Chapter 5 - Global value chains and smallholder value appropriation through cooperation

5.1 Introduction
Modern agriculture in developing countries “is led by private entrepreneurs in extensive value chains linking producers to consumers and including many entrepreneurial smallholders supported by their organizations” (World Bank, 2007: 8). “Farmers are increasingly supplying long and sophisticated supply chains and have to meet stringent food safety standards, particularly in discerning international markets” (Markelova et al. 2009: 1). In studies on international trade the GVC approach has been used to analyze opportunities for small businesses and farmers from developing countries (Gereffi et al. 2005; Humphrey and Memedovic 2006). Inclusion in export chains, is seen as an instrument in the struggle against poverty. However, to date the results of these policies are rather bleak: even if smallholder market organizations are involved, their financial benefits are generally small (Kaplinsky 2000; World Bank 2007; Minten, Singh, and Sutradhar 2013; Donovan and Poole 2014). To increase benefits from participation in global value chains for farmers from developing countries, the emphasis of the GVC approach is on governance in the chain, upgrading, productivity improvements and meeting the demands of Western customers or lead firms (Gereffi et al. 2001; 2005; Humphrey and Schmitz 2001; 2002; Gilbert 2008; Neilson, Pritchard, and Yeung 2014). Development policies, aiming at a reduction of poverty, try to facilitate the inclusion of smallholders in these GVCs. Similarly, NGOs support Fair-Trade. All these policies use the GVC approach to assess the opportunities for smallholder inclusion in export value chains.

Collective action is seen as a promising instrument to improve access to markets and global value chains for rural households (Thorp, Stewart, and Heyer 2005). Markelova et al. (2009) explain that despite growing market opportunities, there is a danger that smallholder farmers will be squeezed out: they face scale disadvantages, high transaction costs, difficulties in accessing knowledge through business development services and a decline in state-funded agricultural support. They discuss collective action as an instrument to address these disadvantages. Insights from studies of collective action in natural resource management are used to derive conditions that facilitate effective producer organizations for smallholders’ market access, with special attention to the characteristics of user groups, institutional arrangements, types of products, markets, and the external environment.
Several case studies show that through collective action farmers are able to solve resource constraints that hamper their activities in the chain. Just to mention a few, Hellin, Lundy, and Meijer (2009) provide a case to show that scale effects can be created and transaction costs can be reduced, Narrod et al. (2009) give an example of effective public-private partnerships and Kaganzi et al. (2009) discuss successful credit and saving, upgrading and better business management, through collective action. These cases show that collective action may help farmers to become competitive. However, many other studies discuss the failures to compete and relate it to a lack of ‘control’ in the chain (Gereffi et al. 2005), a lack of ‘power’ (Kaplinsky 2000; Thorpe et al. 2005; Devaux et al. 2009) or not being involved as one of the ‘driving forces’ (Altenburg 2011; Jespersen, Kelling, Ponte, and Kruijssen 2014; Ponte and Sturgeon 2014). This outcome leads Markelova et al. (2009) to the conclusion that it is important to understand better when farmer organizations make sense and that the opportunities for smallholders finally depend on their ability to compete in the market.

Although the issues addressed in the GVC literature and the discussion on collective action are all relevant for finding opportunities of smallholders in value chains, we claim that this literature does not sufficiently address the key issue involved, namely the resources needed to create and, in particular, to sustain a competitive advantage. Put differently, the resources needed to coerce control, power or a driving force. None of the abovementioned studies discusses the features of resources that may allow smallholders to exercise control or may allow farmers to create a sustainable competitive advantage. Although some of these case studies show that smallholders were successful in targeting the identified market opportunities, it is important to understand which resources should be invested in to avoid that the success is easily copied, or that the benefits evaporate. We argue that it is the bundle of resources, rather than a market opportunity that establishes the root of the smallholders’, or farmers organization’s, competitive position (Wernerfelt 1984; Barney 1991). It is this insight that is helpful to select promising opportunities and to avoid investment failures of an already poor target group.

The literature on Strategic Management and in particular the Resource-Based Theory (RBТ), helps to assess the opportunities for smallholders from developing countries. Unlike most economic theories that focus on competitive market forces and perceive smallholders as homogenous players having access to the same resource base, strategic management literature provides theoretical insights to understand firm heterogeneity and to analyze the importance of ownership, or control, of strategic resources that secure value appropriation. Smallholders in developing countries require strategic resources and capabilities to compete internationally and to establish favorable terms of trade with suppliers and especially buyers (Dawar and Frost 1999). Put differently, firms and farms from
developing countries should develop strategic resources and capabilities of value that make them an indispensable partner for firms from developed countries (Hitt et al. 2000).

