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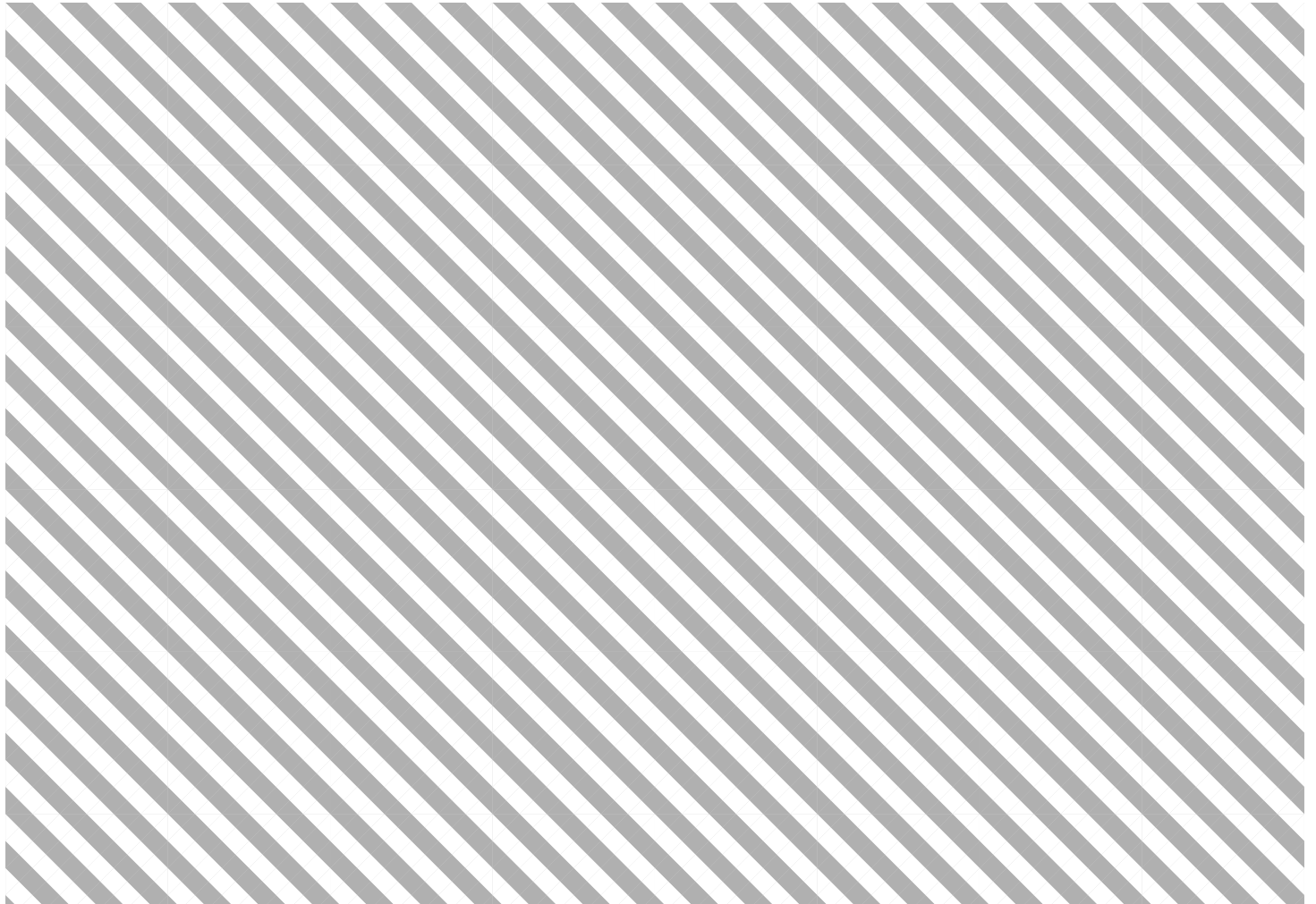
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White Paper

# No Such Thing as a Commodity

## Routes to higher value added for SMEs in developing and least developed countries

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# Foreword

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Small and medium-sized enterprises (SMEs) have a central role to play in achieving the aim of inclusive economic growth within the Sustainable Development Goals. SMEs constitute the backbone of most economies, representing the majority of firms and the principle source of employment. The degree to which they are competitive and able to innovate will determine the success of developing and least developed countries in reducing poverty. Most SMEs in these countries are in commodity-based sectors, where volatile international markets determine the value of their output. Unable to differentiate themselves, these small producers receive only a minor share of the final price at which their products are sold.

The degree to which countries depend on commodities correlates with poor performance on a range of development indicators. For this reason, governments and international organizations alike have promoted economic diversification towards non-commodity sectors, including services and manufacturing activities linked to global value chains. Unfortunately, this does not automatically lead to escaping the trap. If these activities are low value added and undifferentiated from the output of other countries, they, too, can become another form of commodity.

If mechanisms can be found for large numbers of small firms to improve and innovate their products and services, share solutions for transforming, exporting and commercializing what they produce, and connect more directly with end customers, then a significant contribution could be made to reducing their dependency on commodities.

This White Paper takes its inspiration from the management lesson offered to large firms over the last 50 years: that all products and services can be differentiated through innovation and by practising good business and marketing principles. Recognizing that much has changed over the last five decades, particularly with the rise of globalization and digitalization, the paper asks what small firms can now do differently, and what aspects of this change are applicable to developing and least developed countries.

To investigate this potential, the authors propose a framework to categorize the different paths to higher value addition that may be open to SMEs, using success stories to illustrate the approaches and show potential for wider innovation. The paper then summarizes the findings into recommendations for policy-makers, development actors and firms looking to support SMEs towards this destination.

# Introduction

“There is no such thing as a commodity. All goods and services are differentiable,” wrote management theorist and author Theodore Levitt in 1980.<sup>1</sup> Originally addressed to American and multinational enterprises, this rallying call for innovation is the inspiration for this White Paper, which examines how the same rationale applies to the challenge of reducing dependency on commodities in developing countries. If all goods and services can be differentiated, then perhaps new approaches for doing so are still possible after 40 years of innovation in global trade and technology.

