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CENTER FOR INTEGRATIVE AND DEVELOPMENT STUDIES
PROGRAM ON ESCAPING THE MIDDLE-INCOME TRAP: CHAINS FOR CHANGE

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ISSN 2619-7448 (PRINT)
ISSN 2619-7456 (ONLINE)

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An analysis of the experience of three agricultural value chain models[1]

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Reinier T. De Guzman,[4] and Rob van Tulder[5]

ABSTRACT ■ The paper gives an overview of institutions observed in value chain models in the course of action research by the University of the Philippines Center for Integrative and Development Studies (UP CIDS) Program on Escaping the Middle-Income Trap: Chains for Change (EMIT C4C). It reviews key concepts and principles from new institutional economics (NIE) and other schools of institutionalism and illustrates these through observed examples from the models. Key concepts are drawn from the work of North (1990), Ostrom (1990; 1999), Greif (1993; 2005), and Coase (1937; 2005). Concepts found in sociology and political science (e.g., social homogeneity and polyvalent ties) are also introduced and pursued when relevant.

KEYWORDS ■ Institutions, inclusive value chains, interlinked transactions, bundled contracts, smallholders

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[1] The summary of this paper was presented in the University of the Philippines Center for Integrative and Development Studies (UP CIDS) Program on Escaping the Middle-Income Trap: Chains for Change (EMIT C4C) public conference entitled "Chains for Change: Emerging Lessons on Inclusive Agriculture Value Chains" on 18 July 2018 at the UP School of Economics Auditorium.

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Introduction

Market exchanges between lead firms and smallholders rest upon institutions. Written and unwritten rules, norms, and constraints reduce uncertainties in exchange and, in turn, market transactions lead to wealth maximization. Institutions also "determine transaction and production costs and hence the profitability and feasibility of engaging in economic activity" (North 1991, 97).[6]

This paper is based on action research conducted on three value chain models: the Farmer Entrepreneurship Program (FEP), the SKK Rice Processing Center, and the Unifrutti models. All three are efforts to link farmers with small landholdings, called smallholders, to an alternative market through an inclusive value chain. The three cases cover a diverse range of crops, geography, modes of connecting with smallholders, and differing positions of the lead implementing organization within the value chain. Prior to the introduction of these models in their respective communities, smallholders faced numerous challenges, including the lack of capital for production, the lack of organization needed to attain scale, the lack of extension services for improved yield, and the lack of resources for logistics and marketing. These big gaps in value chains could not or would not be filled effectively by then-existing stakeholders. Farmers often sold their products to local buyers and trader-lenders who filled some of these gaps—albeit imperfectly and incompletely—often in a non-inclusive manner.

What the models did in effect was to fill the existing gaps or "institutional voids." The parties and partners-beyond-the-chain worked with each other to create new institutions that are more inclusive and sustainable. The new institutions facilitated mutually beneficial market and nonmarket exchanges.

This paper discusses the institutions which were observed in the value chain models studied through action research. It utilizes concepts

[6] See Box 1 (on page 4) for a brief discussion on institutions.

and principles, mostly from the new institutional economics (NIE), illustrated through examples drawn from the models studied.

I. Institutions before the introduction of the inclusive value chain models

The agriculture value chain models that were studied by the action research are located in rural areas in Luzon (Nueva Ecija and Camarines Sur), Visayas (Cebu), and Mindanao (present in Bukidnon and in various provinces in Region 11 and the Autonomous Region in Muslim Mindanao). Prior to the introduction of these models, smallholders implicitly relied on demand from formal markets,[7] including the National Food Authority (for rice) and the various market centers (e.g., Divisoria in Manila and the Carbon and Mantalungon markets in Cebu for vegetables). However, these markets were physically distant, which increased farmers' marketing costs. In Mindanao, farmers deemed the formal market for banana to be oppressive given the complexity of property rights (e.g., collective land titles) and agribusiness rules in agrarian reform-covered plantations.

An alternative market outlet available to the smallholders are the local traders who often also function as lenders to the farmers. These trader-lenders provide production inputs in exchange for a claim to crops as repayment during harvest season. Note that the trader-lender also usually sets the price and grades the quality of the produce in sales transactions.

The smallholders from Nueva Ecija and Camarines Sur related how they engaged with trader-lenders who provided financing for production and bought the farm products as payment for the loans. They also sold to spot markets if these offered better prices. But if the smallholders indebted to trader-lenders sold to spot markets (also

[7] Formal markets are markets where transactions are monitored by the government and which are typically subject to taxes or fees. This is in contrast with informal markets where transactions are not observed by the government, hence where relevant taxes or fees are not collected.