This requirement establishes a major challenge for smallholders in global value chains as many of them are severely resource-constrained. We argue that some of these problems may be solved jointly, through horizontal cooperation and by developing ‘relational assets’ that strengthen the strategic position of collaborating firms in the GVCs (cf. Dyer and Singh 1998; Markelova et al. 2009; Wincent et al. 2010). In addition to these insights, we suggest a number of propositions regarding the governance of relational assets. Without due recognition of the strategic position of smallholders, insights from GVC literature may fail to explain why smallholders do not appropriate value and why inclusion may lead to ‘immiserising growth’ (Kaplinsky 2000). A strategic analysis complements the recommendations drawing on this literature as it identifies the smallholders that are able to create the appropriate resource base and, consequently, may benefit from participation in global value chains. Concomitantly, those smallholders that are not able to create the needed resource base are advised to position themselves in an alternative market for which they are able to create the required resources (Humphrey 2006; Ponte and Ewert, 2009).

The chapter is structured as follows: Section 2 discusses existing literature on Global Value Chains. Subsequently, in Section 3, the RBT is discussed, highlighting the strategic difference between value creation and value appropriation; Section 4 discusses where the resource based theory and the global value chain approach complement each other. Sections 5 to 8 argue that the relational assets that resource-constrained small firms and farmers from developing countries require must be managed in a proper governance structure. We suggest some testable propositions on conditions for successful cooperation to develop and maintain relational assets. The final section concludes and suggests further research.

5.2 The Global Value Chain
Opportunities for farmers to benefit from international trade are argued to come from so-called ‘global value chains’ linking globally dispersed farmers to globally dispersed consumers (World Bank 2007). In academic literature global value chains (GVCs) are defined as the full range of international production and trading activities by legally independent firms to realize a specific end-product. Important themes include (1) the amount of value created by each firm in the chain, (2) the vertical governance (coordination and control) in the chain, and (3) the options for firms from developing countries to participate in GVCs (Sturgeon
Governance of GVCs is argued to be the responsibility of a ‘lead firm’ that determines “what is to be produced, how, and by whom” (Gereffi et al. 2001: 1). A lead firm governs the chain to facilitate and benefit from cost-effective outsourcing (Gibbon, Bair, and Ponte 2008). To enable smallholders in developing countries to supply lead firms, lead firms may need to help upgrade the farmers in developing countries. This type of upgrading is considered to bring benefits for both firms involved (Humphrey and Schmitz 2001; 2002). Public parties, non-governmental (e.g. Fair-Trade certification schemes) or governmental organizations may try to influence the governance of GVCs in order to benefit small farmers relatively more since they constitute the least privileged and most vulnerable group of actors in developing economies (Sturgeon 2001; Bitzer 2011; Humphrey and Memedovic 2006; Ruwanpura and Wrigley 2011).

Coe et al. (2008) criticize the GVC concept and propose a Global Production Network (GPN) approach: “First, GCCs and GVCs are essentially linear structures, whereas GPNs strive to go beyond such linearity to incorporate all kinds of network configuration. Second, GCCs/GVCs focus narrowly on the governance of inter-firm transactions while GPNs attempt to encompass all relevant sets of actors and relationships” (Coe et al. 2008: 272). They conclude that the Global Production Network approach is a better instrument to analyze the global economy and its impact on territorial development needs. The GPN is a more comprehensive perspective in which more attention is paid to regulatory systems, labor, consumers and civil society organizations, and networks of cooperation and conflict. The authors note that: “The major difference between a GPN and GVC approach, therefore, is that the former aims to be more inclusive than the latter, even though this poses considerable practical problems.”

