

Shifting institutional biases:

Using value chain governance
to address a market's
underlying systemic structures

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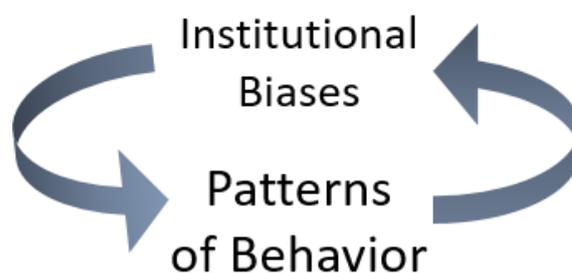
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Introduction

The purpose of this brief think-piece is three-fold: to outline the importance of shifting institutional biases to achieve durable change in market systems, to illustrate how the analytical lens of value chain governance helps make sense of institutional biases, and to illustrate how these insights can be used to improve intervention strategies. The paper draws from market development cases and composite sketches of market systems from the experience of its authors and key informants.

Institutional biases

Market systems are often visualised as patterns of behaviour of how actors interact with one another, like when vegetable farmers and exporters cooperate to meet market requirements, or not. Over time, patterns emerge from these interactions. Some patterns are short-lived; they emerge in response to isolated or sporadic events like fuel shortages where exporters may buy only from farmers closer to their pack-houses. When events pass, behaviour patterns likely revert to more consistent ones. These more consistent patterns are embedded, or rooted, in the rules, incentives and structures of the system, also known as a system's institutional biases.¹ Biases reveal themselves in all manner of behaviours, such as, around patterns in business strategies, trade relations, innovation rates, etc. In a self-reinforcing manner, patterns of behaviour shape and are shaped by the biases of the system. For example, the more women are excluded from certain roles, the stronger the biases become against women ever filling those roles, and so on.



For the development of market systems, two sets of biases – *relational* and *strategic* – seem particularly influential in shaping the most common patterns of behaviour. Relational biases affect the interactions that people and businesses value and the types of inter-relationships they tend to form. Strategic biases affect the ways people and organisations ensure their continued existence and how they prepare for unforeseen stresses and shocks. Table 1 illustrates each bias through the behaviour patterns typically found at the opposite ends of their spectrums.

Table 1: Strategic and relational biases and patterns of behaviour

		Patterns of behaviour
Strategic	Extractive	Actors withdraw revenues and extract rents from commercial and political activities that strengthen small group ties and their and the group's capital reserves.
	Solution seeking / value add	Actors develop their capacities and those of their organisation and its connections in order to innovate and solve problems and take advantage of new opportunities.
Relational	Loyalty / Patronage	Actors show favouritism to members of their own group and actively exclude others.
	Merit/Interest-based	Actors favour inter-relationships with others based on merit or according to interests, which effectively connects people with particular skills and abilities with the resources they need to innovate, solve complex challenges, and take advantage of opportunities requiring diverse competencies.

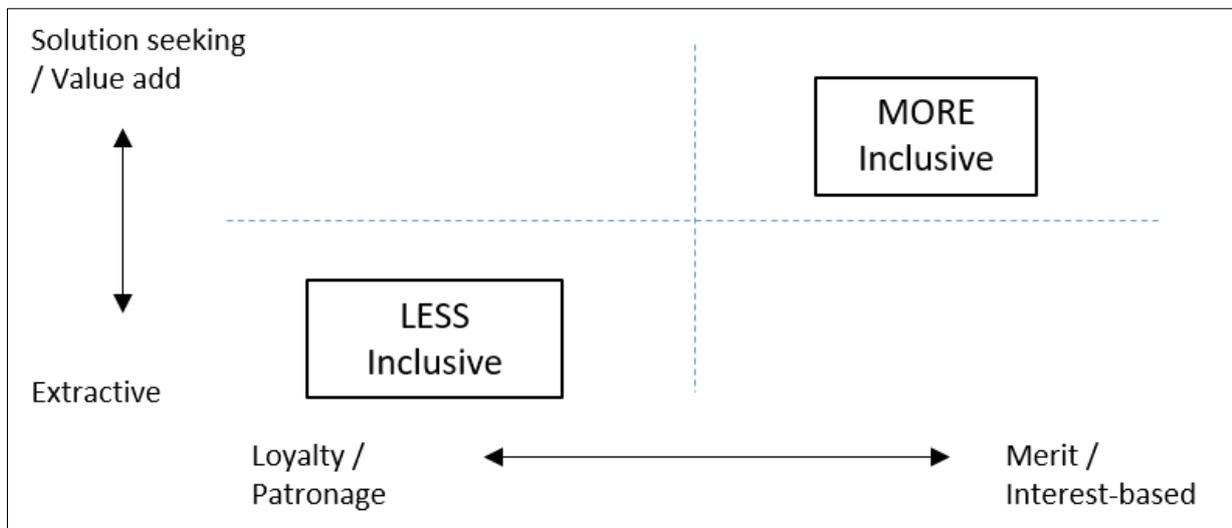
¹ The concept of institutional biases has roots in institutional economics and moral psychology, among other disciplines. Some of the more influential works supporting these ideas include, but are not limited to, those of North, D. (1990) "Institutions, Institutional Change, and Economic Performance," Cambridge University Press; Haidt, J. (2012) "The Righteous Mind: Why Good People Are Divided by Politics and Religion," Pantheon; Rose, D. (2011) "The Moral Foundation of Economic Behaviour," Oxford University Press; Hidalgo, C. (2015) "Why Information Grows: The Evolution of Order, from Atoms to Economies," Basic Books.

