who reintroduced the concept of ‘embeddedness’ in 1985, emphasising the importance of social groups in which people are embedded. Many of these social relationships are geographically localised. People are not simply workers or managers; they are also consumers, citizens, church-goers, kin, and community members. Such social interactions that enhance economic efficiency are also known as social capital (Westen, 2002: 229).

Limitations of the cluster approach

One of the main limitations of the cluster literature is its lack of theorising external linkages. The cluster literature overemphasises the need to improve co-operation and local governance. Even the resources for product and functional upgrading are seen as mainly deriving from within localities themselves (Humphrey and Schmitz, 2001). The dynamics of change within clusters themselves is another area that has been neglected; clusters are often treated as static. Especially clusters in developing countries need to be able to deal with radical changes in their environment (Gilsing, 2000; Halder, 2002; Knorringa, 1999). Another limitation is that the path a cluster should follow is not always clear. Some authors have argued that a focus on ‘key turning points’ can facilitate our understanding of the trajectories of clusters, such as the introduction of marketing reforms in developing countries. Another already mentioned observation is the assumption that upgrading occurs on the cluster level. This seems to overlook the idea that clustering does not benefit all of its firms equally; some groups of firms may even be completely left out (this point was also raised in earlier work of Knorringa, 1999; Nadvi and Schmitz, 1994). Recent studies emphasised that ‘exclusion’ does not only exist among firms, but also among groups within a firm. For example, there are clear signs that particular categories of workers, especially women and unskilled workers, lose out when a cluster upgrades. So far only few cluster studies have explicitly addressed these poverty concerns (Cortright, 2006; Knorringa and Pegler, 2006; Nadvi and Barrientos, 2004: v).
Similar to the GVC approach, the cluster approach pays little attention to the governing role of the state. With all these limitations noted, nevertheless concentrated assessment of the local governance structures (focusing very much on networks between institutions and firms) does provide more room for examining hybrid types of governance, where institutions and firms jointly govern a cluster.

2.3.3 What about the role of the state?

Linking upgrading to development reopened the discussion on the role of the state in both ‘chain development’ and ‘local economic development’. In the 80s, the idea that the state was the governor of trade relations and competitiveness was widely accepted. The success of industrial policy of the ‘Asian Tigers’ and its failure elsewhere, let some authors to conclude that it is not about whether a government should intervene but more on how it should intervene (cf. Lall, 2005: 58). From a political economy perspective, the role of institutions and their interactions with the private sector play a prominent role in fostering the competitive advantage of industries/firms (cf. Griffiths and Zammuto, 2005). Griffiths and Zammuto proposed an integrative framework that drew on both the strategic management and political economy literature to explain variations in national industrial competitiveness. Their study gave an important input for the development of a more dynamic comparative framework for labelling public-private interaction in a GVC. This new framework included two fairly independent dimensions that influence economic governance and decision-making, and thus define the conditions for economic transitions within a particular sector: 1) the fragmentation of the integration of the value chain (McGahan and Porter, 1997); and 2) the level of state involvement versus coordination through market mechanisms (North, 1981; Hall and Soskice, 2001). The framework points out four types of interaction in a commodity chain: ‘state governance’ (a situation where transactions are coordinated through state involvement and the value chain is coordinated through market forces), ‘joint governance’ (a situation where transactions are coordinated through state involvement and the value chain is coordinated through chain integration), ‘market governance’ (a situation where transactions and the value chain are both coordinated through market forces) and ‘corporate governance’ (a situation where transactions are coordinated through state involvement and the value chain is coordinated through chain integration) (figure 2.2).

This framework makes it possible to identify the direction of change over time. The concept of ‘state governance’, originating from the political economy approach, traditionally paid more explicit attention to the role of the state. In this school of thought, the state is regarded as the governor of trade relations and competitiveness.

It is often argued that trade liberalisation and structural adjustment have reduced the mandate and the ability of the public sector to make specific pro-poor interventions. However, even within liberalised markets governments have a significant role to play. For instance the public sector plays an important role in advocating sustainability and the fair distribution of power among actors in value
chains. It can also play a role in creating more favourable conditions for agricultural sector development (see also Joosten and Eaton, 2007: 125). In fact, government led interventions in the agricultural sector have been crucial in most countries with successful agricultural sectors (Berdegué et al., 2008).

Although it is important to reconsider the role of the public sector, I have some doubts that the public sector is truly an ‘enabler’ and also assert that this does not reflect the reality in the economies of developing countries. I believe governments in developing countries cannot be considered neutral players in their economies, the lessening of their role in agricultural development is still a fairly recent phenomenon in most countries. Governments (still) represent the interests of certain economic sectors and groups within society, with some powerful personal interests also playing a role. Moreover, the government of the developing country has a very limited capacity, especially in an African setting, to manage successful interventions geared at pro-poor agricultural development. The same holds true for other actors, such as producer organisations, private companies and non-governmental organisations. These actors also need to be strengthened in order to enable them to overcome pervasive market failures and to secure desirable social outcomes in their countries (World Bank, 2007). To ignore the role of state in policy designs is to ignore the fact that in some countries or sectors the government still plays a steering role. This oversight severely limits the analysis and it ignores the opportunities and constraints for action.

2.4 Linking different governance levels
Both the value chain approach and the cluster approach focus on processes of economic governance, where the interactions between private sector actors are the potential catalysts for change. The GVC approach fails to integrate the importance
of local-firm cooperation and local governance structures. On the other hand, most studies that utilise a cluster approach fail to integrate global governance processes, with some notable exceptions (see Guiliani et al., 2005; Humphrey and Schmitz, 2000; Nadvi and Halder, 2002). Both approaches also pay little attention to the role of the state. Several authors emphasised the interaction between different governance levels as a good avenue for understanding upgrading, both the processes and their outcomes on competitiveness and poverty. In addition to approaches that link global chain governance (GVC analysis) to local level governance (cluster literature) (cf. Humphrey and Schmitz, 2000; Westen, 2002; Guiliani et al., 2005) there are other possible combinations. Earlier I introduced approaches that link strategic management theory to political economy (Griffiths and Zammuto, 2005; Ton et al., 2008). This can provide a more dynamic comparative framework for studying public-private interaction (e.g. state involvement versus coordination through market mechanisms) in a global value chain.

In this study I use both combinations and I look at the interaction between different governance level in creating opportunities and constraints for more inclusive upgrading among small-scale cocoa farmers in Ghana. The idea of ‘rational choice’ dominates the upgrading discussion and emphasises the leading role of ‘modern’ actors. For the African setting, it is much more appropriate to consider the interaction between governance structures in the global value chain, national governance structures and social structures, because there the functioning of the producers is very much affected by traditional structures, the role of the state and the capacity of the state to play this role.