BOX 1 ■ **Institutions**

Institutions are "the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions and codes of conduct) and formal rules (constitutions, laws, property rights)" (North 1991, 97). Institutions are made to create order, control environment, and reduce uncertainty in exchange (North 1991). They can be written or unwritten and formal institutions can be private-order (commercial contracts) or public-order (government rules) in nature.

Without credible commitments and mechanisms to enforce agreements, the risks of opportunistic behavior will force parties to turn to spot market transactions instead of relying on contracts. And while spot markets allow parties to gain from trade, these do not capture many of the potential benefits from specialization (Keefer and Knack 1991). Without reliable promises and contract-enforcement mechanisms, parties to an agreement can also choose to do nothing even if doing something can make everyone better off. Opportunism and free-riding are highly possible because parties are "boundedly rational," which means that their rationality is limited by incomplete information. In putting constraints on shirking and free-riding and in giving incentives to motivate parties, institutions enable exchange. Thus, "markets rest upon institutions" (Greif 2005, 727).

Contracts or agreements between parties and among various participants are also drawn up primarily to mitigate transaction costs.* Contracts assign property rights to the parties. Property rights, among other functions, spell who owns, who benefits, and who carries the costs of production in an exchange. This assignment of property rights is important since many assets (like agricultural lands) are complex.

The extent of the market or the degree of voluntary exchange is determined by its supporting contract-enforcement institutions. These

* Costs that account for the "negotiations to be undertaken, contracts to be drawn up, inspections to be made, arrangements to settle disputes, and so on" (Coase 2005, 34). Firms, says Coase, exist to avoid these transaction costs.

"determine who can exchange with whom and in what goods" (Greif 2005, 730). Contract-enforcement institutions are needed to support exchange because some time elapses between the agreement and the actual delivery of goods and services. The time difference between the quid and the quo, says Greif (2005), gives parties the ability or the incentive to renege. One party will not agree to the exchange without knowing ex-ante that the other party will fulfill his/her contractual obligations ex-post. A key to enforcing contracts is the emphasis on better payoffs in the future if parties will not shirk. For example, when a cooperative informs a farmer-borrower that failure to pay a debt in the future will mean inability to sell goods and borrow capital during the next production season, then the farmer-borrower will think twice about not paying loans.

Greif (2005) emphasizes that the ability to supply private-order and public-order contract-enforcement institutions depends on the prevailing coercion-constraining institutions. Wealth-revealing contract-enforcement institutions will develop and will be effective only if institutions do not undermine the security of property rights. Lead firms often hesitate to engage public-order contract-enforcement institutions because it could mean wealth confiscation. A smallholder who has more than five hectares (the ceiling for agricultural landholdings) might not provide information to the Register of Deeds, the local government, or the Department of Agriculture for fear that the information would lead to land confiscation or non-receipt of support services. A state that is strong enough to enforce the security of property rights is also strong enough to confiscate those property rights (Weingast 1993). Even worse of course is a state that enforces rules selectively and in a biased manner.

called *guerilla* buyers in Camarines Sur), they would be penalized in the next cropping period by being cut off from financing.

The relationship between the small vegetable farmers in Cebu and their *suki*[8] (favored buyer) prior to the introduction of the FEP may be characterized as a clientelistic and hierarchical relationship

[8] See Hendriks (1994) for a description of the *suki* system and interlinked credit in Cebu.

between the trader as the patron and the smallholder as the client. In providing the farmers a means for earning, the *suki* had influence on the cropping and marketing preferences of the smallholders. Over time, their relationship gained personal aspects and so had become sticky. So even if the relationship was imperfect (i.e., the *suki*'s buying price was usually lower than in the spot market, or the *suki* did not buy all of the products despite a prior commitment to do so), the smallholders engaged in repeated exchange with their *suki*.

In the case of the *suki* relationships in Cebu, no legal structures and courts enforce contracts, and government agencies are limited in providing support services that might improve the bargaining power of smallholders. No political institutions are relied upon to create the needed framework and no incentives exist to change or reform the system. More likely than not, the *suki* system in Cebu will not result in the improvement of the material status of the smaller players. The payoffs are not such as to lead to an institutional evolution to more productive economies (North 1991).