When Levitt issued his polemic, enterprises were suffering from the early stages of globalization – namely, increased competition and eroding margins. The solution was to better understand and serve distinct market segments, differentiate through improved products and services and later outsource non-core functions to local and offshore partners. The lessons, however, have not been sufficiently applied by the many small and medium-sized enterprises (SMEs) that make up the backbone of most economies. SMEs contribute more than 50% of employment and 40% of gross domestic product (GDP) in developing countries.<sup>2</sup> Improving their value added and profitability can have a significantly positive spillover effect<sup>3</sup> on economies and communities.<sup>4</sup> Properly equipped and supported, small firms can pursue a path of becoming less dependent on commodities.

## Box 1: What is a commodity?

The term “commodity” is used in a technical sense to cover products from the primary sectors of the economy – farming, forestry, fishing and extractive industries – where all or most value addition has occurred in that sector. In marketing terms, it refers to a service or good, sold on its purely technical characteristics, that is not significantly differentiated from equivalent competitive offerings. Thus, it is generally not branded. Yet a commodity – mangoes, for example – can be differentiated through marketing, such as via branding and packaging, and sold at a premium to undifferentiated competitors.

Commodity dependence occurs when commodities are the main source of export revenue – that is, when commodity exports account for more than 60% of a country’s total export merchandise value. Commodities’ value can fluctuate significantly (as much as 50% a year), significantly affecting national revenue in commodity-dependent countries.

Sources: United Nations Conference on Trade and Development (UNCTAD) STAT, *Free Market Commodity Price Index: Methodological Note*, 17 May 2018, [https://unctad.org/en/PublicationsLibrary/statcpbmn1\\_en.pdf](https://unctad.org/en/PublicationsLibrary/statcpbmn1_en.pdf); UNCTAD, *The State of Commodity Dependence 2016, 2017*, <https://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=1883>.

Commodity dependence can result in cyclical downturns, unstable levels of investment, low-paying jobs and poor development outcomes for life expectancy, education and income per person. About 68% of the world’s developing countries depended on commodity exports in 2014-2015, while approximately two-thirds of them recorded a low or medium human development index in 2014.<sup>5</sup>

Effective national policies and good governance have helped some countries achieve balanced economic growth despite their significant dependence on commodities. For example, in Chile, copper remains an important source of revenue, accounting for about 46% of the country’s exported goods in 2016.<sup>6</sup> The government has taken measures, however, to improve macroeconomic stability; encourage trade; invest in infrastructure, employees and entrepreneurship in non-extractive sectors; and diversify the economy. Its National Innovation System develops and implements innovation policies and initiatives financed by copper royalties.<sup>7</sup> Chile is one of the strongest economies in Latin America in terms of GDP per person<sup>8</sup> and human development.<sup>9</sup>

Commodity-dependent countries have pursued different paths to diversify their production and seek routes to higher value added. Macroeconomic policies have favoured investments in high-tech manufacturing and services, as well as the promotion of investment by lead firms in global value chains (GVCs). Participation in GVCs could promote specialization among SMEs, encourage investment and improve competitiveness and access to international markets.

Such policies have been somewhat successful at diversifying economies and creating jobs in new sectors. Nevertheless, the debate goes on about how much GVCs can be solely relied on to lift countries towards developed status.<sup>10</sup> Commodity-dependent countries must consider how to create and retain more value for their production, irrespective of how much their economies have diversified.

This paper reviews the effect of digitalization and globalization on new paths to higher value added. Through more sophisticated production, marketing and distribution, commodity producers can differentiate their output, position themselves in developed markets and reduce or eliminate the connection to commodity market prices. The paper seeks to show this potential via case studies of firms; these examples, in turn, infer recommendations for policy.

Digital technology and communications have revolutionized how procurement, production and trade are organized. In principle, any firm, large or small, can procure its inputs from the most competitive supplier, trade online with the highest-value customer and optimize production operations through digitalization. Decades of globalization have created networks of suppliers that can provide world-class inputs, reducing the need to invest in every step of production and distribution.

Recognizing this potential and the mechanisms through which firms can pursue higher value added is only the beginning. Governments and development partners need to engage in developing capacities – and providing access to finance – to enable SMEs to pursue a path to higher value added.

# Routes to higher value added

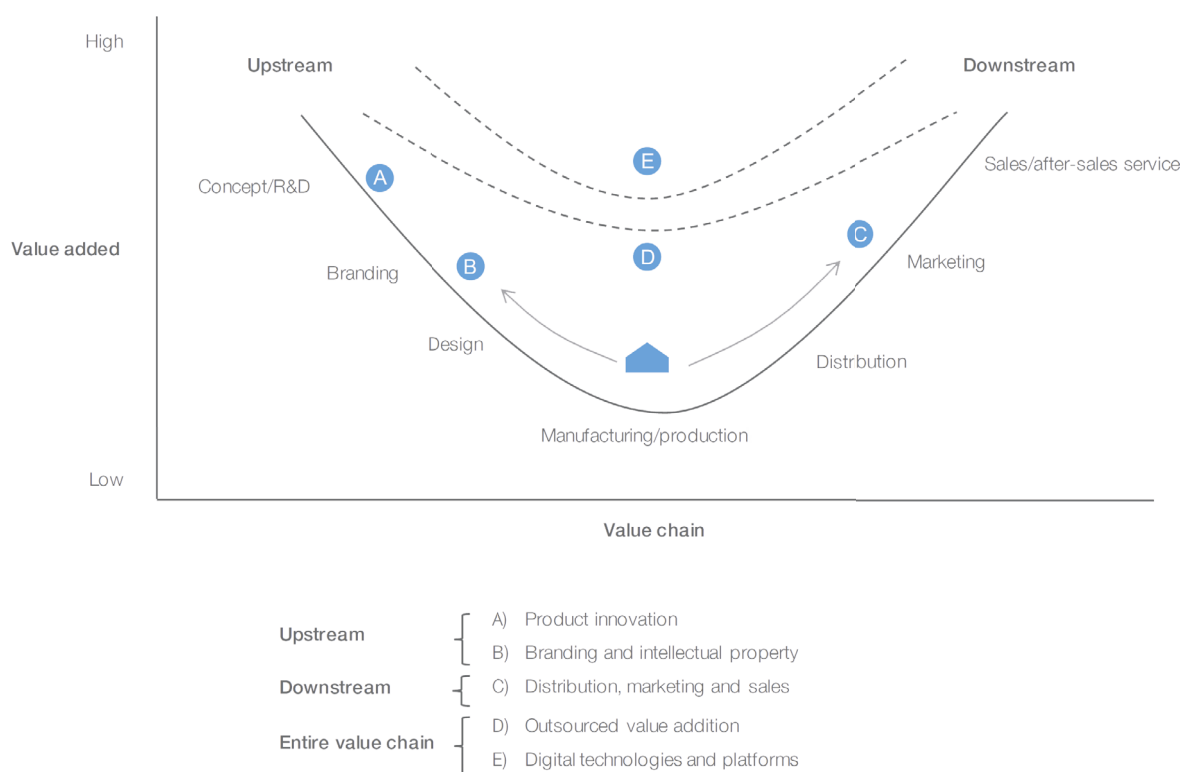
Global value chains (GVCs) offer small and medium-sized enterprises (SMEs) the opportunity to become more fully integrated in the global economy. Instead of manufacturing entire products from scratch and carrying all the associated costs, small firms can simply perform one step of a wider production process. Specialization can create the conditions to invest in quality and innovation, thus driving increased value.

