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LINKING IN TO GLOBAL VALUE CHAINS:

A Guide for Small and Medium-Sized Enterprises



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Introduction

Who This Guide is For

This guide is presented by the Canadian Trade Commissioner Service (TCS) for Canada's small and medium sized enterprises (SMEs) who are interested in expanding internationally. Its intent is to present the global value chain business model as a means for boosting firms' global competitiveness, profitability and long term sustainability.

This guide is not a “*step by step*” or “*how to*” guide. We understand that each firm is unique and is best understood by those closest to its operations. For this reason, we have aimed to present alternate business strategies or options which you might consider in your firm's management strategy. Not every strategy will be relevant for each business; however our intent is to expand your strategic thinking to include options presented by global value chains.

How This Guide Works

The first section of this guide will present the global value chain business model and its relevance for Canadian SMEs. After completing this section, you should be able to answer the question “what can global value chains do for my business?”

Once you have determined the value of the global value chain business model for your own firm, the second section will help you determine whether or not your firm is ready to take advantage of this business model. A readiness assessment will help you evaluate your operational capabilities and determine whether or not your firm has the “three Cs” necessary for doing business internationally.

The third section of this guide will present various opportunities for how to optimize your own global value chain. Whether it be selling, outsourcing, investing abroad or entering into a joint venture, there are numerous ways to successfully participate in global value chains.

Although this guide concentrates on basic, practical information, it also provides you with many other resources which will help you develop your own customized approach to global value chains.

The Rise of Global Value Chains

“A New Business Model”

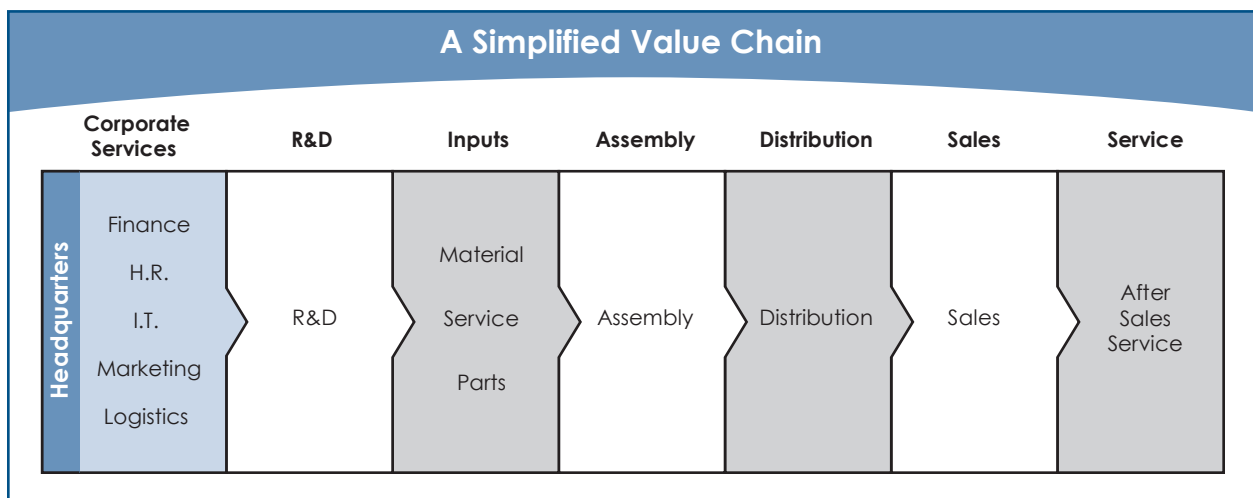
Global Value Chains: an Important Part of Today’s Global Business Environment

Today, Canada’s business environment is a *global* business environment. Canadian businesses are being forced to adapt to the ever-increasing pace, scale, and complexity of globalization. Reductions in communication and transportation costs and the emergence of new technologies have enabled firms of all sizes, from anywhere in the world, to market products and services internationally. This has increased both the scope and scale of competition. Adjusting to this new international marketplace requires that businesses change the way they are organized and operate. The adoption of the global value chain business model opens up numerous new options for firms on the path to greater success.

What are Global Value Chains?

I. Value Chains

A *value chain* includes every step a business takes to produce a product or service and deliver it to the customer from its conception to its end use and beyond. This includes activities such as research and design, production, marketing, distribution, and support to the final consumer. As you can see from this graphic “A Simplified Value Chain,” all of a firm’s individual business processes are represented in the value chain. Research and development, production, distribution, sales and service are all business processes which most firms consider to be integral aspects of their business strategy. Corporate services act as support mechanisms for these core processes.



Although you may recognize these business processes as facets of your own firm, you may never have thought of them as comprising your own *value chain*. When thinking about your own firm and its value chain, it is useful to think of each business process as a link in the chain which adds value to the entire process, or to the entire value chain.

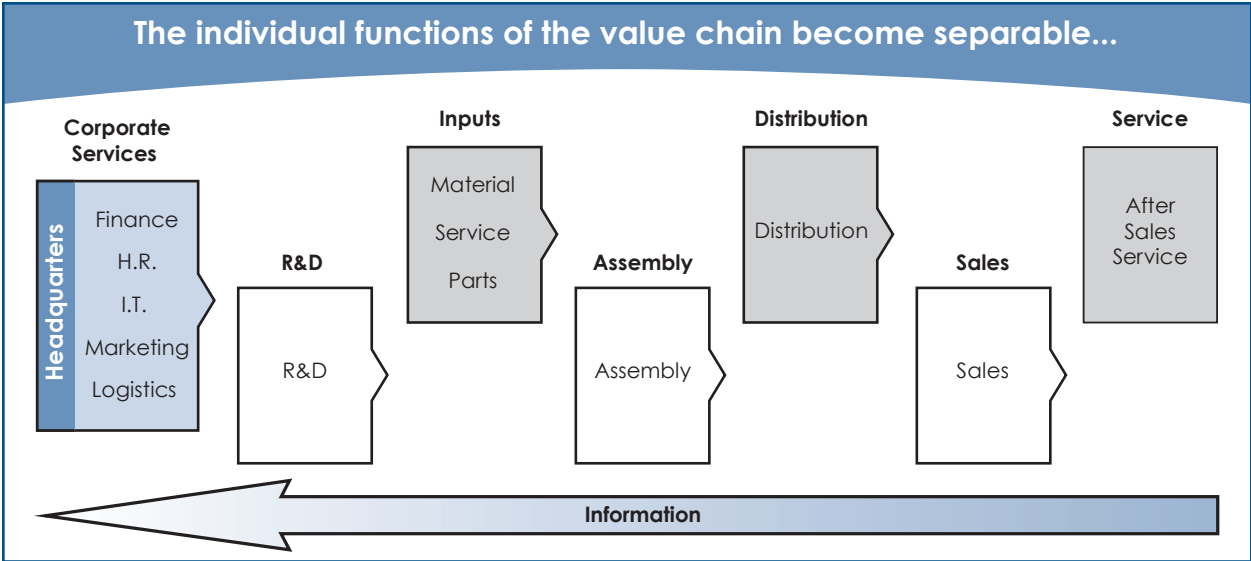
By managing the chain's activities strategically, a firm can create a competitive advantage for itself. This means ensuring that supply meets projected demand effectively and efficiently, with maximum consumer satisfaction. Productivity, innovation, flexibility and responsiveness to the consumer become critical attributes of the value chain and you must choose the most effective solution for each link in the chain. This may require expanding your vision outside the walls of your firm, morphing your previously domestic/internal value chain into a *global value chain*.