In Mindanao, the limited involvement of legitimate political authorities and organizations in addressing peace and order problems discourages firms from investing in the region, particularly in the Muslim areas. The limited investments, in turn, contribute to poverty. Elsewhere, the fragmented delivery of support services to smallholders (e.g., agriculture extension, access to credit, and access to roads and irrigation) stemming from the overlapping mandates of different agencies contributes to the limited negotiating or bargaining power of smallholders.

Civil society groups were present in the areas prior to the models' introduction. However, in some areas the presence of non-government organizations (NGOs) and peoples' organizations (POs) that provided social or club goods was limited. In Cebu, a group that used to engage in community organizing and development ended its program presumably because funding ceased. Many of the NGOs were more focused on organizing for political action and advocacy.

The hows and whys of social enterprises are fairly recent concerns of many of them.[9]

Because the cost of transacting in agriculture market exchanges was high and the risks of lending to smallholders were perceived to be non-manageable, financial service providers did not provide formal financing. This contributes to the perpetuation of the relational exchanges involving trader-lenders, spot buyers, and suki.

'Institutional voids' or the lack of institutions that can facilitate market transactions (Khanna and Palepu 1997) characterized the situation prior to the introduction of value chain models under study. Also called 'wicked problems,' institutional voids are located in the intersection of public, private, and social goods (Van Tulder and Pfisterer 2013; Van Tulder and Keen 2018). The presence of such voids may explain why simple solutions were not sufficient to stimulate an expanding market exchange since these voids needed major plugging.

II. The creation of inclusive and sustainable institutions

The value chain models changed the institutions, or in North's (1991, 98) terms, the "rules of the game," to enable the smallholders and the lead firms to better engage in economic transactions. New institutions were created that plugged the major voids. While big challenges remain, the created institutions, at the minimum, enabled, sustained, and enhanced the exchange between parties.

The innovations can be better explained by imagining the value chain as a series of agricultural contracts that smallholders engage in from the start to the end of a value chain. These include agreements regarding equipment, inputs, credit, land preparation, planting, plant care and maintenance, harvest, storage, processing, and marketing.

9 See Constantino-David (1998) for a discussion on the evolution of NGOs and Tantingco (2011) on the rise of social entrepreneurship in the Philippines.

When production is not fully integrated, different agents may step in to fulfill different processes, allowing for contracts between each step. **TABLE 1** below summarizes the basic parts of the value chain of the models covered by EMIT C4C as well as the relevant agents or organization/s fulfilling the function.

TABLE 1 Stylized value chain and agents per process

<table>
<tr><th>Models</th><th>Financing</th><th>Inputs</th><th>Production</th><th>Consolidation</th><th>Marketing</th><th>End Buyer</th><th>Duration</th></tr>
<tr><td>FEP – KALASAG</td><td>ASKI / ACPC</td><td colspan="4">KALASAG</td><td>JFC – commissary</td><td>Crop cycle</td></tr>
<tr><td>FEP – Lamac MPC</td><td colspan="2">Lamac MPC</td><td>Cluster</td><td colspan="2">Lamac MPC</td><td>JFC – direct to store</td><td>Crop cycle</td></tr>
<tr><td>SKK RPC</td><td>SEDP/self-financing</td><td colspan="2">Farmers</td><td colspan="2">SKK RPC</td><td>Local wholesale and retail markets</td><td>Crop cycle</td></tr>
<tr><td>UTPI – lease</td><td colspan="5">UTPI</td><td rowspan="2">International market players</td><td>Lease (~25 years)</td></tr>
<tr><td>UTPI – contract growing</td><td colspan="2">UTPI</td><td>UTPI & coop</td><td colspan="2">UTPI</td><td>Contract (~5 years)</td></tr>
</table>

Contracts in the value chain and with partners-beyond-the-chain may either be stand-alone (unbundled) or interlinked (bundled) contracts. With this distinction, the models can be characterized by how much the contracts in the value chain are interlinked. In the FEP model, the purchase of inputs, access to production capital, planting, and harvesting are interlinked: smallholders buy inputs and borrow from and sell to their cooperative. The cooperative, in turn, sells the products to Jollibee Foods Corporation (JFC) as well as to other buyers. Under this interlinked arrangement, loan repayment in-kind (or the delivery of harvest) dominates a cash-for-cash scheme because output price is uncertain and farmers are risk-averse (Fabella 1992). Smallholders also enter in unbundled contracts for equipment, labor, plant care and management, and land. They enter and exit these agreements without the involvement of their cooperative. In the Unifrutti model, the smallholders and the lead firm engage in lease and contract growing schemes. In these arrangements, all the activities in the value chain (from pre-production to marketing) are bundled and all the harvested bananas are to be sold to Unifrutti.