From a market systems development perspective, as well as that of poverty alleviation, not all patterns are ideal. For example, where extractive and patronage biases predominate together, which is often the case in developing market contexts,² we see many variations of the following:

- Intermediary traders exploit asymmetries of information to gain the most from every transaction.
- Businesses rely on networks of friends and family, especially those in the public sector, to circumvent regulations or bring down competitors who are getting too strong.
- Businesses in politically protected industries are owned or supported by members of the ruling elite who, instead of reinvesting revenues, extract cash to support or ensure the political position of those in power and, thereby, their own continuation.

In these and other instances where these biases are found together, low innovation rates are common as is the low adoption of new technologies or practices. Information flows are limited price discovery is problematic and actors are unaware of signals from different market channels. People tend to be excluded from functions or positions that are protected or reserved for members of a more powerful group. Also, levels of opportunism are often high such as when farmers put rocks in bags of maize because they expect buyers that are part of a different group will cheat them anyway. Overall, such behaviour patterns significantly limit the capacity for market growth and effectively exclude actors from participating. In essence, these patterns are *less inclusive* as portrayed in Figure 1 and are most pronounced when both extractive and patronage biases predominate.

Figure 1. Matrix of institutionalized biases



Conversely, *more inclusive* patterns of behaviour (see Fig. 1) are most pronounced when underpinned by biases that favour solution seeking, value addition and interest-based relations. These behaviours tend to be more oriented toward growth in ways that are generally healthier for market systems. As outlined in the following section, for example, these biases favour the emergence of transparent rules and their fair application. These biases also tend to lower non-market barriers such as social or gender stigmas, thereby better enabling actors who are willing and able to compete to participate in the market.

In market systems where less inclusive biases predominate, therefore, it makes sense that to bring about lasting beneficial change the goal of development should be to shift a system's institutional biases to ones more favourable to growth and inclusion. Furthermore, to ensure the durability of the

² This idea is more fully developed in Acemoglu, D. and Robinson, J. (2012) "Why Nations Fail: The Origins of Power, Prosperity, and Poverty" Crown Publishing, NY.

transformation, interventions should shift biases and patterns they underpin so they are i) robust, or predominant over other patterns and ii) resilient, or sufficiently embedded in systemic structures so as to withstand uprooting.

Presently, market system development interventions are not particularly effective at addressing institutional biases for a couple of reasons. For one, development practitioners often frame intervention strategies in terms of generating benefits for target populations instead of changes to systems that are then capable of generating desirable benefits, i.e. inclusive growth. Consequently, intervention strategies tend to address symptoms of less inclusive biases that manifest themselves as constraints or bottlenecks to, for example, competitive performance or increased productivity. In response, interventions build capacity or introduce new technologies or practices with the aim of generating benefits for a specific group of actors. Such interventions, because they do not frame the development challenge beyond immediate constraints, seldom delve deep enough to see the patterns of behaviour that engender the constraint or their underlying biases. As a result, they often only succeed in overwhelming system dynamics, shifting patterns for a short period of time, but, as they miss the underlying factors, patterns tend to revert to ones found before.