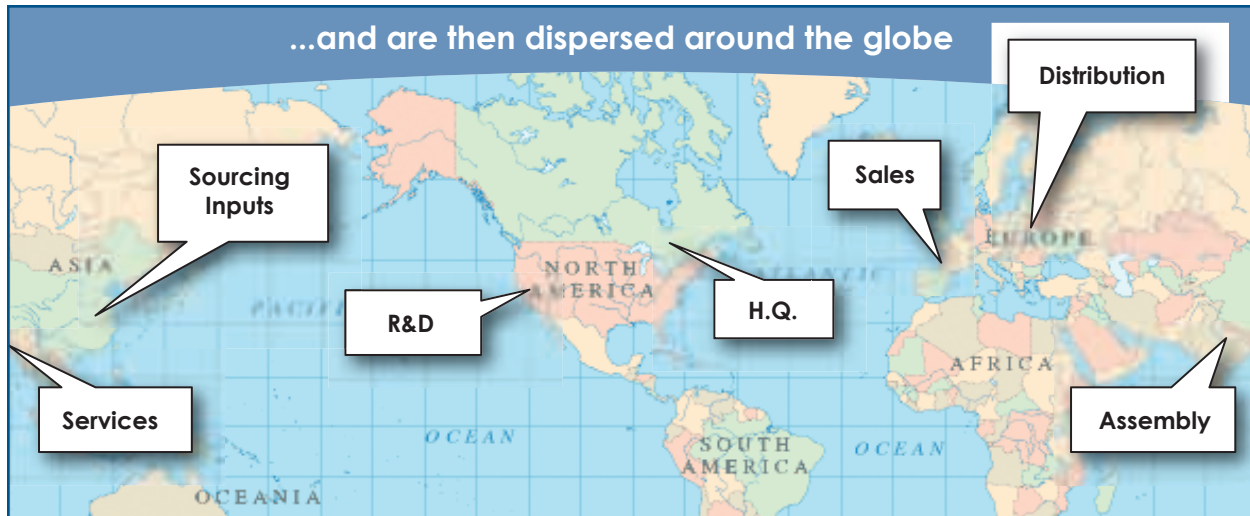
II. Global Value Chains

We know that the activities in a value chain can be contained within a single firm and/or location or divided among different locations and/or firms. When those activities are scattered internationally, a *global value chain* exists. The next graphic shows how, in a global value chain, the previously internal business processes become fragmented and separable, dividing the production and support processes among many locations and/or international firms, leveraging each hub's core competencies: *firms do only what they do best*.

For example, Company X is headquartered in Canada, has its R&D function in the United States, manufactures its good in China using parts made in India, sells to the European common market, and offers after sales service from Thailand. The firm in each geographic area specializes in one task, performing at a higher level than if one firm were to complete all activities. This is the nature of a true global value chain.

SMEs, regardless of size, can leverage the opportunities presented by global value chains. It may be of a smaller scale, but creating a global value chain can have a positive impact on your business.





Although the term *global value chain* is relatively new, the idea which it represents is not. For decades, businesses have been internationalizing, looking outside their borders for new markets, new suppliers, and new partner firms who can assist them in doing what they do better. Your business may already be using this strategy but calling it something different: *global supply chain management*, *globalization of business processes* or, simply, *business development*.

Global value chains are frequently mischaracterized as global supply chains. Although global supply chains are an important element of global value chains, they are not one and the same. Global value chains include supply chains as well as every other facet of running a business, creating a two way flow of *information*. Customer demand factors significantly higher in a global value chain, with the chain acting as a mechanism for feeding this information into the product development, production and service lines. The global value chain is a *two way street* transporting both *information* and *things*.

So What?

The challenge for Canadian SMEs operating in the international arena is one of limited resources, whether of capital, experience or knowledge. The global value chain business model helps firms to organize operations in innovative ways which deliver greater value to their customers through reduced costs and increased product and service quality. By focusing on what they do best, and using strategic relationships with other partner firms to fill in the gaps, these companies are able to strengthen their competitive advantage in ways which would not have otherwise been possible.

Take Away Message of the Section: Taking advantage of global value chains, the global extension of previously internal business processes, is an important business strategy for SMEs looking for success in the international business environment.

Global Value Chain Readiness Assessment

“Is your firm ready to take advantage of GVCs?”