The value retained by small firms within these GVCs, however, depends on where they sit along the chain. For example, producing a complex piece of technology often begins with research and development (R&D) and product design. These high-value tasks demanding advanced skills are typically the core competence of international firms and are conducted from headquarters. Manufacturing the product and assembling its components often take place in developing countries, where unit labour costs are low.<sup>11</sup> Marketing, sales, distribution and after-sales services may be conducted through partners in the value chain but are typically tightly controlled by the lead firm and occur in more developed economies closer to the end consumer.

This process is summarized in a simplified abstraction known as the “smiling curve” (see Figure). First espoused in 1992 by Acer founder Stan Shih, the curve is used to review the strategic positioning of information technology (IT) manufacturers in Taiwan, China within global production chains.<sup>12</sup> The smiling curve suggests that most of the economic gain from the value chain occurs during product innovation or in later stages closest to the end customer. The lowest economic value is in the production of goods or commodities, signified by the droop in the middle of the curve.

Unfortunately, SMEs tend to operate in the domestic informal sector in most developing countries and are “price takers” for their goods (i.e. market participants that cannot dictate prices). If they do participate in global networks, it is largely in labour-intensive and low value-added production areas, such as agriculture or low-tech manufacturing. Producing commodities is equivalent to sitting at the bottom of the smiling curve.

**Figure:** The smiling curve and five routes to higher value added



Source: James Howe, Senior Adviser, International Trade Centre, Geneva, 2018



Rapid globalization and digitalization have created new possibilities for enterprises to challenge their position as producers of commodities. When participating in global value chains, firms are exposed to new knowledge and techniques that can be used independently of their original role in the chain. As illustrated by the Figure, this paper suggests the following five paths for SMEs in developing countries to reduce their dependency on low-value production and shift their position on the smiling curve:

**A. Product innovation:** R&D and product design, once the domain of highly skilled workers in developed countries, can now be performed by small producers working with international partners and innovating for newly accessible markets. International actors and collaborative tools on the internet can help with these interactions, as digital networks democratize access to market information and research.

**B. Branding and intellectual property:** Simply understanding their product's value is an important starting point for millions of poor producers, especially when it may have some intrinsic differentiation and value (such as distinctive properties or origin). Small producers from developing countries can strengthen brand reputation, thereby establishing new and more profitable sales channels and positioning themselves in higher-value market niches. Rather than relying on their position as a producer within a GVC, firms can explore their own routes to market, with their brands protected under intellectual property and benefiting from licensed distribution arrangements.

**C. Distribution, marketing and sales:** Wholesale and retail partners in the world's most advanced economies are increasingly finding new ways to collaborate with producers from developing countries. In turn, this promotes access to retail channels and innovative product formulations. In addition, consumers in developed countries are becoming more interested in product origins, thus creating an opportunity for SMEs in developing countries to seek more direct routes to market, including through e-commerce channels.

**D. Outsourced transformation and services:** Globalization has created a network of international service partners able to take on segments of the value chain on a contract basis. Supply networks are becoming increasingly transparent and open through digital platforms, allowing SMEs to find suppliers and engage in global sourcing. In practice, formulating and packaging products can take place wherever it is most efficient to do so, relieving small firms of the need to invest in machinery and related processes.

**E. Digital technologies and platforms:** Underpinning these new routes to value addition is the growing use of digital technology and communications. They allow firms to become more competitive at all steps – from design to sales. Thanks to digital platforms, suppliers in developing countries can sell directly to consumers, differentiate their products online and establish digital contracts at a distance.

# Product innovation

With globalization, small firms have better access to market opportunities around the world. No longer limited to local markets, inputs and business partners, such firms can pursue new possibilities in higher-value international trade. Requirements do need to be met, however, starting with product quality and adapting to the needs of international markets. Product innovation can create significant value, but it requires capabilities that traditionally resulted from years of steady effort and investment. Small firms based in developing countries have new options to accelerate this approach – for instance, by collaborating with international firms or other partners.

## Learning through participation in the value chain

Participating in the supply chains of multinational enterprises (MNEs) can expose developing country SMEs to new technologies, management models and materials,<sup>13</sup> and to opportunities to learn by doing. Knowledge will improve across the industry if firms absorb these new technologies and methodologies. Producers themselves may innovate on product design or composition, moving upstream from basic manufacturing towards design.

An early example of product innovation resulting from participation in the value chain was the development of technologically innovative soccer balls in China. Since the 1980s, global companies such as Adidas and Nike have outsourced soccer ball production to smaller manufacturers in Asia, creating an entire industry devoted to the product.<sup>14</sup> While the process led to new jobs and skills for Chinese workers, the smaller producers were still relegated to low value-added tasks. The large multinationals carried out the upstream high-end concept and product design tasks and much of the downstream marketing and distribution.