We agree that from the perspective of the global economy and territorial development this broad approach is appropriate (Johns 2006; Yeung 2009; Murphy and Schindler 2011; MacKinnon 2012). However, the broadness may turn into a weakness if differences in the performance of individual stakeholders have to be understood. The GPN stresses the importance of regulations and institutions. Indeed, these are one of the determinants in the value distribution process among actors in the chains. However, only part of the outcomes of value distribution is rooted in constraining rules and regulations set by governments, market authorities and non-governmental organizations, that is, the formal rules of the game (Cramer 1999; Williamson 2000). This chapter calls attention for another determinant in the value distribution process: the play of the game, which is driven by the firms involved in transactions in the supply chain and

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4 GCCs = Global Commodity Chains
based on the resources and capabilities they own. This focus sheds light on the strategic behavior of individual firms and may explain why some firms are successful while others fail in the same GPN or GVC.

In this play of the game value creation, power and value appropriation are key. Value creation is defined as the difference between the value that resides in a finished good and the value that is sacrificed to produce the finished good (i.e. the sum of the consumer surplus and the producer surplus). Value appropriation is that part of the total value created that is appropriated by the firm (capture of rents). The latter results from the relative power of the firms involved. The key question now is to understand the roots of that relative power for the firms involved. We agree with the GPN approach that part of the relative power can be explained by institutions (formal rules of the game), however, another part is rooted in the firm’s resources and capabilities. Remarkably, available resources and capabilities at firm level are given scant attention in the GPN framework.

The GVC approach does not provide the instruments needed to solve this query either. In line with the definition of GVCs given above the unit of analysis encompasses all firms involved in the value chain. In this approach upgrading is generally seen as an instrument to allow firms from developing countries to produce more sophisticated products (product upgrading), to process more efficiently (process upgrading), to become active in higher value-adding activities in the chain (functional upgrading), or to participate simultaneously in separate GVCs (inter-sectoral upgrading) (Gereffi 1999; Gereffi et al. 2001; Humphrey and Schmitz 2002). The GVC literature suggests that, through governance and upgrading, trade between globally dispersed and legally independent firms can be realized. However, the fruits from upgrading may not accrue to the small firms and farmers. This is acknowledged by several researchers who point their fingers at inappropriate governance in the chain, for instance by the lead firm. Upgrading may mean that value is created in GVCs and, simultaneously, that the firms from developing countries may not appropriate the value created. This can lead to ‘immiserising growth’: increased economic activity and improved products are accompanied by decreasing economic returns to players in developing economies (Kaplinsky 2000; 2006). Similarly, Humphrey and Schmitz (2002) distinguish different forms of upgrading and discuss serious barriers to functional upgrading. They note the importance of strategic intent and that significant investments have to be made. Ponte and Ewert (2009) criticize the focus on upgrading and argue that in some cases, downgrading may be more promising. In the same vein, Humphrey (2006) argues that regional market opportunities may provide more attractive options for smallholders in developing countries. Although most studies provide industry-specific details to understand the position of the stakeholders in the value chain, a major drawback of this literature is that not much insight is given into the generic forces that determine
the distribution of value among actors in the chain. In other words, the focus is on higher value creation without paying explicit attention to the factors that determine value appropriation.

Gereffi et al. (2005) provide a theoretical framework for better understanding the governance structures between firms involved in GVCs. The governance structures distribute not only the activities and responsibilities among actors in the chain, but also the created value. In the framework, power is a factor, but it is unclear on which features this power is based. Reference is made to Penrose (1959): ‘how and whether firms can capture value depends in part on the generation and retention of competencies (that is resources) that are difficult for competitors to replicate’ (Gereffi et al. 2005: 81). Reference also is made to the doctrine of ‘core competence’, such that firms that rely on the complementary competencies of other firms and focus more intensively on their own areas of competence, perform better than firms that are vertically integrated or incoherently diversified (Prahalad and Hamel 1990). These remarks are interesting, but the framework does not elaborate on how these insights work in value chains. In other words, it does not give much insight into the drivers of value appropriation in the supply chain. An analysis at the individual firm level, or at a specific business relationship in the chain, is needed to shed more light on this process.

An important question in GVC literature should then become how farmers can appropriate value. This obvious question has not been adequately addressed so far. Kaplinsky (2006) merely suggests that farmers should ‘innovate’, as innovation results in entry barriers and consequently rents from scarcity. Although Kaplinsky’s suggestion is a step in the right direction, it remains unclear how small firms and farmers from developing countries (1) may create the strategic resources required to innovate, and (2) have the opportunity to appropriate the value from innovation (Teece 1986; 2006). We argue that the Resource Based Theory (RBt) provides some valuable insights to address these queries (Barney 1991; Grant 1991; Teece et al. 1997; Sirmon et al. 2007; Sirmon et al. 2008).