Global Value Chain Readiness Assessment

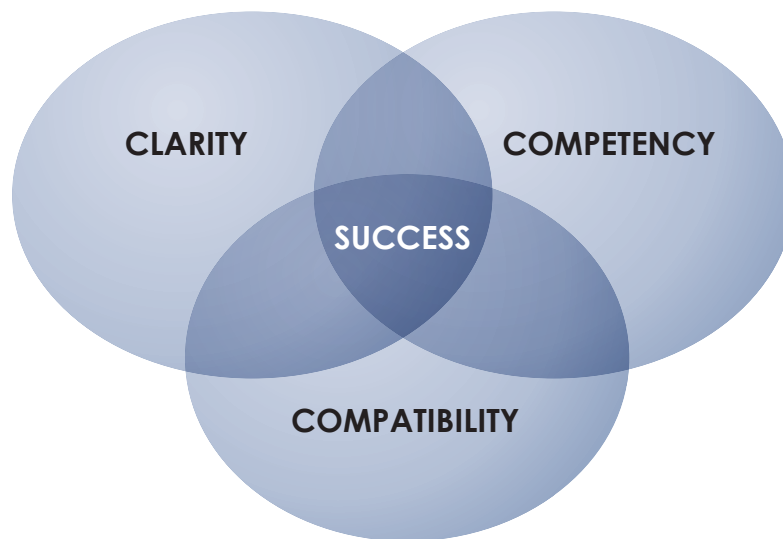
To successfully compete in the international business environment, it is crucial to be certain that you have the operational requirements necessary. In order to facilitate this evaluation, a readiness assessment may prove useful.

The “3 Cs” Readiness Assessment Model: Clarity, Competency and Compatibility

The 3 Cs readiness assessment model is designed to help evaluate whether or not your firm has what it takes to compete internationally. It does this by identifying three key factors of global value chain success: **clarity**, **competency**, and **compatibility**. In order to evaluate your firm’s readiness, the model asks three simple questions:

1. Does your firm have clarity in a strong common vision or business strategy?
2. Do you have competitive core **competencies** which your business can leverage?
3. Is your firm able to build **compatible**, well functioning business relationships?

In order to answer these questions firms must break down their operations and examine each aspect of their business individually. The 3 Cs model, displayed below, will help you through this process. Proceeding in steps, work through each of the three Cs, checking your firm’s operational capacities against the model as you go. When you have completed the exercise you should have a better idea of whether or not your firm is ready to consider competing in the international marketplace.



The First C: CLARITY

The first factor is **having a strong and clear vision or business strategy**. Giving direction to your operations, your business strategy should specify your firm's vision and mission and provide high level strategies for meeting these objectives and goals. To be effective, this strategy must not only be understood, but embraced, by each member of the organization, who should also understand how that vision affects their everyday work and their specific role in the organization. Achieving such widespread understanding of your firm's vision and strategy will ensure that all employees are working towards the same goal. As your company adapts to new environments or new organizational structures a strong and clear strategy will help maintain organizational solidarity, increasing your chances of success in the complex business environment.

It is important to remember that a business strategy should always speak to the purpose of the organization, its goals and objectives, and its preferred strategy for meeting those goals. As a tool for guiding decision making and providing a sense of direction for the company's internal and external stakeholders, your mission statement should identify your firm's goals (market share targets, international status, largest domestic player etc), your primary *stakeholder* whom you are trying to win over (international clients, domestic clients, multinational enterprises - MNEs, other SMEs etc.), your key *strategy* and *comparative advantage* which will help you meet those goals (low cost leadership, differentiated project, niche target etc), and the *core competencies* and crucial business processes which are essential for ensuring this comparative advantage (innovative manufacturing plant, strategic partnerships, heavy investment in local research and development etc.).

The following is an example of a clear and direct business strategy:

"To become a preferential supplier in the global semiconductor market, Company X aims to integrate itself into the global supply chains of large MNEs in the industry by promoting their innovative product X which features a longer useable lifespan and an easier installation process made possible by intensive research and development conducted at company X headquarters."

Exercise 1 is designed to help you evaluate whether or not your firm has a clear and effective vision and business strategy. Tips for developing a strong business strategy follow for firms who wish to enhance the clarity of their strategy.

Exercise 1: Does your firm have a clear and effective business strategy?

In order to evaluate whether or not your firm has an effective business strategy please answer the following questions:

1. Does your firm have an official business strategy which outlines your organization's goals and high level strategies for achieving success?
YES NO
2. If yes, is the interpretation of this strategy consistent across different facets of the organization?
YES NO
3. Is the content of your business strategy specific enough to provide high level direction for your organization?
YES NO
4. Are your employees familiar with the high level goals and objectives of the organization? Do they understand how these goals and strategies relate to their specific work description?
YES NO
5. Do the goals and objectives outlined in your business strategy factor into decision making processes on a regular basis? Do referrals to your official mission and strategy facilitate decision making?
YES NO

If you answered 'NO' to any of the above questions your firm's high level vision and strategy may not be clearly defined. See below for tips to improve your mission and vision statement.

Improving Your Firm's Business Strategy

Whether you are creating a business strategy from scratch or aiming to improve your existing strategy, there are strategic questions you can ask yourself in order to prompt your thinking and get you headed in the right direction. The questions below are designed to provoke thought and provide guidance in terms of what you might want to include in your strategy statement.

1. Where would you like to see your business 5 or 10 years from now?
2. How do you envisage getting there?
3. What do you need to focus on in order to achieve this goal?
4. What are your firm's strengths which currently propel you towards your goals?
5. Who do you need to work with to achieve your goals? What is the best way to engage this party?

These reflections should provide you with some food for thought in regards to your firm's business strategy. Are the answers to the above questions included in your current strategy? Should they be? The most likely answer is yes. A clear and effective mission statement should include elements of each of the questions above. Expanding your strategy to include these elements will strengthen your firm's vision and provide stronger direction to your firm's key decision makers.

The Second C: COMPETENCY

The second C in the 3 Cs readiness assessment refers to a firm's **core competencies**. Core competencies can be defined as the internal business processes critical to a firm's success. If *distinctive* and *innovative*, core competencies provide 'added value' to a firm's operations and can lead to a strong comparative advantage in the industry. In the context of global value chains, core competencies make up the foundation of each link in the chain. Firms work together as a network, each contributing what they do best (their core competency) in order to offer the most innovative and cost effective product or service. To be part of a global value chain, therefore, it is essential that your firm has distinctive and value adding core competencies which can contribute to the efficiency of the larger global value chain. To ensure that your firm has these core competencies your current business processes must be evaluated for effectiveness, efficiency and their innovative quality.

The first step in evaluating your firm's business processes is to fully understand your operations. Although this may seem a straightforward task, it is often more complicated than initially perceived. Mapping exercises can be helpful in breaking down your firm's operations. By separating your organizational capacities into individual but connected business processes, it is easy to see each task your firm is currently performing. Looking at this 'dissected' version of your operations can help you identify your firm's process strengths (your core competencies), your process weaknesses, areas for improvement and innovation, and possibly areas which your firm shouldn't be performing at all. It should help identify process duplications, production bottlenecks or gaps between requirements and capabilities. Mapping your own value chain can also help facilitate a greater understanding of how your product moves through the market, providing a larger picture of how suppliers, partners and customers interact within your value chain.