The situation changed in 1997 when the Taiwanese firm Top Ball developed the capability to machine-stitch the commonly used 32-panel ball. This innovation allowed factories to produce up to 40 balls per day versus five balls when stitched by hand. According to Khalid Nadvi, Senior Lecturer in Development Economics, University of Manchester, United Kingdom, “this was a radical transformation that revolutionised the football sector in China and allowed China to substantially increase its global market share.”<sup>15</sup> In 1998, Adidas began sourcing these machine-stitched balls from Top Ball, completing the upstream transformation of this small firm from simple

manufacturer to product designer. This transformation began with GVC lead firms sharing new skill sets and technologies necessary for creating a product, which in turn increased the knowledge base for soccer ball producers in the region more widely.

## Adapting to new tastes and preferences

Globalization has not only afforded MNEs access to low-cost labour in developing countries, but also connected small producers in remote locations to larger and wealthier consumer markets. These markets offer great opportunity, given the right product.

Coffee has provided producers and markets with a recipe for transformation. LetSequoia, a social enterprise based in Rwanda, the Democratic Republic of the Congo and Burundi, empowers local populations through economic opportunities in the coffee sector. Founder Inyoung Anna Kim was inspired to innovate its product formulation and packaging after meeting with international companies, including eBay and DHL, at an International Trade Centre (ITC) event. Supplying high-quality coffee directly to customers in Europe from the producer online was a potential opportunity, but doing it profitably would require developing a premium product. Aware of the higher margins in the single-serve coffee market, Kim sourced capsules compatible with Nespresso coffee machines. An immediate buyer, eBay, was available for testing and promoting the new product internally. In addition, a European packaging supplier was able to supply biodegradable capsules – a point of difference that, together with the product’s quality and freshness, could justify premium pricing.

Coffee has great potential for innovation and improved value retention in the countries of origin. To start, producers must be educated about their product’s true value in international markets. The Taste of Harvest coffee competition, organized by the African Fine Coffees Association (AFCA), brings local coffee producers together to showcase some of the continent’s best coffees. Once competitors are made aware of their coffee’s quality, they can negotiate better prices more easily. The competition also teaches processing, cupping and roasting techniques.<sup>16</sup>

Appealing to local and international customers can further evolve the transition to higher value-added propositions. Many small producers start to experiment with roasting locally and develop a strong local clientele at outlets near the coffee farm, such as coffee shops, hotels and bus

stops.<sup>17</sup> They learn to distinguish customer preferences in these locations. The AFCA organizes internships with larger cooperatives and firms operating internationally to familiarize them with the roasts and blends preferred by foreign customers.<sup>18</sup>

The growing market for “natural coffees” is another example of successful product innovation and differentiation. Dry processing is used where water is scarce; the full cherry is sun-dried before the coffee beans are extracted. For several years, these coffees were considered over-fermented; however, if done right, they produce a bold, fruity flavour and are finding a new audience among international coffee connoisseurs. The Taste of Harvest competition now judges them as a separate category, recognizing their appeal to different markets and tastes.

### Box 2: Innovating for new markets

Novica, an e-commerce platform, markets artisan-produced handicrafts to international customers and handles all logistics and payment processes on behalf of the producers. Artisans are able to focus on design and production, while Novica handles packing, shipping, quality control, testing and branding. The platform’s local representatives advise producers on innovative product ideas, namely how to add value to their products while incorporating references to their regional culture.

Roberto Milk, Novica’s co-founder and chief executive officer, notes that the platform also provides market intelligence to its producers-turned-designers. It supplies users with data on how well certain items sell, including click-through rates, conversions and price benchmarks. This gives producers the market intelligence for creating new products for specific markets.

Leonor Martiniez, a new Novica designer based in Ayacucho, Peru, was discovered by one of the platform’s agents. She was earning a marginal income by occasionally producing knitwear, but Novica representatives helped her to develop a line of mini knitted sweaters to use as Christmas ornaments. Leonor now regularly produces similar items and employs local women in the production. Better designs that appeal to international customers allow the artisans to charge higher prices.

Source: Interview with Roberto Milk, Co-Founder and Chief Executive Officer, Novica, by the ITC and World Economic Forum, 18 September 2018

## Partnering with international firms

Partnerships with large international firms can lead to product innovation. The fashion accessory firm Della is an example. Launched by Los Angeles, California native Tina Tangalakis in partnership with the local Ghanaian entrepreneur Selorm “Nii” Addotey, Della describes itself as a “socially responsible fashion line that provides jobs, education and skills training”.<sup>19</sup>

In 2012, Tangalakis entered into an agreement with US technology company Apple to create a series of exclusive, limited-edition cases for the company’s MacBook series of laptop computers. Della’s employees in Ghana hand-made colourful cases from locally sourced materials.<sup>20</sup> Apple ensured the cases met the necessary technical specifications and tested and approved the finished product. The resulting designs were highly innovative and appealed to Apple’s more socially-minded customers. Della continues to sell the cases through its e-commerce website.

# Branding and intellectual property

Branded products are the opposite of commodities. Once a product is recognized for its distinctive attributes and origins, it can no longer be easily substituted: as a brand, it carries a value beyond that of a basic commodity. Brand reputation can insulate products normally considered commodities from price volatility and enable a firm to earn much higher margins. Building such a reputation for the brand can be a long and costly process and has traditionally been the preserve of firms from developed countries. But globalization and its consequences have helped to generate new findings and tools here, too. Moreover, new potential exists to efficiently and cost-effectively create brands owned and managed by small firms, or groups of such firms, from developing countries.