The question remains, however, why some contracts are bundled, while some are not. If bundling contracts serves to internalize different steps within a process, then the rationale is similar to Coase's (1937) explanation for the existence of the firm and how it integrates processes in order to minimize transaction costs. The bundled contracts identify the mechanisms for exchange and spell out benefits and costs for each party. While the contracts are formal and clear, like other contracts, these are incomplete. Incompleteness is an offshoot of internalization, since the stability of the relationship makes up for the instability or uncertainty of outside conditions. An arm's-length relationship would be unable to guarantee stability, while a complete contract would increase the contracting cost.

The pre-commitment of JFC and Unifrutti to buy from the smallholders enabled partners-beyond-the-chain, particularly the financial service providers, to extend production loans to smallholders. In recalling the reason that they engaged in the pilot model of the FEP with the Kalasag farmers, the microfinance institution Alalay sa Kaunlaran, Inc. (ASKI) said they just "prayed for the risks" because the farmers had no collateral and financial records. However, ASKI also knew of the pre-commitment of JFC to buy from the farmers and they valued the presence and commitment of the Jollibee Group Foundation (JGF) to help the farmers. Other reputable stakeholders (e.g., community organizers, agriculture extension providers) were also committed to the program. The mechanisms to be employed (including the interlinked transaction) seemed workable. These sufficed to persuade ASKI to extend credit.

The features of the bundled contracts are simple. Uncertainty regarding the state of the world (including of nature) and the complexity of property rights typically lead to the creation of simple contracts which are enforced largely through reputation (Allen and Lueck 2005). The role of nature[10] is difficult to minimize in the models because of the lack of viable crop insurance. Another factor that induces the crafting

[10] Nature is defined as the aggregate of natural forces that can influence the outcome of agricultural production and includes forces like climate and weather, pests, seasons, geology, and hydrology (Allen and Lueck 2005).

of simple agreements is the complexity of assets in agricultural areas (op. cit.). In Sudlon in Cebu, smallholders who are part of the FEP wonder why they must pay land rental fees to "landowners" in lands declared as "protected areas" by the government. It is possible that the "landowners" were given stewardship titles by the government. How they "transferred" this title to the smallholders, along with its accompanying rights and obligations, is unknown.[11]

An innovation in the interlinked contracts of the FEP model (and SKK RPC) is the provision that smallholders only need to supply around 60% of their farm produce to their cooperatives. This flexibility allows the smallholders to take advantage of higher spot prices without reneging on long-term contractual obligations. This also recognizes that smallholders also have market relations with other buyers. This provision diversifies the market exchanges of the farmers and guards against lock-ins or being trapped in value chains that are not desirable.[12]

Flexible contracts are also an innovation in the agreements between smallholders and Unifrutti. Both sides understand that since they are part of a global value chain, conditions can vary in major ways during the life of an agreement. It is agreed that, all things being the same, the contracts should hold; if, however, unforeseen shocks should occur (e.g., bananas being hit by diseases or big changes occur in global prices), then they can set aside their purchasing agreement and adjust their terms to respond to their situation. In one instance, Unifrutti increased its buying price because of favorable changes in the export market. When the global spike ended, Unifrutti decided not restore the previous lower buying price. There was also an instance

[11] Unclear property rights are an obstacle to accessing agricultural finance and securing investments. Among the reasons stated by financial institutions on why they hesitate to lend to agrarian reform beneficiaries is the unclear assignment of land rights, particularly in lands covered by collective land titles. With collective titles, the actual parcel or tillage of smallholders is not clear given the lack of land survey that determines the metes and bounds of individual ownership.

[12] The interlinked contracts are only meant for the crops that are covered by the exchange with the lead firms (onions, vegetables, and other high value crops). The other crops being produced by the farmers are not included in the bundled agreement.

when both parties agreed on belt-tightening measures mid-contract. Trust built over the long term and transparency in benefits, margins, and costs are both a cause and a consequence of this flexibility.