Pathways to more inclusive biases

Of course, not all pathways originate where extractive and patronage biases predominate. Contexts vary with regard to the mix and degree of institutional biases at work. For example, markets dominated by large family-owned conglomerates, like ones in India and Bangladesh, often have high rates of innovation and pursue wealth creation through value-addition. However, many of these businesses still strongly favour friends and family members for positions of responsibility and hold themselves accountable only to members of their own social groups. In another example, many telecoms and IT firms in developing countries depend on networks of people with diverse skills and abilities (merit-based relational biases) yet some exhibit extractive tendencies when it comes to strategic planning and growth.

Another reason is that understanding and identifying the institutional biases shaping visible patterns of behaviour is a complicated process. For one, this is dynamic terrain; the causal relations between patterns of behaviour and biases run both ways and are constantly reacting to changes in the environment. For two, for implementers, it is mentally and organisationally challenging to shift between the strategic objectivity of a systems perspective and the tactical immediacy of implementing activities with actors in a system. This difficulty is exacerbated by gaps in practical, analytical frameworks for discerning and monitoring changes in institutional biases and other aspects of complex systems.

Value chain governance and institutional biases

To address some of these gaps, this section aims to show how variances in value chain governance, namely whether they are more or less inclusive, help identify and make sense of the predominant institutional biases at work.³ By value chain governance we typically mean the rules and enforcement mechanism which coordinate production in value chain relationships, in other words, who determines which products get produced.

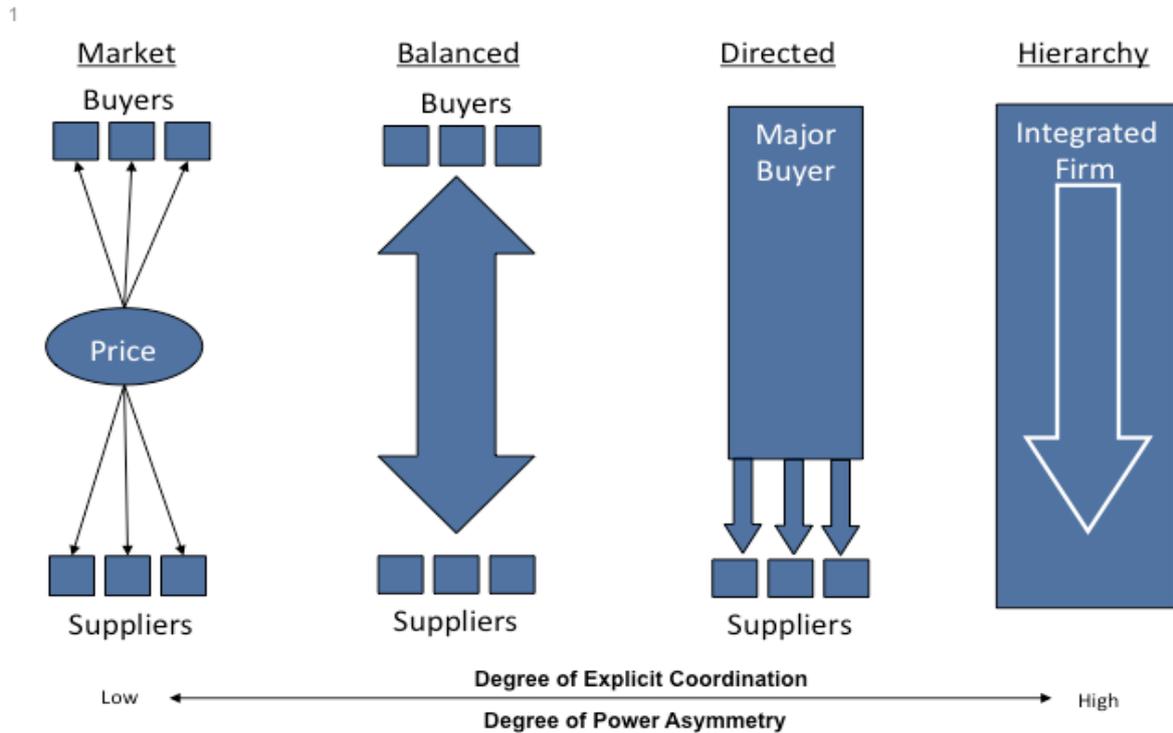
Recognisable to many market development practitioners is the research by Gereffi, et al.⁴ on governance patterns in global value chains. These researchers noted that more or less explicit forms of coordination (i.e. rules and enforcement mechanisms) varied consistently with regard to three key variables; i) the complexity of individual transactions, ii) the ability of actors to codify transactions, and iii) the capabilities of the supply base. Researchers also noted that different levels of coordination typically gave rise to different structural arrangements between buyers and sellers

³ The political economy, gender, etc. are other analytical lenses for detecting and framing institutional biases.

