Global Affairs Canada (GAC) has expressed interest in better understanding the 'Lead Firm-centric Value Chain Development' ("LF-VCD") method as reflected in the approved Proposals and Project Implementation Plans (PIPs) for newly launched projects in Kenya and Tanzania and how this approach differs from the value chain development approach GAC is accustomed to seeing in the projects it funds, including others implemented by MEDA. This is referred to herein as the 'Small Entrepreneur-centric Value Chain Development' ("SE-VCD") method. This paper first identifies how MEDA defines the term 'Lead Firm' and then describes the differences between these two methods and the reasoning for preferring, at times, to apply one rather than the other.

What is a Lead Firm?

In 2008, the USAID-funded Field Facilitation Working Group ("FFWG"), which included MEDA, defined Lead Firms as "Small, medium, and large firms that have forward and backward commercial linkages with targeted micro, small, and medium scale enterprises (MSMEs). In this context, Lead Firms are 'inclusive businesses' that play pivotal roles in moving their industry and other value chain participants related to it forward. Lead Firms:

- *include buyers, traders/exporters, input suppliers, processors, service providers, etc.*
- *vary significantly in size and may operate as part of either the formal or informal economy*
- *have varying levels of formality in their relationship with targeted MSMEs, ranging from completely informal (market-based governance system) to formal, contract-based arrangements (directed governance systems)*
- *manage and control different phases of the value chain; are frequently engaged in aggregating production among producers*
- *are distinguished by the commercial interest they have for engaging with MSMEs (not just corporate social responsibility) and the leverage potential they have to impact MSMEs (important characteristics from a development programing perspective).*

Source: Cycle 1: Defining Lead Firms and Principles of Facilitation, Field Facilitation Working Group Working Paper, August 2008, USAID.

To begin with, it is helpful to think of the two approaches (SE-VCD and LF-VCD methods) relative to the bottom and top ends or 'poles' of a value chain that delivers a commodity – for instance fresh-packed, retail shelf ready vegetables, to an end customer, a food retail chain for example. The SE-VCD method begins at the bottom of the value chain with an identified end-market opportunity for an identified target population (in this case small farmers) and establishes new value chain linkages from these[1] to end customers. In contrast, The LF-VCD method begins with Lead Firms at the top of the value chain as the 'entry point' for intervention, working with these to positively impact the SEs or small farmers participating in their value chains.

[1] The 'baseline condition' is that while the farmers targeted may already sell opportunistically to visiting traders, these trading relationships are typically solely price-based, informal and insecure. In contrast, value chains reflect trading relationships that involve continuing mutual interests that go beyond the price of a single trade. The SE-VCD method generally seeks to establish new value chain trading relationships benefiting the farmer clients targeted.

Both approaches aim to resolve factors hampering the growth, profitability and competitiveness of existing trading relationships by:

1) Improving the business competencies, productive and financial resources of small producers, small entrepreneurs and larger businesses to supply customers profitably and competitively [impact: expanding profitable markets for the producers, entrepreneurs and businesses concerned];

2) Improving 'support markets', the supply of financial services, productive inputs and equipment assets small producers, small entrepreneurs and larger businesses need to operate efficiently and profitably [impact: more efficient and cost-effective access to needed factors of production strengthens the output, efficiency and profitability of the producers, entrepreneurs and businesses concerned].

Now, to the central question – which approach is preferable under which circumstances?

MEDA's GAC-funded Phase 1 and Phase 2 horticulture value chain development projects in Ukraine provide a useful comparative example.

Ukraine Horticulture Development Project (UHDP, 2008-2013). SE-VCD approach applied. In 2007, with GAC in Ukraine then interested in sustainable development initiatives directly targeting and aiming to lift smallholder farmers out of poverty, and based on markets and economic analysis, MEDA determined that 5,000 smallholder farmers in the Zaporizka and Crimean regions in Southern Ukraine could greatly increase incomes and escape poverty by strengthening their capacities to meet robust market demand for greenhouse vegetables. The high value of fresh produce made even small greenhouse plots economically viable. But profits were squeezed since seeds were inferior, greenhouses were outdated and farmers did not sell collaboratively, the 'market linkage' being individual road-side selling that was not truly profitable for either the smallholder farmers or the (then) very small intermediary traders concerned. MEDA deployed the SE-VCD approach in UHDP for two key reasons: (a) to persuade smallholder farmers that it would be more profitable for them to sell collectively, a complex behavioural change challenge that demanded a direct, hands-on style of intervention; and, (b) the absence of any established Lead Firm-centric value chains that might be targeted with an LF-VCD approach.