## Associating the brand with high quality

A strong brand creates differentiation, justifying higher prices in targeted market segments. Take coffee once again as an example: although commonly traded on commodity exchanges, it can be highly differentiated into categories such as “appellation”, “specialty”, “gourmet”, “organic”, “fair trade” or “eco-friendly”.<sup>21</sup> The Ethiopian Trademarking and Licensing Initiative, launched in 2004, worked to trademark three distinctive specialty coffees (Yirgacheffe, Sidamo and Harar) on behalf of Ethiopia, and is credited with making a significant contribution to the jump in earnings achieved by the sector and its producers.<sup>22</sup>

Malawi’s Mzuzu Coffee Planters Cooperative Union positions its product as a specialty coffee and has used reputation-building events, such as the Taste of Harvest competition, to build recognition, strengthen its brand and secure additional buyers.<sup>23</sup> Winners of the competition will be allowed to use a logo on their packaging and communications – for many, a first step in building brand recognition.

The pashmina sector in Nepal provides another example. The local word for cashmere, pashmina refers to the fine, soft wool from goats in Kashmir and the neighbouring region, and is one of the 19 commodities promoted by the Nepal Trade Integration Strategy. In 2017, the Enhanced Integrated Framework, a multilateral partnership assisting least developed countries to use trade to support growth and development, and the ITC worked with the Government of Nepal to develop a brand strategy for Chyangra Pashmina, a label collectively owned by the Nepalese cashmere sector and the government. Pashmina’s reputation had been damaged by counterfeit products, inadequate quality controls and unreliable product labelling. The project set out to

correct these failures by working with sector participants to improve the value chain and building a shared commitment to promote high-quality products to international buyers. The brand was built to convey the use of high-quality wool and adherence to social and environmental standards.<sup>24</sup>

## Connecting with end consumers

Reputation depends on building trust and a connection with the end consumer. While small firms generally cannot afford to invest in significant marketing communications, they do have the potential to capitalize on their individual stories and use digital platforms to target customers.

Brand storytelling can be a powerful way to connect with potential customers and is very important for Novica. The platform’s branding strategy includes telling the personal stories behind each product and artisan. A new generation of consumers is increasingly demanding to know where products are sourced and the stories behind them, and is willing to search for distinctive products.<sup>25</sup>

For Chyangra Pashmina, producers in the pashmina sector could not afford to launch the new brand in the United States and Japan through classic media channels. Cost-effective approaches through digital channels were explored, with a social media campaign finally launched using organic posts and modest paid promotion. The campaign raised awareness of the Chyangra Pashmina brand among 1.3 million social media users and created a highly focused fan base in an international audience. Several important influencers were also reached, including high-profile bloggers and boutique owners. Social media allowed Chyangra Pashmina to extend its brand awareness and reach within the fashion market; it positioned itself more prominently as a high-end product and garnered more attention from consumers and potential industry partners.<sup>26</sup>

## Securing value by protecting intellectual property

Owning a brand and effectively escaping the commodity trap can be a significant source of value to firms in developing countries. Inherent in brand ownership is intellectual property (IP), in the form of trademarks, copyright or geographical indications.

Enforcing IP rights can be critical to generating income for cultural groups vulnerable to commercial exploitation. Over many years, cultural references and images of the Maasai,

an indigenous group of 2 million-3 million people from Kenya and Tanzania, were used to promote products, including in developed countries, without consulting the group. Moreover, tourism posters of Maasai people were sold in Parisian subways, and even shoes branded as “Maasai Barefoot Technology” sold for \$300 per pair with claims that wearers would be able to “walk like the Maasai”.<sup>27</sup> In 2009, the group’s elders contacted Margaret Brindle and Ron Layton, authors of *Social Entrepreneurship for Development: A business model*. In consulting Brindle and Layton, Maasai leaders wanted to regain control over their image and ensure they would benefit appropriately from its use in international markets.

The challenge was to understand how to define the Maasai brand and protect and manage its use. The strategy included analysing why the Maasai IP was valuable, why companies found the use of tribal images on their products attractive, what the brand value was in terms of market size and which IP tools to use (e.g. trademark, licensing). A seven-part strategy resulted to recover the Maasai IP and build the brand into a sustainable source of income.

The Maasai Intellectual Property Initiative Trust was set up to ensure the Maasai people would own their brand and be able to license IP rights. Checks and balances were established within the initiative to ensure transparency of revenues for all Maasai district representatives, as well as Maasai non-governmental organizations (NGOs) and community organizations. The initiative’s team set up connected programmes to increase value retention by labelling authentically produced local products and licensing the use of the brand. The African IP Trust was employed as an advocate for the Maasai people to apply public and legal pressure on MNEs to respect the Maasai trademark. Applications for the certification mark of “Maasai” and “Masai” were filed in Tanzania and other target countries, along with requests to cancel trademarks registered by enterprises without approval.<sup>28</sup>

# Distribution, marketing and sales

Importers and retailers, who make up the value chain's distribution segment, traditionally retain a high share of a final product's value in the food<sup>29</sup> and consumer goods<sup>30</sup> sectors. Those margins are under pressure from increased transparency in trade and the potential to bypass the role of the importers and retailers.<sup>31</sup> Retailers suffer under price competition from e-commerce channels and also need to respond to changing consumer tastes. They are thus looking to develop direct relationships with producers to increase margins and source unique inventory to drive customer traffic. These trends – the opening of retail to distinctive products and the disintermediation of importers – offer small firms from developing countries the opportunity to enter new markets and retain a higher share of the final sales price.

In recent years, consumers in developed countries have become both increasingly interested in understanding the origin of the products they buy and more concerned about the working conditions among producers.<sup>32</sup> In fact, the trend towards greater compliance with sustainability standards is clear; for example, the growth of sustainable agricultural products that conform with internationally recognized standards is outstripping markets for conventional products. Coffee is poised to become the first sustainable commodity with at least 25% of its production compliant with one or several sustainability standards.<sup>33</sup>

## Benefiting from supplier training

Walmart, the world's largest retailer, relies on a range of SME suppliers and provides training materials and best practices through its Responsible Sourcing Academy Training Portal. The retailer is implementing its Global Compliance Guidance Tool, which will allow suppliers to communicate information regarding their product, origin and destination and get the full list of requirements to meet Walmart's standards.<sup>34</sup> Its Women's Economic Empowerment Initiative has set targets and worked to increase sourcing from women-owned businesses and artisans through training and technical support.<sup>35</sup>

The Walmart de Mexico Foundation chose 30 Mexican farmers based on their project proposals and provided them with training on business development, packaging, compliance with standards and manufacturing best practice

over 13 months. Following this, products will be tested in Walmart stores for 180 days.<sup>36</sup> In Central America, Walmart's *Una Mano para Crecer* (A Hand to Grow) programme has been operating since 2007 to develop suppliers' ability to create new products, management skills and access to new markets.<sup>37</sup> The Chinantlan Agroindustrial Cooperative in Nicaragua, producing wine, juice and jam, has become a supplier through this programme.