⁴ Gereffi, G., Humphrey, J., and Sturgeon, T. (2005) 'Governance of global value chains' *Review of International Political Economy*

(see Fig. 2). For example, in arrangements where untrained suppliers need technical guidance and products must meet strict specifications, structures tend toward directed or hierarchical, which support more explicit forms of coordination. These concepts have proven useful as ways of understanding how certain market factors shape value chain structure and identifying leverage points for interventions.

Figure 2: Value chain structures



Source: Gary Gereffi

However, governance patterns are also strongly affected by and reflective of a system's institutional biases. As such, an examination of the rules and enforcement mechanisms in the value chain can suggest to market development practitioners which institutional biases are at work. To understand this idea better, the following section depicts two exaggeratedly different scenarios of less and more inclusive governance patterns.

Scenario 1: Less inclusive governance patterns

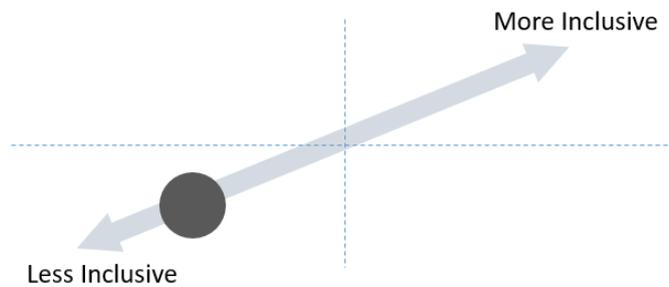
In Country X, five medium-sized businesses are the only exporters in the value chain for fresh tree-fruit. All firms have strong ties to the ruling elite in the national government. Despite having been in business for over seven, and some for more than 15, years, these businesses are largely indistinguishable today from their second year of operations. Most profits have gone to the owners and local and national politicians, who, respectively, help mobilise smallholder suppliers through political connections and streamline the export process and requirements.

Grades and standards for each fruit crop are poorly defined and out-of-date with regard to all but the lowest-value segments of the international market. Furthermore, grades and standards are poorly communicated to suppliers and are selectively applied; some suppliers are seldom penalised for substandard produce and others seldom receive quality premiums. The exporters primary mechanism for exerting control over suppliers is by using cash reserves to purchase crops before harvests, when school fees are due, effectively driving down prices.

Consequently, suppliers are mistrustful of exporters and they do not expect transactions to be fair. Many feel little compunction to respect trade agreements, often adulterating their products or camouflaging sub-standard produce. Unsurprisingly, most suppliers do not invest in inputs or practices that would improve yields, preferring to diversify into other revenue generating activities instead.

The governance patterns in this scenario indicate the predominance of less inclusive biases. The inadequate fit of the rules (i.e. grades and standards) with evolving market requirements and the arbitrary and predatory way they are applied are designed to maximise short-term gains to the advantage of a small group of individuals. These less inclusive governance patterns effectively drain buyer and supplier relations of any inclination to cooperate. Asymmetries of information are high as are levels of mistrust. As a result, opportunism abounds and perceptions about the sector's growth potential are low. All of which stymies incentives for innovation and performance improvement. In effect, these biases have fostered a vicious cycle of behaviours between buyers and sellers that will likely be antagonistic to change.

