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# The 'hidden middle': catalysing transformation and growth in the agricultural mid-stream sector



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All blogs

**USAID's Agricultural Value Chains Project (AVC), implemented by DAI, has explored the factors that limit development of Bangladesh's mid-stream segments and identified targeted areas for intervention to begin to work around these barriers and catalyze transformation in the mid-stream.**

Thomas Reardon draws attention to the role rapid transformation in the mid-stream segments of the agricultural market system (processing, logistics, and wholesale) plays in driving market inclusivity (1). These segments comprise 30-40 per cent of the value add and production costs in food value chains, and developments in these middle segments can have huge impacts on systemic health. Contrastingly, countries with under-developed mid-stream segments struggle to achieve growth and poverty reduction.

## Theory in context: Bangladesh's mid-stream sectors

The economic and political climate in Bangladesh is constrained by high levels of uncertainty and informality. Unpredictable weather patterns result in storms and floods that can wipe out an entire season's crops; political polarisation and corruption creates distrust around regulations and institutions; and distant regional relationships make it hard to forge robust commercial networks. Businesses react rationally to an unpredictable market by creating a close circle of trust around family or community networks, with hiring, promotion, and growth based on trust and loyalty, rather than the merit-based system that could emerge were the market

more formal. There is a bias towards relying on your family/inner circle trust to mitigate risk.

Additionally, businesses operating in an informal economy with limited governance or institutions do not trust the system to function well enough to support a return on investment in expanding market share or to present a safety net when shocks arise. Because the system is void of trusted financial or regulatory institutions, entrepreneurs react by chasing cash, resulting in many small, extractive businesses. Logistics, aggregating, and distribution market actor transactions are facilitated by a loose network of these extractive micro-SMEs, with a lack of social capital or resource sharing among these mid-stream actors.

This traps mid-stream businesses and entrepreneurs in an auto-catalytic loop – or in layman's terms a vicious cycle where extractive behaviour drives distrust, which drives more extractive behaviour and distrust, leading to high rates of poverty. Without re-investment in growing existing businesses, larger, professional businesses do not emerge in the mid-stream to support a growing commercial sector. Despite these socio-cultural obstacles, there are a growing number of high-achieving and forward-thinking entrepreneurs and SMEs in the Southern Delta's agricultural market, who are messaging a clear interest in investing in and growing their business in a strategic way. However, because these leaders from different networks are not interacting with each other, this limits opportunities for effective innovation and collaboration.

### In practice: from diagnosis to intervention

Limited investment in the mid-stream sectors of agriculture puts a significant systemic constraint on the market. For development projects, balancing the need to understand the challenges as a systemic constraint, rooted by socio-economic norms, with an effort to facilitate chipping away at these challenges through targeted interventions can seem impossible. AVC is working to strike this balance by targeting interventions at mid-stream sectors with the most potential to leverage large-scale impact and quick returns. The project aims to use quick returns on investment in high-impact sectors to catalyse and speed behaviour change in the mid-stream. To do this AVC has taken an approach that:

- Focuses on understanding what the biases are and what the wider norms are that the system is reinforcing through stakeholder engagements, market assessments, and relationship mapping.
- Designs interventions targeted at mid-stream sectors with the most potential to leverage large-scale impact and quick returns to catalyse and speed behaviour change.
- Looks for areas where the project can create more bridging capital around this issue to encourage collaboration and professionalisation of firms and services.

This is often about helping market actors move into a system where socially, the business sees a reason or avenue to jump across networks and to build social capital with a range of firms.

Guided by this strategy, AVC is addressing issues in the mid-stream via three different intervention areas: transportation and packaging, supply chain management, and input distribution.

### Transportation and packaging

Transportation is the most significant constraint in bringing produce from the Southern Delta to the processing hubs or national markets, giving even slight changes and improvements in the transportation sector the potential to have significant impact on a large net of market actors. As the market in the Southern Delta has matured, with increased production, purchasing power, and inter-trade with commercial markets, the need for commercial transportation has emerged. However, the informality and limited governance in the market results in transportation transactions that operate on an informal and deal-by-deal basis, with no long-term agreements, no commitments or formal partnerships, and no one taking ownership for packing, unloading, and other logistical services. The result is a system that is predatory against drivers, inefficient and extractive, and not geared at commercial needs to promote industry growth.

AVC is working closely with stakeholders in the market to test and pilot new models for transportation and logistics support that can shake up the current system and encourage market actors to explore more efficient solutions. As part of this effort, AVC is supporting a local ICT logistics software company in launching a trucking pilot in partnership with a national agri-business. Through the pilot the ICT company will act as a logistics service provider, linking through a formal MOU 50 trucks with local agri-business representatives in the Southern Delta. The agri-business will contract and train corporate drivers, while the ICT firm will provide them with GPS technology to coordinate pick up, loading, and delivery to maximise the efficiency of the transportation process and routes. The pilot will support market pressure towards professional logistics and transportation services as a growth opportunity for savvy entrepreneurs and SMEs.