UHDP successfully persuaded thousands of smallholder farmers to engage in collective sales, and this attracted a mix of astute small intermediary traders and larger retail food chain buyers, thus catalyzing some of the first, nascent Lead Firm-centric horticulture value chains in Southern Ukraine. While UHDP yielded dramatic income gains for a few thousand farmers, it required a 'heavy touch' at a cost of C$2,000 per farmer. It also seeded the conditions needed for future initiatives to more purposefully, robustly and at scale, leverage and build on the Lead Firms positioned in value chains at the end of UHDP. By 2013, GAC's Sustainable Economic Growth (SEG) Strategy launched in 2010, had sharpened GAC's focus on prioritizing initiatives offering grander and more systemic poverty impacts and harnessing the private sector. MEDA prepared a Phase 2 proposal for GAC.

Ukraine Horticulture Business Development Project (Phase 2, 2014-2020). Phase 2's LF-VCD approach was motivated by: (a) mutual agreement that Phase 2 should aim to achieve larger scale poverty reduction and economic growth impacts; (b) the, by then, new opportunity to leverage the Lead Firms positioned as leaders of the nascent LF-centric value chains catalyzed by Phase 1[2]; (c) the need to deploy a 'lighter

[2] As well as other Lead Firm candidates operating in Phase 2 locations not targeted in Phase 1.

touch' method in order to sharply reduce the implementation cost per client. The LF-VCD approach better enables MEDA to achieve the scale impacts of mutual interest. Phase 2 aims to directly and indirectly impact 44,000 smallholder farmers at a cost to GAC of C$450 per farmer. In contrast to the 'small farmer' starting point of Phase 1, Lead Firms are the 'starting point' in Phase 2. It will strengthen the value chains led by Lead Firm candidates that MEDA chooses to partner with. Not all Lead Firm candidates will pass MEDA's rigorous screening criteria, but those that do will receive incentives to rapidly expand their supply chain operations and benefit larger numbers of smallholder farmers. Phase 2 will help selected Lead Firms by providing business training and by providing funds and technical assistance to help offset their costs of training smallholder farmers, extending credit and improving efficiencies, etc. Phase 2 will thus spend less time and money identifying and working directly with tens of thousands of small farmers, yet benefits from leveraging existing commercial networks of participating Lead Firms.[3]

Kenya and Tanzania Projects: The newly launched projects in Kenya and Tanzania were designed as LF-VCD initiatives reflecting mutual interests in achieving large scale impacts on poverty and contributions to economic growth and private sector leverage. Much larger geographic catchment areas were identified along with more diverse sectors (agriculture, extractives and construction, rather than just horticulture). Each project will select approximately 20 - 25 Lead Firms with unique characteristics. From a large pool of candidates, MEDA will narrow the options through a strict due diligence process that includes a review of each Lead Firm candidates' financial performance, examination of the social character of the firm and analysis of its potential for scale and effective outreach to MSMEs.

By co-opting established, successful companies into LF-VCD projects, costs are reduced, mutually beneficial commercial relationships are exploited, scale is possible and sustainability is enhanced. Together, the small producers[4] and the businesses that serve them share the local knowledge, the reach and the creativity needed to make livelihood improvements that are mutually rewarding and scalable. MEDA will further leverage Lead Firms as channels through which to 'pipe' financial services, new technologies and new knowledge to the small producers they serve.

At the same time (and for marginal additional investment), there is great opportunity to strengthen the competitiveness of Lead Firms in ways that make them more effective market intermediaries for small entrepreneurs. Business support, marketing, mentoring and advisory services will be offered, in this model, to all qualifying small and medium enterprise (SME) applicants and to Lead Firm partners.[5]

Back to the central question. It is not that the LF-VCD or the SE-VCD approach is better or worse than the other. It is really a matter of project focus, goals, location and timing. Project design involves making choices to maximize value relative to desired outcomes. Where industry is nascent or corrupt, in more rural or less developed areas and where communities are particularly vulnerable (post conflict, post disaster), the producer-centric SE-VCD approach may be more appropriate. *Where business is more formal, economic growth is strong and markets are well-established, a LF-VCD approach allows better leverage and scale.* Where a project targets a specific geographic area, narrow demographic space or

[3] See the Lead Firm column B in Table 1 below.
[4] Alternatively referred to as "small producers", "small enterprises" or farmers; all are involved in production at small scale.
[5] SMEs are also referred to as "Small, Growing Businesses" (SGBs) in Tanzania and Kenya project documentation.

particular commodity, the SE-VCD approach may be suitable. *Where the goal is scalable systematic market improvement that is less concerned with "who exactly" benefits, the LF-VCD approach may be preferred.*

Table 1 profiles the chief differentiating features of these methods.