5.3 Competitiveness: Outside-in vs. Inside-out

A key issue in strategic management is the development of a business strategy that creates a competitive advantage over rival organizations. A competitive advantage means that a firm is able to outperform its rivals, that is, to earn a higher profit or to appropriate a relatively large share of the created value. Firms may take the environment as a starting point (outside in) to choose an advantageous market position, or firms may take their own resource base as a

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5 Even in developed economies firms see the majority of the benefits emerging from innovation flowing to others and to consumers (Baumol 2002).
starting point (inside out). Except for Penrose (1959), early work on firm competitiveness focused on environmental factors that explained industry attractiveness (cf. Porter 1985). An outside-in perspective to competitiveness argues that firms should try to enter attractive industries. Kaplinsky’s (2006) emphasis on entry barriers resembles aspects of outside-in analyses of competitiveness. However, the resources and capabilities needed to operate successfully in an industry may be complex and thus entering may be a daunting process for smallholders. In addition, an outside-in perspective on competitiveness can explain the attractiveness of industries, but not performance differences between firms within that industry (Teece et al. 1997).

The literature on RBT stresses the importance of an inside out approach and focuses on the firm’s resources and capabilities. We follow Amit and Schoemaker (1993) in defining resources as stocks of available factors (patents, licenses, property, plant, equipment, human capital) and capabilities as a firm’s capacity to deploy resources to effect a desirable end (a product or service for the market). The RBT argues that resources that are Valuable, Rare, Inimitable, and Non-substitutable (VRIN) have strategic value and, consequently, are denominated strategic resources providing firms the opportunity to gain a competitive advantage relative to other firms in the same industry (Barney 1991; Priem and Butler 2001a; Sirmon et al. 2007; 2008). The features of these resources make them difficult to copy or imitate and therefore the RBT concludes that these resources may form the basis for value appropriation. These resources make the producer unique and difficult to replace by other suppliers in the chain, i.e. they form the power in the negotiation process with buyers. As long as the VRIN features of the resources hold they may establish the root for a sustainable competitive advantage. However, VRIN features are not sufficient for a competitive advantage. The potential of VRIN resources to gain a competitive advantage depends on the firm’s capabilities to bundle, deploy, or ‘orchestrate’ these resources (Armstrong and Shimizu 2007; Sirmon and Hitt 2009). This means that the bundling of VRIN resources may lead to the creation of a competitive advantage, but only if it results in a product or service that is valued by the market.

5.4 Integrating RBT and GVC
From research in the field of RBT it is evident that if small firms want to appropriate more value of the value created in a global value chain they need to make a strategically attractive value proposition that leverages resource advantages (Sirmon et al. 2008). Just like a ‘lead firm’ that owns and controls resources to orchestrate the upgrading by an army of primary producers, heterogeneous small firms and farmers must develop and orchestrate VRIN-resources themselves too if they want to appropriate value. RBT logic even
implies that upgrading of large groups of homogenous farmers cannot result in a competitive advantage for these farmers. Instead, the RBT prescribes firms to distinguish themselves from competitors and to deploy their resources for opportunities in those value chains where they fit best. Studying strategic opportunities of farmers to gain advantage from participation thus requires firm- and industry-specific analyses on their uniqueness (cf. Rouse and Daellenbach 1999).

Although currently no empirical RBT data or analyses on farmers from developing countries are available in the literature, some propositions can be formulated that suggest conditions for farmers to be able to make an attractive value proposition to other actors in a GVC. These propositions are formulated below.

A key insight from the RBT literature is that firms involved in a GVC should create VRIN resources in order to be able to capture a reasonable part of the value created. Current literature has addressed resources that are a prerequisite to accessing a specific value chain (Markelova et al. 2009). Meeting demands set by lead firms, i.e. qualifying for orders, does not distinguish them from others active in the same stage in the value chain. Based on the RBT logic small firms and farmers would be well advised to develop and control resources that distinguish themselves from others. Thus, they can make a unique proposition that is valued in the markets. From this we derive the first proposition.

**Proposition 1:** The success of smallholders’ involvement in GVCs depends strongly on the extent to which these farmers control or create strategic resources that can be bundled to make a unique value proposition.