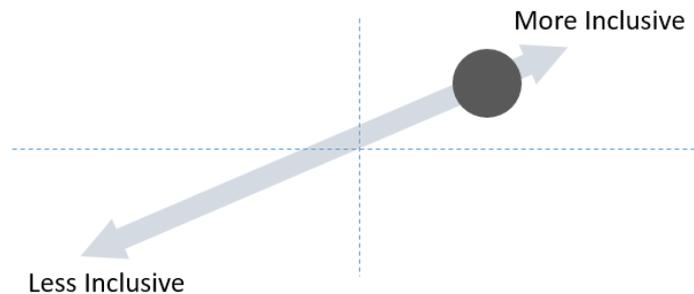
Figure 3



Scenario 2: More inclusive governance patterns

In the fresh tree-fruit value chain in Country Y, there are eight to ten exporters of a range of sizes and years in business. The newest entrant secured financing based on a business plan targeting a small, but growing, niche for speciality products of superior quality. Most other exporters specialize in two to three different market segments, each with specific grades and standards. To be competitive, exporters attract and retain suppliers using a range of supply chain management practices including preferred supplier programs that offer different tiers of support based on a supplier's performance. Most exporters provide some form of technical assistance, if only to clarify grades and standards and how suppliers can adjust practices to improve yields and quality levels. Some exporters provide packaging to reduce spoilage rates while others organise transportation to reduce shipping costs and ensure proper handling.

Figure 4



Most suppliers know who the top performers in their area are and most believe that transactions are fair. Some suppliers have expanded their orchards while others have purchased neglected strands with an eye toward future replanting. In addition, providers of specialised services like spraying, soil testing, and grafting have emerged in response to investments by suppliers to improve operations. The governance patterns in this scenario suggest that more inclusive biases are at work. The rules – the grades and standards and preferred supplier program details – are clearly defined and correspond to different market channels. This aspect and the perception that they are fairly applied create attractive openings for any supplier willing to compete in this sector. The governance patterns also create a virtuous cycle of cooperation and information flows, grounded in the mutually

held notion that *the success of my business depends on the success of yours*. Corresponding increases in trust and drops in opportunism improve rates of inter-action and investment and the emergence of specialised services that thrive in a regenerative environment.

Practical applications to improve intervention strategies

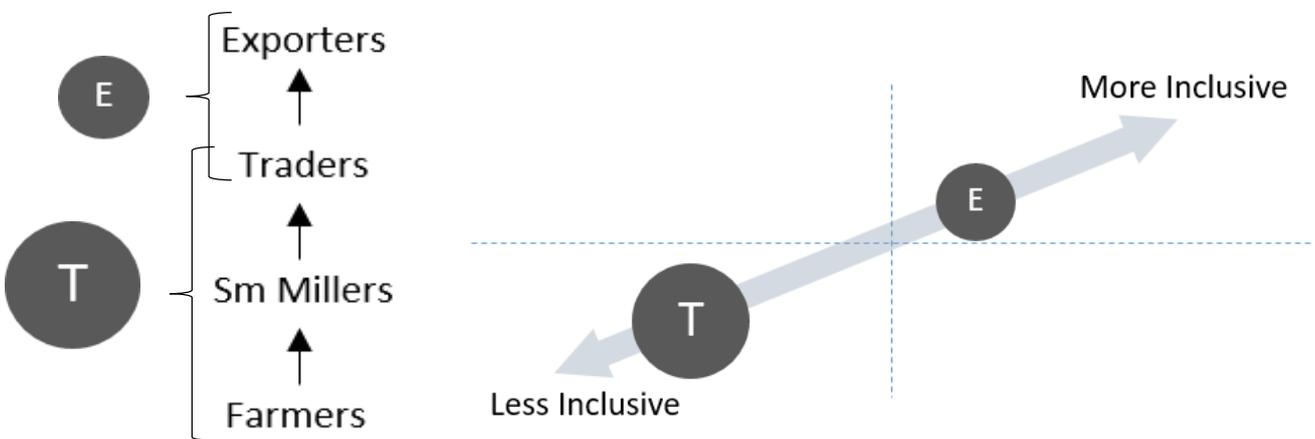
As noted earlier, where less inclusive biases predominate, the goal of development practitioners should be to shift biases to more inclusive ones. From the preceding section, an analysis of value chain governance patterns such as the coordination mechanisms, incentive structures, and grades and standards, reveals whether such behaviours are more or less inclusive, whether they, for instance, create opportunities for actors and spur value chain innovation and growth or whether they succeed more at entrenching poorly performing organisational structures and small-group interests.

This analysis also helps identify leverage points for interventions to shift these patterns. In essence, by differentiating between less and more inclusive governance patterns found in the value chain, locating them in the value chain structure, and gauging which patterns predominate, implementers can identify leverage points to:

- Catalyse the emergence of more inclusive governance patterns so as to overtake, or overshadow, less inclusive patterns
- Disrupt less inclusive patterns in order to erode their sway on overall value chain governance

To illustrate what these leverage points look like in practice, the following four mini-cases are drawn from actual projects.⁵ They illustrate the different types of intervention strategies involved and cover a range of contexts from where inclusive governance patterns are almost entirely absent to where less and more inclusive governance patterns actively clash in the value chain.

