

Applying the Value Chain Framework to the Health Sector

Concept Note

I) Definition of value chain analysis

Value chain analysis is an economic development strategy to reduce poverty by better integrating micro, small and medium enterprises (MSMEs) into competitive markets. It offers a framework for understanding the relationship between firms in a particular industry, by examining the overall performance or governance of a chain and identifying the conditions under which it would better perform. Value chains themselves define the sequence of transactions that bring a product from its raw inputs to the final consumer. The value chain framework helps to identify the services and solutions critical to improving the productivity and competitiveness of a given industry and to enable MSME's to upgrade their services, products and overall productivity (Kula and Farmer, 2004). As such, value chain analysis considers both macro and micro level factors—it addresses policy constraints to achieving economic growth, trade and competitiveness, while it also responds to localized constraints faced by individual enterprises and households.

II) Purpose and use of the value chain framework

MSME's employ the majority of low-income people in many developing countries and actively participate in global supply chains (Goldmark and Barber, 2005). Such enterprises are important vehicles for poverty reduction as they stimulate private ownership, generate employment, and promote income distribution. MSME's vary by size and industry, as they also operate in both informal and regulated sectors.¹ Nonetheless, they share certain qualities: they are flexible and responsive to changing markets, and able to offer specialized inputs often at lower cost. They are also constrained by limited access to resources and information and restricted in their competitiveness across shifting global borders.

The value chain framework seeks to overcome these constraints by identifying different entry-points and linkages that small and medium enterprises can leverage in a given production or supply chain. A value chain traces the full range of activities required to bring a product or service from its conception to end-use, including the design, production, marketing, distribution and delivery to the final consumer. While these activities can be contained within a single large firm, in an economy where borders are porous and production inputs and assets dispersed, they are likely to be shared by specialized firms of varying sizes and cost-structures, working in different locations.

Exactly how businesses participate in the production process of a given industry determines their competitiveness and growth, as well as the strength of the overall chain. The literature on value chains distinguishes two types of inter-firm relationships, vertical and horizontal, that define this strength. Vertical linkages are at the core of any production process and constitute the relations between input suppliers, manufacturers, distributors and retailers of a

¹ USAID defines a microenterprise as having 10 or fewer employees, small firms with 11-50 employees and medium firms with 51-300 employees.

given product or service. These linkages define a value chain's fundamental efficiency. Horizontal linkages tend to be ancillary—they lead to collective efficiencies and reduce transactions costs. These may be achieved through grouping individual firms in a network and partnering with a business development service (BDS) provider to realize economies of scale.

III) Why use the value chain framework in the health sector?

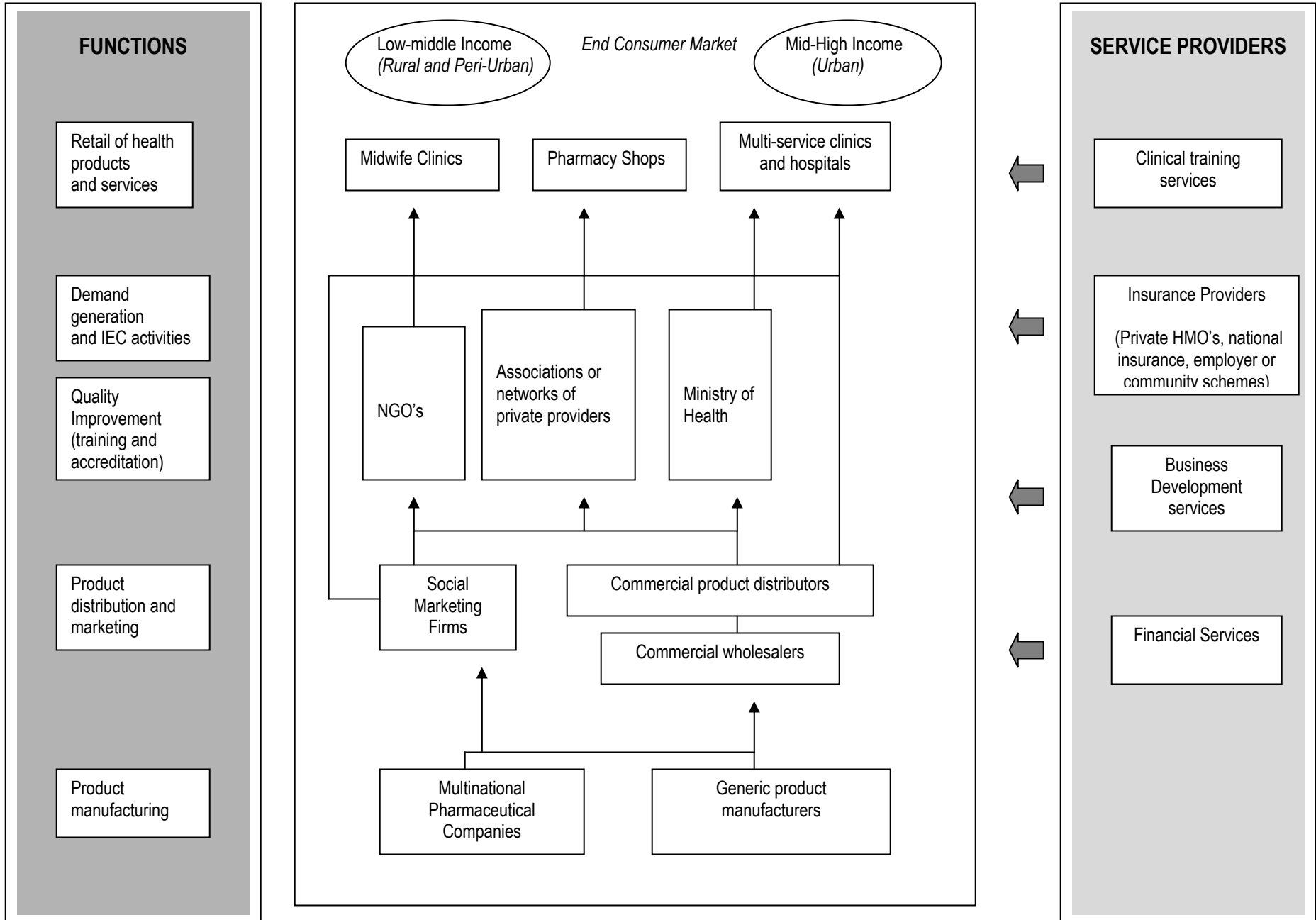
Value chain analysis can be used to improve efficiencies in the health sector by mapping and responding to the constraints and opportunities faced by health care businesses in a particular market. The size and complexity of the private health sector is increasing in developing countries; health sector reform and decreasing government health budgets have meant that private sector providers are playing an increasingly critical role in the delivery of healthcare. (Brugha 1998, Bloom, 2001, Smith 2001 et al). In this context, improving access and quality of services and promoting contraceptive security through private channels is an important goal of public health practitioners and the donor community.