5.5 Joint Production and Relational Assets

Central to the remaining propositions formulated below is the importance for smallholders to cooperate among themselves. There is a clear need for joint production (Thorp et al. 2005; Markelova et al. 2009; Foss and Lindenberg 2011; Craviotti 2012) since many primary producers are resource-constrained in important ways. When poor and small farmers cooperate horizontally they may be able to create access to missing resources. Inter-firm cooperation has received some attention in RBT research, making the argument that an ‘atomistic view’ of firms prevents one from gaining insights into relational sources of competitiveness and the assets that may arise from joint investments and production. Firms can but need not act alone (McEvily and Zaheer 1999; Uzzi

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We stress the importance of horizontal cooperation as a first step in creating a stronger market position. Vertical cooperation may become interesting in a later stage. We expect that resource constrained individual smallholders have difficulty in finding partners upstream or downstream in the chain that are willing to team up with a weak partner, i.e. individual smallholders lack the resources to negotiate an attractive agreement. Horizontal cooperation is also a condition for getting access to Fair-Trade value chains.
Cooperation enables firms to obtain “relational rents” that give rise to an “inter-organizational competitive advantage”. Potential sources of inter-organizational competitive advantage are “(1) relation-specific assets, (2) knowledge-sharing routines, (3) complementary resources/capabilities, and (4) effective governance” (Dyer and Singh 1998: 660).

Relational rents, or “supernormal profit jointly generated in an exchange relationship that cannot be generated by either firm in isolation and can only be created through the joint idiosyncratic contributions of the specific alliance partners” (Dyer and Singh, 1998: 662), may be especially important for small- and medium-sized firms and farmers in developing countries (Mesquita and Lazzarini 2008; Markelova et al. 2009). Such primary producers tend to face scale and infrastructure limitations. From this the second proposition is derived:

**Proposition 2:** Joint investments in relational assets allow smallholders to create strategic resources that provide them a stronger position in the GVC, to appropriate a larger share of the benefits.

The idea of small firm cooperation is not new – there is a relatively well-established literature on formal market-oriented farmer cooperatives as an organizational form (cf. van Bekkum 2001; Beverland 2007). Since this is mostly studied in developed market economies, what is relevant for understanding the conditions under which small firms and farmers cooperate in developing countries is not straightforward. In the following sections we propose a number of propositions that indicate boundary conditions and potentially successful directions for strategic action when these firms aim at making an attractive value proposition to seek competitive advantage. The propositions refer to a number of important dimensions to cooperation, such as composition of the group in terms of member characteristics, the number of participants, goals for the cooperation, and governance mechanisms.

### 5.6 Group Composition

Proposition 2 discusses the potential of bundling different resources of smallholders. In order to compete, a collective of small farmers should leverage its bundle of resources such that a unique “club good” is created. A club good is a good produced by a group and, as opposed to public goods, only the members of the group can enjoy the benefits (Torre 2006). However, with differing individual farmers, the question arises what persuades them to contribute voluntarily to the creation of a club good, especially if contributions of other farmers and outcomes of the cooperation are uncertain. Heterogeneity in terms of contributions is in line with Olson’s (1965) reasoning that smallholders will voluntarily contribute to a club good if individual gains are higher than individual costs, even if this allows others to enjoy benefits from the club good as well, while hardly contributing to
it\textsuperscript{7}. Thus, there is room for intra-group heterogeneity in terms of the size of firms and their contributions.

Intra-group heterogeneity also aligns with RBT logic that members contribute complementary resources and capabilities to the development and maintenance of a club good (cf. Hitt \textit{et al.} 2000; Araujo \textit{et al.} 2003). Olson (1965) and Williamson (1975) emphasize that there should not be too much heterogeneity concerning the importance of a common goal to each of the members. Agarwal \textit{et al.} (2010) tested this logic empirically and found support for it. Put differently, groups may be composed of heterogeneous members with respect to contributions and gains (individual interest), but should be homogenous with respect to group goals (group interest).

Although there seem to be reasons for expecting intra-group resource heterogeneity to benefit group performance outcomes, it is impossible to be exact in how heterogeneous a group should be (Barham and Chitemi 2009). If heterogeneity in terms of resources (such as knowledge and experience) is relatively important, a group of small firms that cooperate to create relational assets may be in a good position to compete with a large farmer. However, reversing Olson’s (1965: 35) exploitation of the great by the small, the exploitation of the small by the large should be prevented by ensuring that differences between group members in terms of contributions to the group are not too large. Resource dependency theory (Pfeffer & Salancik 1978; Casciaro and Piskorski 2005) and appropriability theory (Teece 1986; 2006) suggest that mutual, rather than one-way, dependency is what needs to characterize the situation (cf. Ozcan and Eisenhardt 2009).