## Featuring in pop-up markets at retail stores

Stiff competition from online retail has forced traditional brick-and-mortar retailers to innovate and offer customers new experiences at their stores that cannot be found online. Macy's, the US-based department store chain, has introduced in-house pop-up markets branded as The Market @ Macy's at some of its locations. They allow smaller brands to utilize prime retail space; benefit from marketing, set-up and sales expertise; and access the chain's customer base. Moreover, Macy's allows those brands to keep 100% of their sales.<sup>38</sup> Importantly, the producer can focus on its brand vision while Macy's handles the logistics and staffing; this allows online brands which don't have physical stores of their own, such as Love Pop Cards, to access retail space. Real-time data analytics on product sales, the number of customers at the store and conversion rates are provided.<sup>39</sup> Apparel by brands Tanvi Kedia from India and J. Salinas from Peru have been featured, as have products by Love Is Project, a social enterprise that offers products from different artisanal communities around the world.

Similarly, Pop-In@Nordstrom is a series of pop-up shops featuring different designers at the US retailer's physical and online stores. After working with the Mexican Consulate of Seattle to create a concept, Nordstrom featured Mexican artisans and designers under the theme *¡Viva México!* in August-September 2018.<sup>40</sup>

## Using e-commerce platforms as a stepping stone

The rise of e-commerce platforms has provided a route for developing-country SMEs to distribute products on better terms, have more control and visibility over pricing and, in some cases, become micro-retailers themselves through branded online storefronts.<sup>41</sup> Barnhill Organics, a Jamaican

skincare line made from natural products, has developed an online platform for selling its goods and also sells internationally through Amazon.<sup>42</sup> The company sources its ingredients from Caribbean islands, increasing opportunities for local farmers to upgrade their production to organic standards and raising production quality and prices.

In October 2018, Ethiopian shoe manufacturer soleRebels opened its 22nd retail location, in Hamburg, Germany. With a business model based on eco-sustainability and community empowerment, the shoes are handmade by locally trained artisans from Ethiopian designs, and recycled tires are used to make the shoe soles. The company engages in an extensive social development programme and is recognized as the first Fair Trade-certified shoe manufacturer. Headquartered in Addis Ababa, soleRebels also has stores in the United States; Greece; Singapore; and Taiwan, China.

From the beginning, e-commerce has formed part of the firm's international growth strategy. Early partnerships were forged with e-commerce giants Amazon, Endless, Javari and EU-based footwear retailer spartoo.com. Seeking independence and direct contact with end consumers, soleRebels launched its own e-commerce store, [www.solerebels.com](http://www.solerebels.com). The company also licenses stores and allows retailers to buy the product wholesale, providing free pairs of shoes for staff to wear, signage, banners and window displays to better market the brand. The powerful combination of sustainable manufacturing, excellence in branding and retail management, digital communications and e-commerce is driving the growth of soleRebels' international business. The company has even greater ambitions, targeting 500 global soleRebels branded retail stores and revenues of \$1 billion by 2028.<sup>43</sup>

## Leveraging subscription models to target high-end consumers

Low sales volumes can make international distribution too costly for small firms. An innovative alternative is to offer repeat orders through online retailers using a subscription model. Pacari, a family-owned Ecuadorian enterprise, chose to sell its high-quality, organic chocolate in the European market through the subscription-based online retailer Cocoa Runners.

Cocoa Runners sells assortment boxes of sustainably sourced chocolate to its global network of subscribing customers. It works directly with farmers, cooperatives and chocolate makers and markets directly to consumers, effectively cutting out traditional intermediaries.<sup>44</sup> The online retailer has built its reputation on a distinctive, high-quality product and is able to attract a niche of high-end consumers.

Founded in 2002, Pacari sells the first single-origin organic chocolate made entirely in Ecuador – “from tree to bar”. The firm works directly with small-scale farmers to ensure fair compensation and sustainable farming practices.<sup>45</sup> The firm sells its products in more than 42 countries through distributors, in its physical store in Quito, and through its website and own online subscription service.<sup>46</sup>

## Adopting a multichannel retail strategy

Small coffee farmers tend to earn less than processors, roasters, importers and retailers because they are far removed from the end consumer in the value chain. Through cooperatives, they can use their collective power to negotiate with importers and roasters. The Pachamama Coffee Cooperative, for example, was set up in 2001 as a California-based cooperative owned by producers in Latin America. The three original member cooperatives (from Peru, Nicaragua and Guatemala) plus two additional ones (from Mexico and Ethiopia) each own a membership share and collectively represent over 100,000 farmers. Pachamama brands and distributes members' coffee, and recognizes that consumers in developed countries are increasingly interested in buying from known origins and producers. The aim is for the coffee to become attractive to connoisseurs, similar to the evolution of fine wines.<sup>47</sup>

Initially, Pachamama sold its coffee to food cooperatives in North America. While it continues to sell at the wholesale level, the cooperative has also developed direct channels to consumers. This includes a retail café and an e-commerce website. At its Roastery Coffee bar in Sacramento (USA), customers can drink the coffee, tour the roasting facility and learn more about the business model.<sup>48</sup> Its website allows consumers to subscribe for delivery of packages of freshly roasted coffee and to send coffee as gifts.<sup>49</sup>

# Outsourced value addition

Outsourcing became a key feature of global value chains as they grew in importance and proliferated. Large companies in advanced economies found it commercially viable to outsource different parts of the value chain to other countries depending on labour costs and availability of skills. SMEs became suppliers of goods and services in these chains. Now, small firms have the opportunity to benefit from outsourcing production processes that other actors can undertake more efficiently. Some studies have found that while most SMEs do outsource some logistics tasks, they could outsource more, creating opportunities for increased efficiency and lower costs.<sup>50</sup>

## Collaborating on value addition

The poorest producers often have little power or the financial means to transform their commodities into higher-value products. Bringing firms together to share resources or to establish a local value chain has been shown to work in developed countries: cooperative models have driven the development of some of the world's most valuable clusters, whether in textiles in Italy or champagne in France. Similar models are being applied in developing countries and lifting the value produced by a cluster's members. The Cotton Association of Zambia commercializes the varied products of its members. Organized into a cooperative, the value chain's entities sell to one another at market prices: farmers to ginners, ginners to spinners and spinners to weavers. The cooperative shares earnings among its firms, upgrades the production quality and negotiates on behalf of its members.