Exercise 2: Mapping Your Operations¹

As mentioned on the previous page, the first step in assessing whether or not a global value chain approach is right for your business is to ensure that you have core competencies which will make you an attractive partner in a global value chain context. Mapping your value chain can help you identify these core competencies, or if you do not yet have strong competencies, can help you identify opportunities for process improvement which will strengthen your competitiveness in this area.

This exercise is designed to help you create a process map for your own organization. As part of the mapping process, it is important to define your internal processes, your suppliers *and* your customers. Although it is often your suppliers who help to create value in your chain, it is your customers who define value, giving direction to your operations. You should also be cognisant of the resources (both internal and external) which are being dedicated to each process.

Step 1: Getting Started

Using the following template, map your value chain for your main product line.

1. Start by identifying the end product that will be going to consumers and work backwards from there. Write the name of that product in the circle on the diagram on the worksheet.
2. Once you have identified the end product, ask “What happens to the product right before it gets here?” This answer goes into the process box before the end product. Do this until all processes have been captured.
3. Now look at all of your processes and identify what partners and resources are involved in each process. Identify all other members of the chain, their roles and the resources which are involved in the process.
4. When finished, ask yourself the following questions:
 - Are all my partners included in the diagram?
 - Are all my resource dedications accounted for?
 - Are all the stages of my value chain (corporate services, research and development, production, assembly, distribution, sales and support) included in my map?
 - Is the chain complete from end to end?

¹ This mapping exercise is conceptualized from *Value Chain Guidebook: A Process for Value Chain Development*. Second edition, Agriculture and Food Council of Alberta, Value Chain Initiative. September, 2004. Pg. 65-67.

Step 3: Evaluate your Value Chain

The next step is to evaluate your current chain. Looking at your diagram, answer the following questions.

1. What are you doing well?
2. What are you not doing well? Where are the weak points of the chain?
3. Where is there room for improvement (product quality, production or processing efficiencies, logistics, and/or specialized product qualities)?
4. Where are most resources concentrated? Does this correspond with your most value adding process competency?
5. Where are there limited/abundant resources?
6. What limits your growth?
7. What do you wish you had more of? Less of?
8. Are there logistical problems (think of supply, transportation and storage issues)? Where are they in the chain?
9. What information do you and your partners need which could help you operate more efficiently?
10. What change(s) would provide your firm with the greatest benefits?
11. What relationships in the chain are the strongest and which ones could use more work?
12. What would your consumers say are the product or service strengths or weaknesses? Are these reflected in your chain?

Step 4: Following Up

Once you have identified your areas of process strengths and weakness, brainstorm ways to improve the efficiency and effectiveness of your chain. Remember that the key objective is to identify areas where you can create stronger core competencies.

It is important to recognize that value chain mapping is an ongoing process. As your organizational landscape changes, your map should be updated to reflect the firm's current state. A map is only useful in identifying inefficiencies and areas for improvement if it is up to date and complete.

Strengthening Your Core Competencies: “Doing things right ... doing the right things!”

SMEs should decide what their core competencies are (or sometimes what they *should* be) and focus their time and resources into developing those critical skill sets. Every business process must provide some ‘added value’ to the organization’s larger goal. Inefficient business processes cost money and bog down a firm, limiting ability to compete against lean and innovative competitors. Continuous improvement and innovation are key to successful integration into global value chains.

Given this prescription, SMEs face a critical decision regarding every process and functional activity they currently perform. Am I doing this well? Does this add to my product or service offering? Could I improve this process? Could somebody else do this better than I can? These are all questions which SMEs should ask of each internal business process. SMEs must realize that being efficient means *not only doing things right, but also only doing the right things!* When evaluating current processes, therefore, firms must address the following questions:

1. What *should* I do and what *should* I *not* do?
2. What *should* I resource and what *should* I *not*?
3. Who *should* I collaborate with to fill in the gaps?
4. Where *should* I do it?

When looking for partner firms with whom they can collaborate, SMEs should treat the world as their playground. Globalization has created a ‘borderless world’; your most appropriate partner may not be next door, but halfway around the world. Taking a global approach to your business processes and subsequent production alliances will present you with multiple possibilities and allow you to choose the most efficient arrangement. In turn, your own competitiveness will be improved.

By reducing the strain of inefficient processes on the firm’s limited resources, SMEs will be better able to dedicate the necessary time, money and effort towards the continuous improvement of their core competencies.

The Third C: **COMPATABILITY**

The third C in the 3 Cs readiness assessment refers to a firm’s **compatibility** - its ability to engage in well functioning business relationships. Essential to effective coordination and partnership, strong business relationships are crucial to the success of global value chains. A complex and difficult process, firms must actively seek out partners who are willing to work collaboratively for the mutual benefit of the partnership – a win-win.

Once established, these relationships become assets of the global value chain. Firms able to function as partners in one larger production process are able to leverage each other's core competencies, becoming more productive and competitive, both as individual firms and as a collaborative whole which is greater than the sum of its parts.

Exercise 3: Building Strong Business Relationships

Successful business relationships are founded on trust. In order to build strong and effective relationships, firms must be willing to embrace their prospective partners, respecting them as valuable and integral members of the team. The questions below are designed to help you evaluate your firm's willingness to do exactly that.

1. Are business partnerships valued as part of your organization's high level strategy?

YES

NO

2. Does your firm have confidence in its existing partners?

YES

NO

3. Has your firm dedicated sufficient resources (financial, human, information, time etc.) for the building and maintenance of strategic business partnerships?

YES

NO

4. Is your firm comfortable sharing valuable market information or best practices with business partners?

YES

NO

If you answered 'NO' to any of the above questions your firm may not be equipped to enter into meaningful business partnerships. It is recommended, therefore, that you consult the following tips for preparing for successful collaboration before integrating into a global value chain.