The complexity of the private health sector is reflected in the relations between cadres of different service providers, product suppliers, manufactures, policy makers, government ministries, and consumers. Sector-wide assessments of health care provision and product distribution are necessary to develop strategies that can facilitate private sector growth and increase the utilization of health services and products. The value chain framework can be adapted for this purpose. It will serve as a tool to identify bottlenecks along the health sector supply chain and harness synergies between different provider firms, professional associations, manufacturers, distributors and other stakeholders—towards expanding the overall supply and quality of health services and products in the private sector.

PSP-*One* can benefit from applying the value chain framework to advance the role of the private sector in providing RH/FP services and products. Rather than analyze different pieces of the value chain in isolation, such as by service provider networks or generic product distributors, the tool will offer a way to approach an entire health sector through a total market lens. It will enable PSP-*One* to analyze each component of the value chain, identifying bottlenecks and opportunities to expand the private sector's role in supplying RH/FP services and products. In particular, it could potentially be an important tool to address contraceptive security in the private sector, examining the opportunities and barriers to linking contraceptive manufacturers to distributors to health providers to the end users. In taking a systemic market approach that is critical for scaling-up any private intervention, the value chain framework can directly support PSP-*One*'s work in achieving scale.

IV) Preliminary map of a health sector value chain (See below)

**A Health Sector Value Chain
for Contraceptive Products and Services**



V) Towards applying the value chain framework for RH/FP services and products

Following are the primary components in utilizing a value chain approach for health care provision. It is a starting point to map the different factors relevant to the private health care market and to identify potential areas for strengthening the overall supply of health services and products.

1) Upgrading at the firm level

Small and medium firms need to improve their overall efficiency and/or the quality of their services in order to gain competitiveness. Upgrading relates to technology improvements as well as the clinical capacity of a health care business.

- Improving competitiveness and productivity: Small healthcare businesses can become more competitive by enhancing the quality and menu of their services or by becoming more efficient and cutting operating costs. Small providers may diversify their line of services to offer curative or specialized diagnostic care as a way to enhance productivity; alternatively, medium or large health providers may outsource a particular laboratory service that is costly to retain in-house.

2) Leveraging horizontal linkages

Horizontal linkages ensure that small firms cooperate to reduce transaction costs and benefit from economies of scale.

- Networks of health providers: When organized into affiliations or networks, individual providers can benefit from economies of scale with easier access to training and ancillary services such as credit, business development, or marketing, etc. Networks may be comprised of homogenous or differentiated providers, depending on context. Referrals between different specialized providers, such as drug retail shops and midwife clinics, can facilitate cooperation among small firms and ensure that consumers have knowledge about reputed providers and are able to easily access a “bundle” of quality health services. Networks can also serve as a mechanism to bring generic manufacturers into the supply chain through pooled procurement agreements.
- Institutional linkages to facilitate learning: Strong information channels can generate knowledge among providers and improve the quality of their services. Formal linkages between institutes of higher learning, ministries of health and associations of individual providers are useful to facilitate learning and build capacity. These relationships can be global (with different donors) and/or national, but the idea is to develop a local market for this knowledge over time. Providers should recognize the value of this knowledge and be willing to pay for it. From a policy standpoint, incentives to spur the growth of local educational/training institutions are important to enhance learning and innovation.