Firms can become collectively stronger by working in cooperatives; it also helps them add shared capabilities that would be beyond any individual member. More significant and radical upgrading of commodity products can be undertaken by outsourcing parts of the value addition to business service partners.

## Using global trade networks for value added

A company may ask: Why invest in expensive packaging equipment when a service partner close to the consumer has the ideal solution at a lower cost and higher quality? Such was the case for LetSequoia, a social enterprise operating in Rwanda that sources packaging solutions for its African-grown single-serve coffee in Europe.<sup>51</sup> By outsourcing roasting and packing, the firm can conform to local quality and taste requirements at a competitive cost. Multinational partners provide the links to market: DHL handles European fulfilment and eBay online sales. This "inverted" global value chain demonstrates that coffee can be sold by producers, with the help of logistics partners,

directly to customers in international markets. Meanwhile, the firm is also investing in local roasting facilities in Africa, building local cooperatives' capability to develop their own regional trade.

LetSequoia is not alone in seeing the potential of innovative coffee formulations. Cafés Pierre André, based in Libreville, Gabon, buys its coffee locally and from neighbouring Cameroon and the Democratic Republic of the Congo, packages it in Lavazza or Nespresso-compatible capsules and sells roasted coffee to consumers or in bulk.<sup>52</sup> Its coffees are distributed throughout Central and West Africa and as far away as France.

Chocolate, like coffee, provides commodity producers with great opportunities to enter higher value-added segments. Ghana, the world's second-largest grower of cocoa beans, is home to a number of producer-driven value chain initiatives, including the growers' cooperative, Kopa Kokoo, which owns 44% of UK- and US-based Divine Chocolate.<sup>53</sup> In addition, Niche Cocoa, with headquarters in Ghana, began as a commodity processor exporting cocoa solids for transformation in developed countries. But in 2011, under the direction of Chief Executive Officer Edmund Poku, the company evolved its strategy to refining cocoa into finished chocolate products, including bars, powders and drinks.<sup>54</sup>

Niche Cocoa is growing its business and diversifying from its commodity base, balancing a portfolio of customers for semi-finished cocoa products and chocolate in local, regional and international markets. Rather than abandon the sale of cocoa solids entirely, Niche has targeted high-value segments, including organic, Fair Trade and Rainforest Alliance Certified beans. The company produces a range of branded consumer chocolate products in Ghana, which it markets through local retail channels (it is expanding this business in West Africa). Niche began in Europe by supplying the German chocolate industry with cocoa solids transformed into cocoa liquor by a Hamburg-based partner. In parallel, the company produces a white-label, bean-to-bar product for a German company.<sup>55</sup> By working with value chain partners and customers in this way, Niche has been able to explore building a presence in Europe for its chocolate before making capital investments.

The company is now ready to go further and acquire a minority stake in a melting facility in Hamburg. This will allow Niche to serve European chocolate manufacturers by delivering cocoa liquor and cocoa butter on a just-in-time basis to their refining facilities. This experience is steadily building Niche's capabilities to eventually sell its own branded chocolate in Europe and elsewhere.<sup>56</sup> The company has also benefited from the ITC's Alliances for Action initiative.



# Digital technologies and platforms

Digital technology, which has improved and spread over the past decade, has opened new paths for small firms in developing countries to sell directly to global consumers. In addition, the technology allows these firms to understand the international market and sign digital contracts, to access automated platforms for selling and shipping their products, and to process payments – all while keeping costs to a minimum. Services such as Skype and Google Translate have made it easier to communicate across distances and borders. New technologies, including blockchain, are enabling smart contracts and better tracing of the origin of products and producers.

Nonetheless, new risks of commoditization and eroding margins arise from the growth of price comparison websites, price matching offers from retailers and online bidding. Yet despite these pressures, small firms in developing countries are increasingly using digital platforms to engage in downstream activities, such as marketing and sales, as well as in upstream tasks like market research, branding, concept and design. New digital routes to market, including mobile-friendly e-commerce platforms, provide an easy and efficient way for local producers and small firms to directly connect with global customers.

## Connecting to consumers via e-commerce platforms

E-commerce platforms help small producers to sell their goods outside their immediate vicinity. One such platform is GoCoop, which helps weavers and weaver cooperatives in India sell beyond their region to other parts of the country and abroad. It provides a range of services to assist producers in improving their offering and accessing new markets. Most of the producers using GoCoop create luxury saris by handloom. Often located in rural areas, the weavers use the online marketplace to connect to more established markets willing to pay more for origin-identified artisanal products. The platform runs on mobile devices and can be used easily in remote areas.

India has over 1,000 handloom and craft clusters. GoCoop identifies clusters with products likely to be attractive in domestic and global markets and visits the villages to hold workshops, introduce producers to the online platform and train them on how to use the internet and access information about different markets. These outreach efforts enable the platform to sign up the most committed groups and artisans.<sup>57</sup>

Such was the case for Koyyalagudem Weavers, established in 1950 and one of the oldest cooperatives in its region. Although locally reputed for its home furnishings and dress materials, the cooperative lacked a national sales presence, internet access and IT equipment until GoCoop approached it in early 2014 on the suggestion of the Department of Handlooms and Textiles. Restricted to selling locally, Koyyalagudem Weavers overly relied on a few clients; moreover, its orders were unreliable and it offered poor payment terms. GoCoop registered the cooperative as a business partner on the platform, created the cooperative's first online presence and trained its staff. Koyyalagudem Weavers then started receiving orders from domestic and international buyers, including Fair Trade retailers from the United Kingdom and Europe.