Preparing for Successful Collaboration: Tips for Building Strong Partnerships

Tip #1: Choosing the right partner is critical to success. Careful selection of a partner, although time consuming at the moment, will pay off later on in the form of a lucrative relationship. When considering potential partners be mindful of the organization's long term goals, culture, preferred methods of doing business, strengths and weaknesses, ways which the firms can complement one another, location, comparative advantage, and attitude towards partnerships in general. You may also consider their history and whether they have had experience with successful collaboration.

Tip #2: Successful partnerships are built on trust. Trust is built on reputation, past experience, behaviour and keeping commitments; it is earned through familiarity and dependability². Firms must make an effort to earn the trust of their partner but also learn to trust their partners. Without a two way exchange of trust, business relationships will be strained and inefficient.

Tip #3: Decision making can be an area of contention in any relationship. It is a good idea for firms to agree upon a predefined decision-making process. In order to be successful, this decision making process must be perceived as being fair to all parties involved. It must be transparent and provide clear direction on who is responsible for decision making in which situation.

Tip #4: It is important to ensure that business relationships are mutually beneficial to be sustainable. This can be achieved by identifying early on what each partner aims to gain from the relationship. As the relationship develops, firms should remain cognisant of their partner's needs and should work towards the satisfaction of their goals alongside their own.

Tip #5: Successful relationships require the commitment of all involved parties. This requires each partner to commit sufficient and equitable or acceptable amounts of money, time and effort. Discussions surrounding the commitment of resources should take place early in the relationship in order to avoid later conflicts.

Are you ready?

Now that your firm has completed the 3 Cs readiness assessment you should have a better idea of whether or not you are well equipped for global value chains. For further information on evaluating your firm's readiness please consult the reference section of this guide or contact your local Trade Commissioner.

Take Away Message of the Section: To be successful, firms must first ensure that they have clarity of strategy, distinctive and competitive core competencies, and the ability to nurture compatible, well functioning business relationships.

² *Value Chain Guidebook: A Process for Value Chain Development*. Second edition, Agriculture and Food Council of Alberta, Value Chain Initiative. September, 2004. Pg. 51.

Optimizing Your Global Value Chain

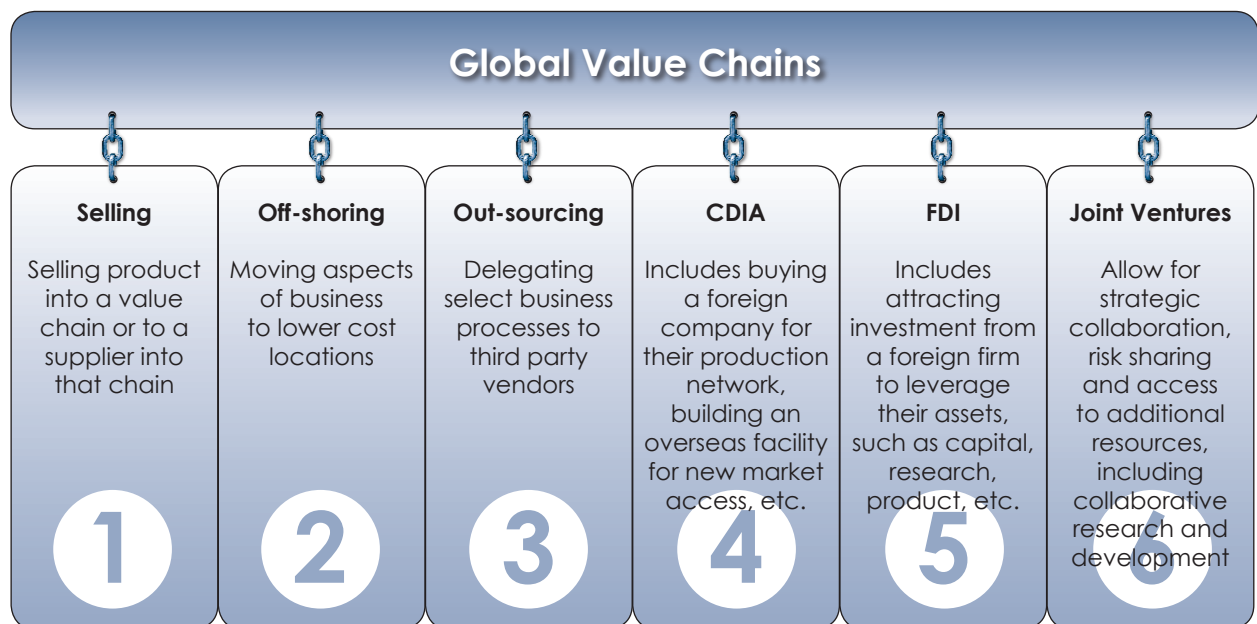
“Opportunities to Compete in the Global Business Environment”

Now that you have determined that your firm has the capabilities needed to successfully compete in the international arena, you should begin assessing your options for integrating your current business model with the global value chain approach. In this section of the guide, we will explore different avenues which will help your firm leverage the global marketplace, improving your firm's profitability and long term sustainability.

Within the global value chain framework, there are numerous opportunities for growing your business. Each of them takes a different approach, integrating your firm's operations at a different stage in the value chain. Maximizing your firm's potential requires that you find the most appropriate place for your organization in the value chain. Although you may be attracted to many of the opportunities presented in this business model, you should remain cognisant of your firm's vision and business strategy. In choosing which approach your firm will take, and therefore where you will fit in the chain, it is important to ensure consistency with your firm's core competencies and long term objectives.

Options for Optimizing your own Global Value Chain

Although there are a large number of different ways to integrate into global value chains, some are more widely used than others. Here we will discuss the most frequently used ways of adapting your business model towards the global value chain approach. The following graphic presents an overview of these integration methods. Each of these approaches will be discussed in further detail below.



1) Selling

As we have learned, global value chains take advantage of open borders, allowing each link in the chain to specialize in what it does best. As a result, many large firms have reduced their in-house activities, sourcing needed parts and services from outside firms who can deliver the product or service better, faster or cheaper than the firm could itself. This creates an opportunity for SMEs with strong capabilities in their product or service area. If your product or service is something that another firm (domestic or foreign) uses as an intermediary input (i.e. parts, raw materials, other components, management or financial services etc.) you may be able to link into that firm's global value chain by supplying directly to the company. You may also link into that same chain, further down the line, by selling to an existing supplier of the value chain. Where you link into the existing chain will depend both on the structure of the network and where in the production process your good or service is most highly demanded.