Figure 5. Uganda Robusta coffee value chain⁶



Exporters exhibit fairly inclusive governance patterns. They employ well-calibrated grades and standards to assess the *robusta* coffee's international market value and set prices to pay suppliers accordingly. Their primary suppliers are a small group of politically connected large traders who employ much more rudimentary standards with the traders and millers supplying them. The social status and financial reserves of the large traders give them a commanding influence on the behaviours and strategies available to upstream actors. The rules and enforcement practices they

⁵ These cases contain selected details and should be considered as practical illustrations of concepts as opposed to examples of unambiguous proof of these approaches.

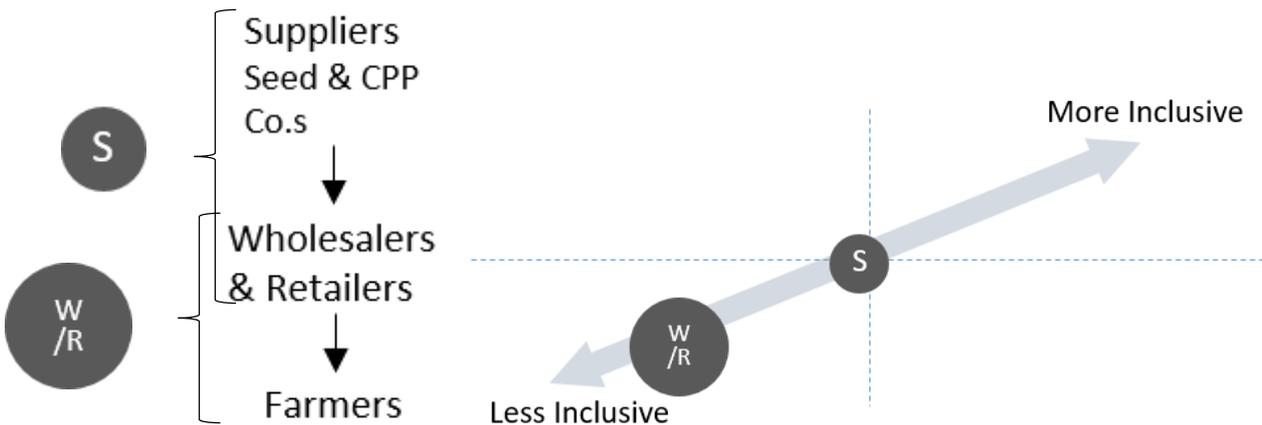
⁶ From the USAID Feed the Future LEAD Project, implemented by Tetra Tech.

abide by are essentially the predominant extractive social norms that favour those loyal to their groups and those who do not try to advance themselves above their social superiors. Presumably, one important factor why the market system is declining is that traders' less inclusive behaviours effectively prevent an alignment of incentive structures between farmers and differentiated market channels. To catalyse the emergence of more inclusive governance patterns, the LEAD project chose intervention strategies that would:

- Align millers' incentives with those of exporters and be able to communicate and apply more robust grades and standards with farmers and other suppliers
- Connect millers and exporters to ensure that millers benefit directly from new governance patterns
- Showcase the performance advantages of millers shifting to more inclusive governance patterns (e.g., offering quality differentiated pricing) through media coverage, industry forums and case studies
- Enable a national millers' association to promote aligning farmers and millers' incentives with those of exporters

The LEAD project did not pursue strategies to disrupt the predominant governance pattern of large traders. However, one key leverage point would have been to increase millers' access to finance to lessen their dependence on traders for funds.

Figure 6. Uganda agro-inputs value chain⁷



There is largely an absence of explicit rules and enforcement mechanisms in the Ugandan agro-input value chain. A few exceptions exist in the governance patterns of local seed companies and suppliers of crop protection products (CPP), but those are mainly limited to simple exclusive distribution agreements with rural sellers and marketing and technical support reserved for loyal, high volume, wholesale customers. However, even these explicit mechanisms are weak; sellers seldom keep an exclusive arrangement for more than two seasons and support from suppliers is erratic and selectively applied.