GoCoop's sales grew over 230% in 2017 and are expected to more than double in 2018. The platform has over 30,000 consumers and 55 domestic and international retailers and designers sourcing and buying handcrafted products. It works with 330 cooperatives, NGOs and master weavers, with an estimated base of over 85,000 artisans. The platform retains 8-15% of sales generated, depending on the product category and producer's status (cooperative, master weaver or NGO). Founder and Chief Executive Officer Siva Devireddy believes that, despite existing challenges for handloom weavers and cooperatives, e-commerce social platforms are useful tools not only for sales and marketing, but also for creating the identities of the weavers and cooperatives and sharing their history, traditions and products.<sup>58</sup>

## Building a following on social media

Social media can be a highly cost-effective way of building awareness among a targeted audience. Indeed, firms from developing countries are using this to significant effect.

The Chyangra Pashmina brand was able to quickly generate a following on Facebook in Japan and the United States, to connect with fashion opinion leaders and to drive sales enquiries. In short time and on a low budget, the collectively owned label established a link with international buyers. LetSequoia believes the effective use of digital marketing through platforms such as Instagram and Facebook led to a sharp rise in its 2018 sales. Founder Inyoung Anna Kim noted: "Social media is the only way we can communicate with the outside world."<sup>59</sup> The company stresses maintaining a continuous, direct dialogue with customers through social media and has received significant orders because it reaches buyers online.

## Harnessing data intelligence through online platforms

Novica found from a study of its sellers that the most appreciated service was neither financial assistance nor marketing support, but the market intelligence data provided by the site – that is, web analytics giving insight on conversion of visitors into customers and on the level of pricing.<sup>60</sup>

This information provides sellers with better knowledge about the drivers of demand and helps them understand their products' value. Firms like Algopix offer market research software for companies selling online, with tools tailored to specific marketplaces, such as eBay and Amazon. For its part, Amazon provides some information to sellers on its Sellers Central resource centre on sales and traffic. These big data analytics, available to small firms, are enabling better market entry strategies based on information that used to be available only to the largest companies.

Powerful though this big data may be, they are of no value to small firms that do not master the basics of managing a business in the digital age. A formal culture needs to be established, namely structured processes to manage production, inventory, orders, customer services and financial accounting. All too often, small businesses in developing countries launch themselves into e-commerce without the accompanying competence and fall foul of e-commerce platform requirements and expectations of international customers.

# Conclusion

To tackle the challenge of inclusive economic growth in the 2030 Sustainable Development Goals, the value created and retained in the primary sectors of economic activity of commodity-dependent countries needs to be addressed. Diversifying into additional sectors is good, but sustainable and significant upgrades in the value achieved from commodities is even better.

Setting out on this journey to improve value added and value retention means starting with an understanding of where and how to succeed at this within the global value chain. Depending on a product's distinctive qualities and its origin, as well as the capacity of producers to organize, producers will have greater or lower potential to negotiate.<sup>61</sup> Importantly, these strategies should not be seen as a zero-sum game among developing country producers. The increase in margins should be linked to higher consumer value or at least to capturing some of the value from intermediaries.

Small firms in commodity-dependent countries can radically increase their operating margins by applying solutions gleaned from globalization and enabled by digital technologies. A local producer of cocoa in Ghana need not rely on consumer goods firms in developed countries to design and launch a new range of flavoured chocolate bars. Now, concept testing and identifying partners in product design and formulation can be done online.

Coffee producers in Rwanda no longer need to invest in local roasting and packaging facilities. Instead, they can outsource the packaging, as well as the processing done to world-class standards, by negotiating with service providers who are close to the final customer. Sophisticated legal devices, such as IP protection and contracts for marketing and distribution, can be managed through partners on behalf of producers in developing countries. Rather than see their IP given away or abused, the Maasai can negotiate royalties and see a future where their culture and heritage is valued and remunerated. E-commerce marketplaces are opening up new channels directly to customers and creating transparency on pricing. Artisans in India's rural communities better understand the value of their handicrafts and obtain much higher prices for their work. Getting closer to the consumer leads to higher prices and knowledge of what commodities are worth.

The case studies have shown how these steps to significantly increase value are already being applied by a select group of entrepreneurs. However, they also serve to remind parties how exceptional these examples are; indeed, the developing-country entrepreneurs able to capitalize on

new potential benefits of globalization and digitalization are in a small minority. With the current accelerating changes in technology and global trade, a new generation of entrepreneurs has the opportunity to realize significant value addition in commodities, with consequent impact on millions of low-income producers. Partnerships with international enterprises can open access to services in areas such as packaging, transformation, logistics and transportation. Governments and international agencies need to collaborate with the private sector to ensure local capacities grow across a broad range of required skills – from digital literacy to using the legal instruments of IP, to contracting and understanding international markets and global value chains.

Moving forward, the recommendations include:

- Ensure access to affordable and appropriate technologies that in turn enable access to the internet, training and support for firms in their use of digital communication tools
- Build alliances between international, regional and local value chain actors to support access to advanced product transformation, marketing and distribution services
- Promote entrepreneurial skills in formulating, transforming, marketing and distributing products in developing countries; educate and inform on undertaking these tasks with the support of online partners
- Enable SMEs to take advantage of local and international world-class services
- Create business structures in commodity-dependent countries for shared access to advanced support services and mutually owned trademarks, marketing, branding and distribution arrangements

Though small firms are the essential actors in generating local economic value, few will achieve the potential for value added in trade by acting alone. Collective action is necessary to support their success: by governments adapting policy, by institutions promoting producers and collectives, by consumers exercising their power and by private-sector leaders willing to invest in a future of profitable and sustainable commodities. Commodity-dependent countries must recognize this new potential and build strategies to grow and retain value in their current production, as a priority and as a complement to diversifying their economies.

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