3) Leveraging vertical linkages

Vertical linkages are important to generate growth by increasing efficiency and competitiveness. These linkages demonstrate a direct relationship between the input supply and the final consumer market, and may be confined within local and/or national boundaries or linked into global markets.

- Linkages to address contraceptive and drug security: Segmenting the market to ensure the appropriate targeting of commercial and/or subsidized products is necessary to ensure that consumers have continued access to a full range of affordable health services and products. South-to-south linkages with product manufacturers can increase competitiveness of the private health sector and lower costs to targeted consumers as well as support southern-based generic manufacturers.
- Linkages between different types of healthcare businesses. Relations between different specialized providers whose inputs are directly integrated into the supply chain – including laboratory or diagnostic services, etc – may be strengthened to improve the overall efficiency of the chain.

4) Developing the market for supporting services

The existing market for supporting services will affect the strength of the health care value chain—in many developing countries this market will need to be stimulated.

- Business development, financial and sector specific services: Ensuring that small and medium service providers have access to financial services, updated technology and information, including clinical and other health training, is necessary to upgrade their businesses.
- Insurance mechanisms: The market for private health insurance is an important factor in expanding utilization of preventive services. Private providers can be financially incented to offer preventive services through a capitated scheme for which there may be little consumer willingness to pay upfront. Private HMOs that are supported through employer or private contributions, national insurance schemes that contract with private providers, or community based risk-sharing arrangements are several ways to encourage the supply and utilization of health care, and particularly of preventive RH/FP services.

5) Ensuring an enabling environment

The role of governments and donors in setting and shaping policy is important to ensure an environment conducive to the private sector provision of health services.

- National quality standards/accreditation: Enforcing and monitoring quality health standards require that individual providers – whether individual businesses or larger hospitals – are required to upgrade the quality of their health services. Nationally enforced standards also serve an incentive to develop the market for local institutions to offer training and clinical support.
- Service supply: The broader policy environment should support the participation of small and large private health providers. Incentives to support private health insurance, or contracting with private providers within a national health insurance program are examples of such support, and can serve as a mechanism to license and regulate health care businesses.

- Product supply: The regulatory environment is probably the most critical factor influencing the availability and quality of contraceptives. (Armand 2005). The lack of a sustained supply of affordable products can immediately constrain the growth of the private health sector, and arrangements with generic manufacturers may be needed to enhance supply and lower prices to the end consumer. In countries where the market for local generic manufacturers is non-existent, incentives to encourage south-to-south cooperation with regional manufacturers can be developed, for example, by relaxing import taxes or negotiating long-term agreements with a particular pharmaceutical firm.

6) Facilitating end-market opportunities

Stimulating demand among consumers and providers is often necessary, especially around the provision of RH/FP services. Demand is interdependent with service provision and strategies to generate demand should be institutionally linked with their supply.

- Partnerships with different stakeholders: Public sector ministries, large firms, schools, community based institutions, etc., can play important roles in stimulating demand for preventive health services, especially related to RH/FP service utilization. Commercial pharmaceutical companies may also partner with NGO's and direct information campaigns to a particular consumer group in exchange for increased market share.
- Demand-based financing mechanisms: Targeted vouchers or savings based micro-insurance products can be used to attract clients who are less inclined or able to pay out of pocket. Other forms of private or employer based insurance and risk-pooling mechanisms can also increase demand for and utilization of RH/FP services.
- Diversifying service mix: Small-scale providers can stimulate demand for preventive RH/FP services by also offering services for which there is higher immediate demand. Such curative, lab, or other diagnostic services are also more lucrative for the provider.

VI) Initial considerations in applying the value chain framework to the health sector

1. Many inputs in the health service sector are soft, variable and specialized. Beyond the supply of drugs and equipment, production inputs in the health sector relate to human capacity. For example, clinical skills, experience and even individual motivation are important factors that determine the initial make-up of the supply chain. In a conventional product-driven value chain the inputs at the small-firm level tend to be physical assets or resources such as crops or raw material, whose quality are readily determinable. The process of building and measuring the quality of human capacity assets in the health service sector is incremental, and potentially complex and expensive.
2. Demand for services in the end market may need to be stimulated. Underlying inefficiencies in the market for public health goods, particularly for preventive RH/FP services, mean that these services are under-provided and under-consumed. Typically, the public sector and non-governmental organizations have provided these services in the form of free or subsidized care. While consumers are increasingly using private sources and paying

out of pocket, consumer demand for preventive care still needs to be stimulated. Likewise, incentives for providers to offer services for which there may be inadequate immediate demand, or where consumers are unable to pay for such services, will need to be considered.

Conventionally, the value chain framework is applied in growth-oriented industries that are driven by consumer demand. The end-user articulates clear price, quality and product preferences that different suppliers in the value chain, often globally dispersed, are able to respond to. For example, local coffee producers in Kenya may supply quality organic coffee for a niche international consumer market. The end-market for preventive health services, however, is always local and may not be immediately driven by consumer demand.

References

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- 5) USAID, AMAP 2005, Value Chain Approach to Poverty Reduction: Equitable Growth in Today's Global Economy.