\textit{Proposition 3:} Groups consisting of smallholders heterogeneous with respect to contributions to a club good, though homogenous with respect to the common interest, are better capable of making a value proposition by using a club good than groups composed otherwise.

\subsection*{5.7 Group Size}

Formal farmer cooperative models are often characterized by open membership and one of their main aims is to gain benefits from economies of scale (Van Bekkum 2001). Little research is devoted to possibilities of small firms and farmers using a cooperative to help develop an attractive value proposition in order to appropriate more value in a value chain. One exception is Beverland (2007), claiming that cooperatives could make a unique value proposition if the

\textsuperscript{7} The reasoning by Olson (1965) is, needless to say, based on the assumption that firms and individuals act according to their self-interest. In practice individuals, including commercial actors, also act in the interest of others (Van de Ven, Sapienza, and Villanueva 2007) or the collective (Wagner III 1995). This may particularly be true in collectivist cultures (Wagner III 1995), such as in many developing countries (Hofstede 2001). Nonetheless when the issue is one of value appropriation and circumstances are dire, it can reasonably be assumed that if a firm can appropriate value it will.
cooperative is small or if a large cooperative makes use of fixed term contracts, tradable shares, appreciable equity shares, defined membership, and minimum up-front investments.

Addressing this problem, Olson (1965) reasons that firms will voluntarily contribute if expected individual benefits from contributing to a collective good exceed individual costs. Although this raises the opportunity that firms contributing little or nothing at all can benefit from such a situation (“the ‘exploitation’ of the great by the small” [Olson 1965: 35]) it may be beneficial for an individual firm to contribute. The likelihood that such a situation occurs depends on the size of group: there is a need to keep group size restricted. The reasons are that the larger a group becomes, the more members will have to share the benefits created, and governance costs increase with group size. This means that the larger the group the lower the likelihood of providing an optimal supply of a club good; “very large groups normally will not, in the absence of coercion or separate, outside incentives, provide themselves with even minimal amounts of a collective good” (Olson 1965: 48).

Wincent et al. (2010: 45) hereby refer to the “paradox of group size”. The paradox or trade-off is that the larger the group of firms that cooperates, the more resources are accumulated, yet, at the same time, the larger the group, the more difficult it is to realize and govern voluntary contribution. Wincent et al. (2010) test the possibility of an external board to mitigate problems associated with large groups, and although they do find that an external board can perhaps mitigate the disadvantages associated to a large group size they still find that small groups are generally better at generating funds for innovation than large groups.

**Proposition 4:** Larger groups may deliver more investment for strategic resources but also face more daunting governance challenges.

### 5.8 Governance mechanisms

To realize participation in the creation of club goods by a group, opportunistic behavior should be prevented through the regulation of the membership. In inter-firm cooperative agreements some firms may be “keen to appropriate more than their fair share of rents streaming from the combined use of such assets. Cooperation is thwarted by the fact that, whoever invests first, runs the risk of being held to ransom by the owners of complementary assets” (Araujo et al. 2003: 1258). Restricting entry to high contributors increases overall individual contribution to club goods, yet, preventing exit by high contributors may reduce

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*The objective of a cooperative would be to jointly develop a new resource or capability, rather than, as the strategic alliance literature, leverage the combined, existing resources and capabilities of alliance partners (e.g., Sampson 2007). Since no formal agreement is made (see further below) and no equity is invested, a cooperative is not like a joint venture either.*
the pressure on low contributors to pay their share (Ahn, Isaac, and Salmon 2008). This issue relates to the voluntary nature of cooperatives.

An important question then becomes how a group contributing to a common good is governed, distinguishing between formal and informal, or relational, governance mechanisms. Each may have their function and they can exist alongside another (Poppo and Zenger 2002; Torre 2006). Formal governance mechanism may “promote more cooperative, long-term, trusting exchange relationships […] promote longevity in exchanges by increasing the penalties that accompany severing an exchange relationship” (Poppo and Zenger 2002: 708). Informal mechanisms, by contrast, may “heighten the probability that trust and cooperation will safeguard against hazards poorly protected by the contract” (Poppo and Zenger, 2002: 708). It is expected that small firms and farmers in developing countries do not have the resources to realize formal governance forms, and thus may need to rely on informal self-governance (Ostrom, Walker, and Gardner 1992).