The inclusive governance patterns implemented by a few local seed and crop protection suppliers largely fail to flourish because the less inclusive business behaviours and governance patterns of wholesalers and retailers predominates.⁸ Evidence of this can be seen in the high levels of counterfeit products sold and low levels of repeat transactions by both buyers and sellers along the

⁷ The USAID Feed the Future Agricultural Inputs Activity implemented by Tetra Tech.

⁸ A very weak regulatory regime plays a considerable role as well.

chain. These patterns reflect underlying extractive biases where businesses seek to maximise quick returns over growth through customer retention.

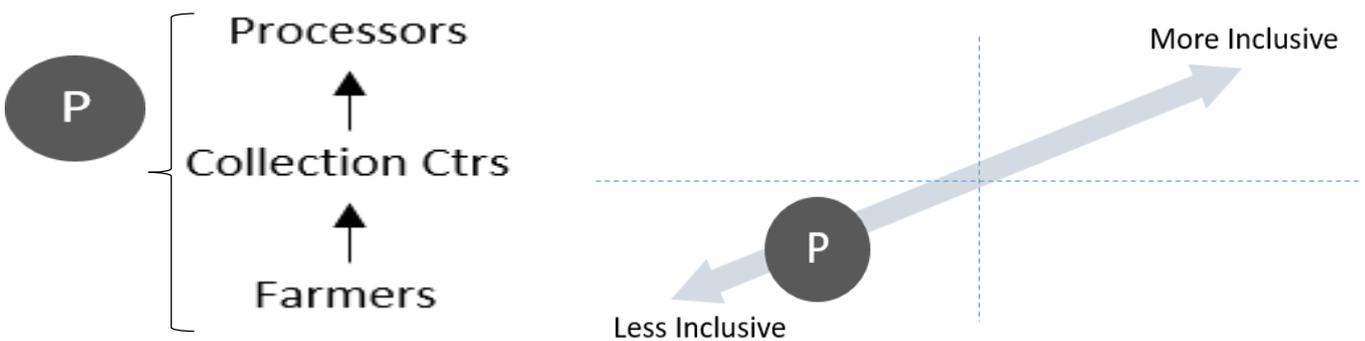
The interventions the Ag-Inputs project identified to catalyse more inclusive governance patterns included strategies that would:

- Increase the number of seed or CPP suppliers employing explicit, preferred distributor programs that reward sellers with specific types of support for achieving clear performance targets or practices
- Align incentives of wholesalers and retailers with those of seed and CPP suppliers by enhancing distributors' responsiveness to farmers' needs by offering, for example, specialised services like spraying, technical support, and small-sized trial packs
- Foster the emergence of local networks of businesses across different sectors that are engaged in their own process of attracting and retaining customers through clearer value propositions and customer service (e.g., owners and managers of hotels, local telecoms, bank branches, agro-inputs). These networks are the beginning of system structures and feedback loops that reinforce businesses' trajectory of more inclusive governance behaviours and, by extending across sectors, they are more likely to persist and influence members' behaviours in an environment largely absent of such positive reinforcement.

Interventions for disrupting less inclusive patterns of behaviour included strategies that would:

- Curb the prevalence of counterfeiting through an industry-led counterfeit hotline and mobile phone technologies for customers to verify product authenticity
- Enhance the role of rural media to advocate for smallholder farmers through audience-led programming
- Improve the transparency and judicious application of local regulations regarding the sale of agro-inputs

Figure 7. Kenya dairy value chain⁹



Much like Scenario 1 in the preceding section, the Kenyan dairy value chain has been dominated by a small group of politically connected, family-owned dairy processors. These firms outline their requirements based on outdated grades and standards and they communicate them and apply them in less than uniform fashion. Their internal organisational structures and practices prove resistant to change, whether to upgrade facilities, staff competencies or operational efficiencies, preferring not to adjust the formula that generates a consistent, albeit low, revenue stream. Understandably, the upstream operations of farmers, transporters and collection centre operators prove similarly resistant to adopting improvements.