TABLE 1	A	B	Features of 'B' versus 'A'
	SE-VCD	LF-VCD	
Primary purpose	Enhanced livelihoods for small-holder producers, often targeting more marginalized communities.	Enhanced livelihoods for small-holder producers leveraged by existing commercial relationships.	Greater potential for scale and sustainability [potential advantages: better prices paid to small entrepreneurs, rising numbers of small entrepreneurs engaged]. Cheaper to strengthen and expand existing supply chain relationships than to stimulate or establish new ones from scratch.
Target client priority	Smallholder producers in locations specified in project design; some impact on market intermediaries and business support companies.	Smallholder producers, Lead Firms and business support companies. Precise locations not specified in project design	Recognizing that Lead Firms and other market intermediaries are themselves hampered by internal and external constraints, these are also directly addressed. Building relationships with Lead Firms is complex and time consuming and is only practical once the project is underway. [limitation: Lead Firm partners are only determined on a rolling basis over the life of the project. Ultimate beneficiaries are thus identified at implementation rather than at the design stage].
Primary orientation	Strengthen producers' capacity to profitably supply markets identified. Resolve associated barriers in cross-cutting support markets (access to inputs, finance, technology)	Strengthen entire producers-to-Lead Firm supply chain capacities including support market functions. Spur Lead Firm growth to expand profitable trading opportunities for the poor.	Producers benefit most from well run and socially-minded Lead Firms. Thus selection of good Lead Firms is foremost after which cost effective and meaningful interventions for small-holder producers can be designed.
Geographic Scope	Suited to more remote, post conflict/ post disaster locations	Suited to areas with stronger and faster growing economies. Usually more populated.	'A' tends to involve mobilizing producers to handle the 'supply to market' function. In 'B', the LF tends to handle the market linkage role, simplifying the 'business challenge' for producers
Commodity / Sector focus	Commodities / sub-sectors typically selected through	Commodity / sub-sector selections flow from Lead Firm	Selection criteria for 'A' includes market demand/supply, gauging profitability for producers, ranking and shortlisting, etc.

	rigorous market analysis at project design stage	selection during project implementation stage	'B' includes these plus added criteria aimed at gauging the relative quality of Lead Firm candidates involved as buyer and intermediary to the market.
Business resource leverage	Leverage is limited [project designs are not specifically tailored to attract significant resource commitments by business. Business partners tend to be small, less capitalized]	Better capitalized, more well-established companies have resources to spend on expanding and scaling production and marketing.	Responsive mechanisms enables the vested interests, resources and position of the Lead Firm in its market to be leveraged [advantages: pro-poor poverty impacts maximized in ways that the project operating alone cannot; post-intervention sustainability and continued scaling more likely]
Business involvement in farmer capacity-building	Projects tend to fund NGOs to provide small farmer capacity-building	Lead Firms leveraged as 'delivery channels' for the provision of small farmer capacity-building	Led Firms vested interest in the success of their small farmer suppliers allows them to be engaged as service providers at lower cost to project. Services also 'tailored' to specific trade requirement and thus more quickly applied by producers.
External synergies	Limited potential to attract external resources due to limited 'capital invested'	Significant potential to leverage 'footprint' of lead firm relationships to attract external blended finance to fuel lead firm growth	'B' offers greater scope to more quickly expand and accelerate pro-poor economic growth

In summary, MEDA adapts and applies alternative value chain methods to suit different needs and implementing contexts. The systems-oriented, LF-VCD approach purposefully aims to strengthen and spur the growth of Lead Firms to expand profitable market opportunities for small entrepreneurs. It further leverages these Lead Firms to help strengthen the capacities of participating small entrepreneurs to more ably and profitably act as suppliers. This application of value chain practice is well-matched to sustainable equitable economic growth purposes.