Chapter 1. Introduction

While underway for decades, the globalisation process has recently accelerated, as shown by the substantial growth of world imports and exports since the 1980s and, more recently, of foreign direct investment (FDI). The way production of goods and services is organised has also changed. Most notably, the set of productive activities that leads a product from conception to market is increasingly spread across several enterprises and countries. While the reasons are known why such a complex organisation of production emerged, less evident are the effects that the globalisation of value chains has on small and medium-sized enterprises (SMEs), which are more followers than leaders in this process. This study is concerned with the issue of how globalisation of value chains and of large enterprises affects the role of SMEs as traditional partners, suppliers or distributors for larger firms. It explores the benefits of SME participation in global value chains, the challenges SMEs face, and proposes policy actions when appropriate.

This report is structured as follows: the introduction describes the notion of value chain and value chain analysis and explains the methodology of the study; Chapter 2 presents an overview of the changes in the organisation of production at the world level and identifies, on the basis of the existing literature, the main consequences of the globalisation of value chains for SMEs; Chapter 3 illustrates the main elements characterising the globalisation process in five industries selected for this study; Chapter 4 presents the findings of the case studies carried out in the five industries in several OECD and non-OECD member economies to investigate the degree of awareness, involvement and success of SMEs with respect to the participation in global value chains; and finally, the report concludes by highlighting policy recommendations.

The notion of the value chain

The phenomenon of globalisation of production can be usefully analysed through the notion of the industry value chain. The value chain model has been extensively used by researchers to map the linkages and networks at the firm and industry level and to analyse where value resides at these two levels. At the firm level, the basic model of Porter (1985) helps determine which specific activities give organisations a competitive advantage and build their value. The activities are divided into *primary activities* (those that enable the firm to fulfil its role in the industry value chain and hence satisfy its customers) and *support activities* (those which are necessary to control and develop the business over time and thereby add value indirectly). The effective management of primary and support activities generates margins for the firm. In other words, the organisation is able to deliver a product/service for which the customer is willing to pay more than the sum of the costs of all activities in the value chain.

The analysis of the value chain at the firm level is meant to investigate the creation of value within the firm, and to identify the points in the internal chain where the value can be more successfully created. An enterprise's value chain for competing in a particular industry is embedded in a larger stream of activities that are referred to in the literature as

the industry value chain. This includes, upward, suppliers and, downward, distribution channels. A company able to manage effectively the entire industry value chain can gain a competitive advantage over its competitors. In light of this, one central issue in the value chain approach is that of value chain 'governance'. This term is used to describe all efforts aimed at systematically reducing any source of uncertainty in supply and demand through the active co-operation of the key actors in the value chain. By reducing uncertainty, information and trade flows are improved and overall costs reduced. However, this also means that some firms in the chain determine and impose the parameters under which others in the chain operate.

The representation of value creation as a chain, *i.e.* a sequence of activities performed one after the other, was essentially based on a manufacturing/retail view of industry. However, this model of the chain is less appropriate to represent an enterprise's activity and its relationships with customers and suppliers in many business sectors, particularly in service industries. Alternative models of value creation, called 'value configurations', have therefore been developed to describe and analyse firm-level value creation across a broad range of industries.[1]

While it is important to understand the purpose of the value creation analysis at the firm level, this study mostly deals with the notion of the value chain at the industry level and uses the term "chain" in a broad sense, by integrating the idea that the creation of value in some business sectors may be depicted by configurations other than a chain, *i.e.* as a network of activities and not a sequence. In this meaning, the notion of value chain permits the analysis of several critical aspects of the phenomenon of globalisation of production: the production process as a set of value-adding activities performed by separate entities; the fragmentation of activities across multiple enterprises and countries; the distribution of productive tasks along the chain; the type of co-ordination between firms in the chain, often involving asymmetry of power and information.

Also, the notion of a value chain highlights one specific aspect of the links between firms, which is the economic linkage of value addition in the full range of activities that are required to bring a product from its conception to its end use. Indeed value addition is key. It is mainly the pursuit of those productive activities with the highest return that make lead firms in the value chain decide on which activities to keep in-house and which to outsource. The distribution of tasks and the positioning of firms along the chain at stages corresponding to low or high value activities are largely determined by lead firms, and small firms rarely act as the lead firms of the chain.

Box 1.1. Value chain analysis: A tool for understanding competitiveness

The value chain model provides a tool to analyse sources of competitiveness at the firm and industry level. In the automotive sector, for instance, a company entering a value chain will initially begin by producing automotive parts based on blueprints received from companies higher up the chain. However, simply manufacturing automotive components does not have a high degree of value added. With time, the company should therefore acquire adequate skills in product development and design in order to specialise in activities within the chain that have more value added.