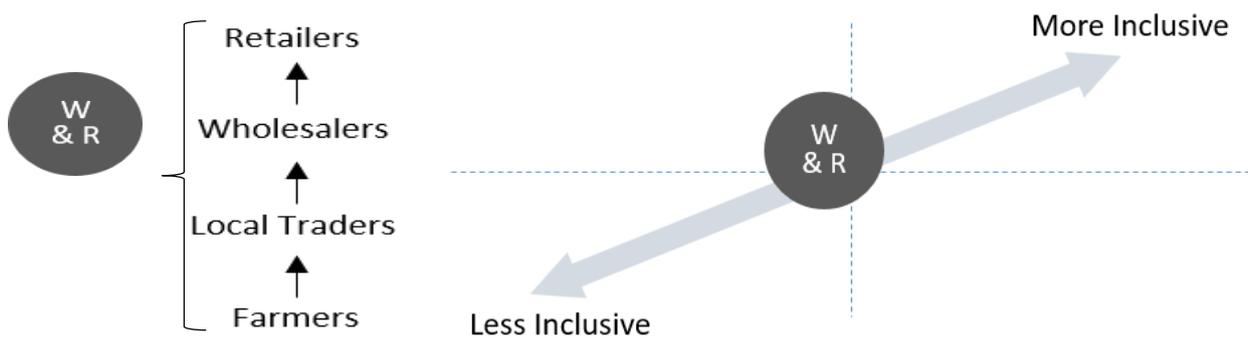
⁹ Kenya Markets Trust-funded Market Assistance Program (MAP), the dairy sector activities are implemented by TechnoServe.

There are, however, three comparatively small dairy processors that recently entered the market whose more inclusive governance patterns are very much outliers in the market system. These firms, because of their size and lack of political connections, risk being brought down by their larger competitors. The project's interventions to catalyse the emergence of more inclusive governance patterns included strategies that would:

- Upgrade the capacities of dairy processors with inclusive governance patterns, helping them grow their businesses based on retaining suppliers through embedded technical and material support
- Upgrade the internal capacities of the same dairy processors to ensure more efficient operations and results-driven management styles
- Connect these dairy processors to actors through support systems (e.g., marketing firms, educational institutions, equity markets, management service providers, etc.) to increase their chances of success and growth through the use of specialised services and access to new ideas

In order to disrupt the predominance of the other dairy processors' less inclusive governance patterns, the project sought to leverage interest among equity investment firms to target the older, fairly stagnant processors as growth prospects. Successful investments would, necessarily, include management support to upgrade internal governance and management systems.

Figure 8. Bangladesh fresh mango value chain¹⁰



The market size for mangos in Bangladesh is close to \$1 billion a year. The value chain governance generally has few explicit grades and standards and weak mechanisms to ensure that farmers' and traders' incentives are closely aligned with end-market requirements. As a result, market actors are rather slow or unable to respond to opportunities in new market channels and there is little circulation of new ideas and practices down to farmers that would improve efficiencies and yields. In general, despite the sizeable demand for mangos and potential for growth, the market is stagnant.

However, there is a new market channel that has the potential to drive improvements in the governance patterns of certain wholesalers and retailers, namely, for "safe" mangos. This channel arises out of growing health concerns about mangos contaminated with high levels of agro-chemicals. To catalyse this dynamic, project interventions included strategies that would:

- Enable retailers and wholesalers to assess the value, growth potential and requirements of this market segment and develop this segment more fully using marketing firms
- Improve the capacity of wholesalers to codify market requirements in specific grades and standards, communicate them to traders and farmers, and quantifiably test products along the value chain

¹⁰ USAID Feed the Future Agricultural Value Chains Project implemented by Development Alternatives, Inc.

- Enable agro-input providers to assist farmers with products and services that adhere to the grades and standards of “safe” mangos

Leverage points for disrupting less inclusive governance patterns included intervention strategies that would increase competitive pressures among farmers and intermediaries to adhere to more transparent grades and standards. For example, the project would showcase through media and other events the commercial and public value of farmers and intermediaries who act responsibly to improve the safety of mangos.

Conclusion

Discerning a system's biases is a challenge, but it is an essential task because we recognise that interventions that ignore systemic structures risk leading only to temporary change (or worse, we risk going unaware that we have created more lasting, unwanted changes).

This paper, by sharing practical experiences and insights, addresses this challenge. It outlines one way of framing market systems by using a known analytical lens – value chain governance and basic, accepted characteristics of better governance like transparency and enforced grades and standards – to analyse behavioural patterns that reveal pervasive institutional biases. By recognising and catalysing changes in institutional biases, market development theories of change reach beyond just the diffusion of new technologies; they seek a durable shift in patterns of behaviour toward ones that engender inclusion, innovation, and the spread of new ideas.

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