There are many benefits to be gained from taking a global approach and integrating as a supplier into a global value chain:

1. With an expanded market, your firm is likely to benefit from increased sales. In addition, because these sales stem from large, well established companies they are likely to be more consistent than sales from other markets, contributing to increased stability.
2. As your firm diversifies your sales toward other international markets, your dependency on your domestic market reduces. This will allow your firm to better withstand demand reductions or economic downturns in your domestic market.
3. The information transfer which takes place in a global value chain (ideas, approaches, marketing techniques, etc.) can be very valuable to your firm and can help keep it competitive in both the domestic and international markets.
4. Selling into a global value chain establishes partnerships that may create opportunities for investment into your business, whether they be financial, technological or managerial expertise in nature.
5. By participating in a global value chain, your firm will gain valuable international experience. As the Canadian and global marketplaces continue to intertwine, this should be helpful in ensuring that your firm remains competitive amidst global competition.

Selling into an existing global value chain is not without its challenges. There are cultural differences to overcome, increased costs from travel, additional staff, possible production and process changes, increased competition, capacity challenges, increased paperwork stemming from export documentation, and adoption of new quality standards and processes required by MNEs (ISO, TQM, Six Sigma, etc.). It is important to ensure that selling is an appropriate strategy for your firm before you invest in this approach. In addition, the gains from selling into a global value chain may not be tangible immediately. To reap the rewards from this strategy, your firm will have to be prepared to stay in it for the long haul, committing the time, willingness, and resources to establish and maintain yourself as a valuable member of a global value chain.

For more detailed information on selling into global value chains please see the *Step-By-Step Guide to Exporting* at <http://tradecommissioner.gc.ca/exporters-exportateurs/guide-exporting-guide-exportation.aspx?lang=eng>.

Exercise 4: Is Selling Right for My Firm?

In order to evaluate whether or not selling into a global value chain is the right strategy for your firm ask yourself the following questions:

1. Does your firm have the production capacity to serve both your domestic customers and your global value chain clients?
2. Is your production capacity easily adjusted in the case that either your domestic demand or demand from your global value chain partners increases?
3. Are product modifications required to make your product suitable for other corporate clients easily achieved? Are the costs of adjustment manageable?
4. Is your after-sales support service easily adaptable to accommodate foreign customers (i.e. language, culture, business environment, hours, etc.)?
5. Do you have the logistical expertise to sell into a global value chain? Does your product's shelf life allow for sufficient transportation time?
6. Are other firms in your sector using this method?
7. Does your product meet necessary international technical or regulatory product standards?
8. Are you able to meet the high performance standards expected by MNEs? Would you make investments in technology to win business?

If you answered Yes to most of the questions, your firm should continue to consider selling into an existing value chain as an appropriate strategy for global integration. If you answered No to most of the questions, selling may not be the right strategy for your firm. You should, instead, consider the alternative options for integrating with global value chains presented in the rest of this section.

2) Offshoring

Offshoring involves the movement of internal business processes to locations outside of a company's domestic headquarters in an effort to lower costs or take advantage of other local strengths, such as labour talent. The processes remain within the total control of the company, they are simply in a different location. In this fashion, your firm would create or expand its own global value chain.

A well-known example of offshoring is that of companies that place their client service call centres in India to take advantage of a large labour pool with low costs and compatible language capabilities.

3) Outsourcing

Another alternative is outsourcing, which is distinct from offshoring although easily confused. The main difference is in the level of control that the parent company maintains – total for offshoring, limited for outsourcing beyond the selection of the source. This strategy has two different approaches. One approach involves the sourcing of intermediate inputs such as raw materials, components, sub-systems, and other goods and services from outside suppliers who offer the most attractive product. These suppliers may be domestic or foreign. The focus should be on choosing a supplier that most directly meets your firm's needs, taking into account any competitive advantages, product quality, cost effectiveness, reliability, speed of delivery, production capacity and flexibility, and extended service package. In doing this, your firm has created its own global value chain, and has increased its own competitiveness by taking advantage of another's core competencies.

The second approach to outsourcing involves the delegation of select business processes to third party vendors who can perform the task cheaper, better and/or faster than your firm could itself. This approach moves beyond efficient sourcing to address business process inefficiencies which may be limiting your firm's success. Outsourcing, allowing your firm to delegate value detracting processes to more efficient providers, can become a competitive strategy for SMEs. By concentrating only on what they do best, and outsourcing non-core processes to more efficient outside producers, SMEs can increase customer value by producing better quality products at lower prices.

When deciding who to outsource to, SMEs should take a global approach. With the opening of borders, advances in telecommunications, and the lowering of transportation costs, a firm's most appropriate partner may now be located half way around the world. A firm should also remain cognisant of its long term business strategy. Keeping both these prescriptions in mind will ensure that your firm partners with the organization most aligned or compatible with its own internal goals. If your firm's strategy is low cost leadership, it will be important to find the most cost efficient partner. If your business strategy is built around product quality, your firm will want to look for an outsourcing partner who will maintain your high product standards. Exercise 5 will help guide your firm in choosing an appropriate outsourcing partner.

Exercise 5: Choosing an Appropriate Outsourcing Partner

When choosing a partner firm to outsource to, we suggest that you work through each of the factors below, considering how the needs, goals and strategies of your firm best align with each of your potential outsourcing partners.

- 1. Track Record:** Has this supplier demonstrated their ability to meet quality, price and logistical commitments?
- 2. Total Landed Cost:** After incorporating all the related costs of doing business with this firm (transportation, customs and duties, brokerage services, banking fees, insurance etc.), is the potential partner still a cost effective option?
- 3. Product Quality:** Does the potential outsourcing partner meet your quality standards? Is their product quality consistent?
- 4. Logistics:** Is transportation between your firm and the potential partner feasible, cost effective and reliable?
- 5. Trade Regulations:** Are there any problematic trade regulations/limitations regarding trade in Canada and/or in the country where you wish to outsource from which could negatively affect your operations?
- 6. Financial Considerations:** Have all financial aspects of the transaction been carefully evaluated? What payment and delivery terms does the potential supplier use? Is additional insurance required?
- 7. Time to Market:** How does your supplier's time to market compare with that of competitors'? Can the supplier be flexible and accommodate change?
- 8. Technological Capacity:** Does the potential supplier have the technological sophistication to meet your production goals? Can they easily expand their production capacity if required?
- 9. Communications:** Does the potential supplier have sufficient information and communication systems which integrate well with your processes? Will you know what has been shipped and when it will arrive?
- 10. Location:** Have you fully considered the benefits/challenges of doing business in your potential supplier's current location? Are there other factors which you have forgotten to consider (i.e. cultural differences, time zones, location in an existing free trade area etc.)?