### Supply chain management

Bangladesh's growing urban middle class is driving a surge in consumer demand for quality and safety standards in horticulture. Initial market analysis and stakeholder meetings showed that firms were not meeting this demand and showed little interest in investing in their suppliers' trading and aggregation transactions, which remained unstructured and extractive. Agricultural firms incorrectly assume consumers to base decisions mainly on price, misreading signals that there is significant trust gap between consumers and brands. Without firms being

incentivised to lead supply chain governance by quick-return profits or a competitive advantage from investing, there is no enforcement mechanism around transparent buying/selling relationships in the mid-stream between entrepreneurs or SMEs that facilitate spot transactions in the market.

AVC is working to amplify consumer pressure and build firms' capacity to read consumer signals for trusted quality, and supporting firms in meeting this demand through investments in improved supply chain management that ensures fairness and structure when firms are buying from smallholders. Large agri-firms can play the role of exerting needed governance over the current system of extractive SMEs and informal spot transactions that move produce from smallholders to regional aggregators to wholesale markets, incentivised by the competitive advantage of certified high grade/quality produce. Based on a combination of pressures from international standards bodies, regional dialogues, and marketing campaigns and tools that have amplified consumer signaling, retailers are showing increasing interest in and commitment to traceability and management of supply chain standards to establishing trust with their customer base. AVC is focusing on leveraging pressure for supply chain management initially in high margin channels (high-quality or organic products that appeal to wealthy, urban consumer pools), as these channels allow for a return on investment relatively quickly, incentivising firms to see value in supply chain investment in all channels.

AVC is supporting a second trend, the emergence of professional supply chain management companies. These independent small firms are working at the trader and aggregator level to professionally manage the movement of fresh produce from the producers to the large agri-firms that they are connected to. These management firms can oversee the process of sorting and grading, smoothing the negotiation and transaction process for the smallholders and traders, while also ensuring that the agri-firms can get a consistent supply of produce at the required standard. The investment in contracting a supply chain management firm makes the flow of goods from producer to aggregator to agri-firm more efficient and organized, reducing mistrust, improving quality control, and mitigating risks that arise from cheating and zero sum transactions between supply chain actors that can drive up agri-firms' production costs and drive down consumer trust. As customers gain confidence and trust that they are paying for quality, this translates into a transparent and merit-based system for farmers.

### Input distribution

Access to quality inputs including improved seeds, safe pest management products, fertilisers, etc. is a persistent problem for smallholder yields and profits. While there are several agri-input companies operating in Bangladesh's Southern Delta production zone, unstructured and informal seed distribution transactions lead agri-firms to invest only in their point of sale transaction with the regional distributor. Agri-firms are uninvolved in managing transactions into their distribution chain,

creating a distant relationship between the agribusiness and their end customers (smallholders). As a result, farmers make poorly informed decisions when buying seeds and regional retailers are ill equipped to provide guidance of the benefits and proper use of branded seeds versus saved/loose seeds or unbranded inputs.

AVC is working with lead firms to improve the way they integrate mid-stream distribution functions into their network. With the support of AVC, large input agribusinesses are developing vertically integrated distribution chains for inputs, creating networks of preferred distributors and retailers in regions with opportunity for market expansion. The agri-firms are investing in fully integrating these retailers into their regional marketing teams by training them in proper application and use of seeds, pesticides, fertilisers, and IPM technologies and providing the shops with branded packages and supplemental information. These preferred distributors and retailers provide information to farmers on input use and the benefits of the branded seed. Because farmers are better informed, they have better yields and outcomes when trialing the branded products, and these initial adopter farmers can be advocates for the agri-firms' brands in their communities. Additionally, because the retailers are regularly interacting with and building trust with their farmer customers, they provide feedback to the firms on what the farmers do and don't like about the products, and which products are most popular in various regions. This improves customer signaling and generates market information for the agribusinesses. By incorporating distribution mid-stream functions into the agri-firms direct regional marketing team/network, the firm ensures there is value added for the farmer and firm at each distribution transaction.

### Looking forward

AVC is continuously assessing and reassessing the mid-stream sector to look for emerging signals around increased cooperation, professionalism, and the emergence of new firms/services to support the commercial market. As these signals emerge, AVC will continue to amplify them and target interventions at speeding positive behaviour changes. To date, AVC has focused on working with lead firms or support firms to extend their reach into the mid-stream and integrate functions further in their supply and distributions chains. The next step will be for mid-stream SMEs and entrepreneurs to be empowered to feel more comfortable working directly with lead firms and partnering across networks to create professionalized service firms in transportation and logistics, supply chain management, and distribution chain management. AVC is already starting to see professional supply chain management firms emerge, and this indicates a trend towards vertically-integrated, professional firms that manage efficiency and transparency from production to consumption.

(1) See Thomas Reardon; The hidden middle: the quiet revolution in the midstream of agrifood value chains in developing countries. *Oxf Rev Econ Policy* 2015; 31 (1): 45-63. doi: 10.1093/oxrep/grv011.

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