Methodology of the study

A sectoral approach was adopted to take into account that globalisation affects different sectors in different ways and that the role of SMEs varies across sectors. The project identified five representative industrial sectors to be analysed through country/industry and enterprise/country case studies. The five industries, which were selected to illustrate emerging patterns in manufacturing and service sectors where the value chains show a significant presence of independent or affiliate SMEs acting as subcontractors or suppliers, included:

Two manufacturing industries:

- *The automotive industry:* this industry has changed dramatically during the past 20 years, in particular as concerns the suppliers and distribution networks, where many SMEs used to play a an important role.
- *Precision and scientific instruments industry*: medium-sized enterprises in this industry still play a rather important role. However, as the markets are becoming more and more global the industry moves towards the provision of packages of "services-and-products" and the strategic role of large global players seems to increase.

Two service industries:

- *The tourism industry:* this industry has become global, with its major players extending their cooperation to reach small or medium sized local players (franchising, management contracts, global reservation systems, branding). The study covered several segments, namely the hotel industry, the tour operator industry, and the travel agency industry.
- *The software industry*: this is a recent industry and yet one of the most globalised, subject to rapid and fundamental changes in production and distribution. Along with large and multinational firms, SMEs have an important role in the market, including providing support tools and a constant flow of independent ideas and concepts.

One creative/entertainment industry:

- *The film production and distribution industry*: in this industry the complementarity between the content providers and the distribution channels is crucial. The methods of collaboration of these two sets of enterprises, their relative sizes and strategic strengths have changed dramatically with the spread of digital and telecommunications technologies in the 1990s.

Data for this project were gathered from two main sources: structured interviews with a limited number of large enterprises and their upstream and downstream partners for each of the selected industries; and country studies conducted through semi-structured interviews based on a questionnaire with a representative group of SMEs in the selected industries that explicitly or implicitly act as suppliers and/or distributors in global value chains. Overall, *the project undertook seventeen country/industry case studies and seven in-depth enterprise case studies.* The latter were co-ordinated by UNCTAD and included Colombia, Egypt, India, Mexico, Nigeria and South Africa. Table 1.1 shows the distribution of case studies by country and industry, while the list of case studies is presented in Annex A.

Table 1.1.Breakdown of case studies by industry and country

Manufacturing		Services		Creative industries	
Automotive	Australia Chinese Taipei Japan Spain Turkey India: Tata Motor Mexico: Volkswagen South Africa: Toyota	Tourism	Australia Austria German/Jordan Korea Poland Spain (Andalusia) Spain (Balearic Islands) Switzerland	Film production and distribution	Korea United States Colombia: RCN and Caracol Nigeria: Nu Metro
Precision and scientific instruments	Australia	Software	Turkey Egypt: Microsoft		

A reasonable level of homogeneity of the case studies was ensured through the use of the same questionnaire for the semi-structured interviews. In particular, the following core set of questions was put to the interviewees: *the awareness and understanding of the global value chains and its participants*; *the co-operation within the global value chains and linkages*; *the relevance of technological skill, standards and intellectual property rights*; and *the role expected from government*. As an additional precaution, the analysis of the findings has taken into account the following differences:

- *Research team*: The case studies have been carried out by researchers belonging to different types of institutions, namely ministries, universities, research institutes, and consultancies.
- *Country and sector*: The background context of each case study is determined by the specific conditions in the country and sector of reference.
- *Coverage/sample:* The number of firms interviewed for each case study varies from a few tens to a few hundred, although the average is around 20 enterprises. The criteria for the selection of the enterprises, however, were always based on the representativeness of the selected firms in the sector.
- *Period of time:* The case studies were completed in different periods of time, between July 2005 and April 2007.

The case study approach used for this project facilitated a greater understanding of the issues investigated and provided fresh insights on them. It is important to remember that the generalisation of conclusions from case study research requires due care.[2]

Notes

1. Stabell and Fjelstad (1998) developed two alternative value *configuration* models as an addition to Porter's value chain model: value workshop and value network, describing respectively problem solving activities (for example, advertising agencies and professional services organisations) and contact establishing, intermediary and disseminating activities (such as insurance companies, banks, telecommunications companies and airlines).
2. Yin (1994) presents a thorough discussion of the issue of generalisation of case studies findings.

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The proceedings from the related OECD global conference
"*Enhancing the Role of SMEs in Global Value Chains*"
(Tokyo, Japan, 31 May–1 June 2007)
are available online at http://dx.doi.org/10.1787/472558038248.

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From:

Enhancing the Role of SMEs in Global Value Chains

Access the complete publication at:
https://doi.org/10.1787/9789264051034-en

Please cite this chapter as:

OECD (2008), "Introduction", in *Enhancing the Role of SMEs in Global Value Chains*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/9789264051034-3-en

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