4) Canadian Direct Investment Abroad

Canadian Direct Investment Abroad (CDIA) can be a powerful strategy for firm expansion. By investing directly in your target market you gain immediate access to a market which might otherwise be hard to penetrate due to trading regulations, transportation challenges etc. This will allow your firm to expand its sales and promote company growth in ways which may not have been possible via exporting. Direct investment abroad allows your firm access to new technologies and more efficient factors of production which may be abundant in, but physically restricted to, the new market. CDIA also allows your firm direct contact with your end users in the new market. Interacting with the end consumer will help guide your firm in developing better products and building stronger customer relationships and local experience. Your firm's presence in the country will facilitate data collection and research, ensuring your firm has the necessary information and tools to adapt to a new customer, a new culture, and a new way of doing business. Local firms may be more willing to partner with a firm who is in close proximity while consumers, viewing your operations as local and not foreign, may be positively influenced to purchase your product.

Specific strategies within the realm of CDIA also have their own additional benefits. By acquiring an existing firm in your foreign target market your firm can take advantage of the other firm's assets and experience. By retaining their production technology, marketing schemes, employee knowledge, existing business relationships and established clientele, your firm can increase its competitiveness in the local market and give you better control over production and distribution networks. You may also gain access to innovative ideas that the rest of your value chain may benefit from. This strategy can also be very cost effective, as obtaining existing production and distribution capabilities through investment means your firm does not need to build them from the ground up.

Setting up a wholly owned subsidiary in the foreign market, by buying or building a facility, also has a range of advantages. This provides access to raw materials, cheaper or uniquely skilled labour, technology, innovative operational methods, etc. Perhaps the most important advantage is that your firm is not dependent on a partner. You maintain control over your subsidiary and can continue to direct operations in a manner consistent with your firm's overall long term strategy and business culture. Your company has the option to replicate what it finds beneficial from this new experience/expertise elsewhere for the benefit of the rest of the value chain.

CDIA, with its range of diverse benefits, can be a solid strategy for your firm. It is not, however, without risks. Before choosing to invest abroad firms should carry out a detailed market analysis to ensure that the market is an appropriate one for their product (their product is in high demand, the market demographics are compatible, competition is manageable, their product is culturally acceptable in the country, etc.) and that there are no major geopolitical risks which may jeopardize the firm's investment (dangers of appropriation, tax policy, corruption, insufficiently skilled workforce etc.). If determined to be appropriate, however, CDIA can be a strategy through which SMEs improve their access to new technologies, new markets and new, more efficient factors of production. This can improve firm productivity, profitability and, in the long term, sustainability.

Exercise 6: Things to Consider Before Investing Abroad

It is crucial that before you invest you understand the dynamics, culture, government regulations, and demographics of the foreign market you are considering entering. This exercise is designed to help your firm with this process by highlighting some of the critical considerations which your firm will want to research before investing.

- 1. Purpose:** Is your intention to sell into the market or move stages of the value chain offshore? This will determine the relative value of subsequent answers to your decision-making.
- 2. Market Demographics:** What is the demographic makeup of the foreign market? Is your target customer abundant in this market? Are there cultural considerations which may influence the success of your product in this market?
- 3. Competition:** Is the local competition manageable? Does your firm have a comparative advantage which will allow it to compete with the local firms?
- 4. Labour Force:** Is there a sufficient supply of appropriately trained workers which your firm can leverage? What are the costs of labour? Are there restrictive labour regulations in this market which could affect your productivity?
- 5. Government Regulation:** What is the tax policy of the government towards foreign owned firms? Are there dangers of government intervention or appropriation? Are there other related regulations which would affect the way your firm operates (environmental standards, production regulations, safety standards, etc.)
- 6. Intellectual Property Protection:** Is there sufficient legislation to protect your firm's intellectual property? Is this legislation enforced? Is there great danger of counterfeiting or process replication which could damage your firm's international success?
- 7. Support for Foreign Operations:** Does the government welcome foreign direct investment? Are there tax breaks for foreign firms setting up operations in certain locations? Does the government support foreign firms and value their operations?
- 8. Corporate Social Responsibility:** Are there ethical questions about investing in this market (environmental, labour exploitation, etc.)?

5) Foreign Direct Investment

Foreign Direct Investment (FDI) can help solidify relationships between your firm and a foreign MNE. The obvious example is an investment of capital to allow you to make changes, upgrades or innovations that would establish you as a vital link in the MNE's global value chain.

FDI can allow you access to other potential suppliers for your own company, while connecting your own operations to the rest of the value chain, opening up linkages for you to supply elsewhere. Additionally, FDI can provide access to innovative technology, techniques, or research and development that you can take advantage of to improve your own operations.

You will want to consider the compatibility between the potential investor's interests and your own, including, but not limited to, method of operation, level of control required, ownership of intellectual property, long-term goals, corporate social responsibility, etc.

6) Joint Ventures and Strategic Relationships

Another way to integrate into a global value chain is through a joint venture or strategic partnership. A joint venture is a partnership arrangement where two businesses each contribute capital to a newly created entity that they operate either together or through a separate management structure which is accountable to the parent companies, or where a foreign firm and a local business enter into a general partnership agreement and operate the joint venture as a partnership. A strategic partnership follows along the same lines, but it can be much more varied in the responsibilities and contributions of each partner. A strategic partnership is more flexible, allowing the partner firms to create a customized partnership plan which works well for both parties.

One of the greatest benefits of partnering with a local firm is that your partner can complement your capabilities so that each firm focuses on what it does and knows best. This can drive progress in your output productivity and also improve the quality of your end product or service. Local partners are also able to provide local expertise, insight and network contacts which will help your business thrive in the new marketplace. These intangible assets are often hard to come by for foreign firms and can make the difference between success and failure in the new market. Forging local partnerships may also help your firm resolve problems related to professional accreditations, movement of personnel across borders, and tax and legal status. In addition, partnerships allow for firms to share the risk of entering a new market, as both contribute resources and share in the profits or losses. Partnering with a local firm will also allow you to pool ideas and resources. Your partner may be able to provide technology or capital which your firm might not have had access to on its own. Combining the technical and financial strengths of two businesses can make both you and your partner more competitive.