Formal mechanisms may function well for farmer cooperative models in which benefits from economies of scale are sought (Beverland 2007), given that these may require capital investments, and provided that the institutional environment ensures contract enforcement (Mesquita and Lazzarini 2008). However, the creation of club goods also requires voluntary action as complete contracts never exist. The common good that needs to be contributed to will involve uncertainties about the future returns that cannot all be included in a formal agreement. Contributions to a club good regulated at least partly through informal governance are based on reciprocity. Terms of exchange are deliberately unclear and subject to discretion. If a group member fails to reciprocate proportionally according to moral norms of reciprocity and social solidarity, exclusion from the group results. Reputation, benefits of continued cooperation, moral norms of reciprocity and social solidarity include forces by which the system is regulated (Dolfsma and Van der Eijk 2010: 65). To value reciprocated favors according to perceptions of justice, communication is vital (Luo 2008; Agarwal et al. 2010; Ahn et al. 2008). In cooperative agreements in which parties have varying “private intents” and “asymmetrical dependence”, procedural justice, as opposed to distributive justice, removes fears of exploitation, creates reciprocal behavior, and decreases the need for inter-firm rivalry (Luo 2008: 28; Kumar 1996). The process through which a distribution of benefits from joint production is reached is thus much more important than the distribution that actually results.

Although the cooperation is based on voluntary action, this does not mean there is no bargaining over the sharing of gains among the group members (Olson 1965). Consequently mechanisms to govern the sharing of gains need to be put in
place. The emphasis will be on informal mechanisms. Informal mechanisms appear effective in groups that rely on voluntary self-governance (Ostrom 1992). Furthermore firms in developing countries often reside to informal mechanisms, including in cooperative agreements (Luo 2008; Mesquita and Lazzarini 2008).

Proposition five then is:

**Proposition 5:** *Intra-group value appropriation may be best governed informally through entry and exit institutions generally perceived as procedurally just, and based on well-communicated and agreed-upon norms for equitable sharing of benefits.*

### 5.9 Conclusion

It is of great importance for smallholders in developing countries to understand in what ways they can gain advantage from integration in global value chains. Farmer strategies that leverage resources such that an attractive value proposition can be offered to the varying actors in the chains can help them to upgrade through creating value. Yet, for small farmers also to be able to appropriate more value of the value created, they have to control, or create, strategic resources. Insights from strategic management are useful to identify these resources and may explain why so many smallholders fail to appropriate the alleged benefits of inclusion. A major conclusion is that strategic management may complement the GVC literature and can be used to identify smallholders or SMEs that are expected to benefit from the market opportunities. Put differently, inclusion and upgrading may be attractive, but not necessarily for all suppliers in the chain.

Being resource constrained and otherwise in vulnerable circumstances, it is expected that cooperation will be a promising instrument for small firms and farmers to create these strategic resources in the quality of club goods. Success of cooperation, however, is dependent on group composition, group size, and governance mechanisms. If the necessary conditions formulated in a number of propositions in this paper are met, the development and deployment of strategic resources and capabilities may be expected. As a group, small firms and farmers can then strategically develop a sustained competitive advantage and prevent ‘immiserising growth’. The propositions need to be tested empirically and provide an agenda for further research in this field.

Small firms and farmers are heterogeneous entities with varying opportunities to gain competitive advantage. Each player in a value chain can make strategic decisions about choosing among different chains to enter. In addition, such a firm can develop resources, itself or in conjunction with others, to help ensure that value is not only created but also appropriated. Theoretically, then, the focus of
attention shifts from the lead firm in a value chain that the GVC literature focuses on, to the strategic resources and capabilities of all players in a chain including small firms. Farmers are then perceived as strategic actors rather than as price-takers of commodity produce (Beverland 2007). To realize structural change it should be understood how even resource-constrained smallholders can strategically position and compete in (global) value chains on the basis of resources and capabilities developed either by themselves but most likely jointly with others. The outcome of this exercise is not necessarily upgraded entry in a GVC. It is well possible that domestic or regional markets provide more attractive opportunities to find a fit between available resources and the required value proposition.