There are many different types of partnership arrangements which your firm may want to consider. If you feel your firm is not ready to participate in a joint venture you may want to consider licensing, franchising, co-marketing, or co-production. It is important that when choosing a partnership arrangement you keep your firm's vision and long term objectives in mind. If the partnership is successful, it must work to meet both firms' objectives and goals for integrating with a global value chain. It is also important to use the expertise of lawyers, accountants, bankers and other professionals to ensure that all parties are absolutely clear on which partner holds which rights and responsibilities.

Exercise 7: Choosing the Best Partner

For any alliance to be successful, the two partner firms must be a good fit for one another. Choosing a partner firm is a very important step in setting up a joint venture or any other strategic relationship. This exercise, although not exhaustive, will point out a few key considerations which your firm will want to take into account when choosing a partner.

- 1. Synergies:** Partnerships work best when the firms complement each others' strengths and weaknesses. What your firm lacks in productive capacity, your partner should excel in and vice versa. This approach will allow each firm to do only what they do best, increasing total productivity and competitiveness.
- 2. Integrative Business Models:** Although each firm may have to make small adjustments to how they do business, partner firms will want to first ensure that their business models are compatible. Once partnered, firms will have to agree on a unified business strategy. Picking a firm therefore which has a business approach similar to your own will make the integration process easier.
- 3. Aligned Vision and Long Term Goals:** In order for a partnership to be effective, firms must be able to align their strategy, vision and long term objectives. Picking a partner that has similar goals and objectives as your firm will increase the chances of a successful partnership. It is important to note that goals and objectives do not have to be identical, but they should be compatible, ensuring that both firms are working together in the same direction.

Many joint ventures/partnerships eventually end, either because they fail or because they were set up from the start with a termination date. It is important to articulate what would be good reasons to terminate or get out of a joint venture before getting into it. What if the alliance does not produce benefits? Alternatively, parent companies may reach their joint venture objectives in a few years and perceive not enough value in pursuing the joint venture beyond that time.

Take Away Message of the Section: There are different strategies for developing or integrating into a global value chain. Selling, Offshoring, Outsourcing, Canadian Direct Investment Abroad, Foreign Direct Investment and Joint Ventures and Strategic relationships are approaches to be considered when choosing your strategy.

Moving your Plan Forward

“Contact Information and Additional Resources”

The rise of global value chains presents many opportunities for SMEs. By integrating into a global production network, SMEs can expand their reach from the local to the global, capitalizing on a larger market with more efficient factors of production. Whatever method is chosen, SMEs can improve their domestic and global competitiveness, expanding their sales and increasing their profitability and long term sustainability.

Moving to integrate with a global value chain is a big step for most SMEs and it is important to remember that your firm does not have to go it alone. There are many resources available to support SMEs in their international expansion. The **Canadian Trade Commissioner Service (TCS)** is dedicated to helping Canadian businesses succeed internationally. The TCS provides four key services. It supports firms by:

1. helping prepare for international business;
2. assisting with international market potential assessments;
3. providing qualified market contacts; and
4. guiding problem resolution when challenges arise.

Visit the Trade Commissioner Service website at www.tradecommissioner.gc.ca for additional information on our services and activities. You can also contact your nearest TCS office in Canada by calling 1-800-267-8376 (toll-free in Canada).

Financing

After reviewing the options for integrating with global value chains, many SMEs may feel overwhelmed. Not only may the presented options seem daunting but they may also seem prohibitively expensive. Although it is true that many of the strategies require substantial investment, SMEs should not dismiss them as unachievable or unfeasible. There are many services, both private and publicly funded, which can assist SMEs with financing their international business endeavours.

Export Development Canada (EDC) is Canada's export credit agency. They understand that SMEs often need financing to support their international strategies. Whether to pay for the up-front costs associated with the production of a large export order, to expand into new markets, or to respond to a buyer's request for financing, EDC offers innovative financing, insurance and risk management solutions to help Canadian firms expand their business internationally. With approximately 80% of their customers being small and medium sized businesses, EDC has valuable experience in working with SMEs and is familiar with their financing needs. For more information on EDC's financing services please visit their website at www.edc.ca.

The **Business Development Bank of Canada (BDC)** is a financial institution owned by the Government of Canada which is dedicated to supporting Canadian businesses through financing, venture capital and consulting services. They work with entrepreneurs in all industries and are committed to helping businesses move forward with their development projects, both local and global. Dedicated to Canadian entrepreneurship, BDC has a special focus on SMEs in sectors such as manufacturing, exporting, innovation and knowledge based industries. For more information on BDC's financing services please visit their website at www.bdc.ca.

Additional Resources

For more information on the various elements of this guide please see the additional resources listed below.

Global Value Chain Information

- **The Trade Commissioner Service – Global Value Chains**
<http://www.tradecommissioner.gc.ca/eng/gvc/home.jsp>
- **CanadExport: Climb Up the Value Chain (Podcast)**
<http://tradecommissioner.gc.ca/canadexport/139813.aspx?lang=eng>
- **Value chains for new markets factsheet**
[http://www1.agric.gov.ab.ca/\\$department/deptdocs.nsf/all/agdex12990](http://www1.agric.gov.ab.ca/$department/deptdocs.nsf/all/agdex12990)
- **Value Chain Assessment Checklist**
http://www.agfoodcouncil.com/media/9550/vc_assesment.pdf

Selling into a Global Value Chain

- **Step-by-Step Guide to Exporting**
<http://www.tradecommissioner.gc.ca/eng/guide-exporting.jsp>
- **Exporting to the United States; A Guide for Canadian Businesses**
<http://www.tradecommissioner.gc.ca/eng/exporting-to-united-states.jsp>

Financing

- **Funding Opportunities**
<http://www.tradecommissioner.gc.ca/eng/funding/home.jsp>
- **Export Development Canada – Financing Solutions for Canadian Companies**
<http://www.edc.ca/english/financing.htm>
- **Business Development Bank of Canada – Financing**
http://www.bdc.ca/en/business_solutions/financial_services/default.htm