Peculiar to the FEP and SKK RPC models, requiring only around 60% of produce and having flexible contracts allow parties in the value chains to address potential shirking or hold-ups. Gow and Swinnen (2001) consider that there is likely a cut-off point for both parties beyond which they will breach a contract. As long as the market conditions stay below the cut-off points, contracts will be honored. Klein (1996) calls this the 'self-enforcing range' which measures the extent to which market conditions can change without precipitating a hold-up by either party. In the three models, the contract provisions widen the self-enforcing range. Contract breach—in a situation where only 60% of products is required or the contracts are flexible—is met with 'sanctions' that are largely reputational in nature (i.e., no future agreements). These provisions, along with other mechanisms, incentivize self-enforcing contracts.[13]

The creation of more inclusive and sustainable institutions entailed significant transaction costs. These included the costs of acquiring and disseminating information, monitoring of process and progress, capacity building of the smallholders and partners-beyond-the-chain, organizing of the farmers, and linking the farmers to other stakeholders (including other major buyers). The basic formal organization of farmers was absent prior to the exchange so that transaction costs of organizing and capacity building needed to be incurred. These are referred to as 'social investment' costs.[14] In the FEP

[13] Despite having flexible contracts, Unifrutti still suffers from instances of pole-vaulting from a few farmer group partners. The temptation to renege from long-term agreements in favor of higher spot prices offered by Chinese traders tests the resilience of farmer groups and the enforcement mechanisms of contracts. Once hold-ups occur, this reinforces the chances of hold-ups in the future since it undermines the reputation of the company (Gow and Swinnen 2001).

[14] It is possible that initial conditions matter but these are not yet explored by the action research. In succeeding action research loops or deep dives, this could be one of the aspects that would be considered. Elinor Ostrom's works could be helpful (e.g., small number of individuals, common culture, among others).

model, the lead firm JFC mandated its foundation (JGF) to partner with other organizations in order to implement the program and share the overhead transaction costs.

Over time, the transaction costs subsided. JGF's implementation of the FEP, for instance, became more efficient in more recent rollouts. For example, the capacity building of farmers (i.e., the eight-step agro-enterprise training) is now meant for local implementing partners like LGUs and other local aggregators (instead of directly training farmers). Rather than JGF and its partners directly organizing the smallholders, which was the arrangement in Nueva Ecija with the Kalasag farmers, community organizing and mentoring are now lodged with local partners-beyond-the-chain who are also more knowledgeable with local contexts and dynamics.

Clearly, what has worked in the models has not been arms-length relationships that leave the smallholders to the vagaries of the market. What worked were relationships that even seem to replicate some of the aspects of trader-lender contracts. However, as compared to trader-lender agreements, the models show aspects of inclusive interlinked relationships.

To summarize, the following conditions have been instrumental in the creation of new and more inclusive institutions with the proviso that such conditions are built on a stable and functional cluster of farmers.[15]

(1) *Pre-commitment of lead firms to purchase from the smallholder partners*. The commitment of JFC, the largest fastfood chain in the Philippines, to purchase onions from the Kalasag farmers was recognized by ASKI, a microfinance institution, and this encouraged ASKI to take on the risk of lending to farmers. This also inspired partners-beyond-the-chain like local cooperatives and local government units to

[15] See Ostrom (1990) for common design principles of enduring institutions and Poteete and Ostrom (2004) for a discussion on the effect of group heterogeneity and size.

be engaged in the FEP. The pre-commitment triggered the accumulation of new knowledge and skills that improved the transactions.

(2) *Partnerships in value chains and the sharing of a common vision*. The gaps were filled in by the partners and the partnering space they created. The partners created a common societal vision and mission that spelled out long-term commitments which helped them address short-term problems and hurdle tipping points. The partnerships created a common ground for developing new systems and arrangements.

(3) *The crafting of interlinked transactions or bundled contracts that do not lock-in the farmers to the lead firms*. The bundled contracts were win-win agreements for the parties and the partners-beyond-the-chain. The transactions allowed financing to flow to the farmers and at the same time, allowed farmers' cooperatives to receive the products that were delivered to the lead firms. The non-lock-in clause of the FEP and SKK RPC transactions allows farmers to maximize price hikes from other buyers. Repeated over time and across different farmers' groups, the contracts improved the institutional arrangements.

(4) *Embeddedness of stakeholders*. The stakeholders who formed partnerships are embedded in the sectors at various levels and varying degrees. SKK RPC and Unifrutti are locally-based and are familiar with local contexts and dynamics. The FEP taps local partners that are immersed in the culture and language of farming communities. Aside from being embedded in local contexts, some of the stakeholders are also deeply embedded in societal networks. JGF, for instance, is embedded in the network of corporate foundations. These levels of embeddedness gave the stakeholders venues to propose institutional arrangements and changes

The models created win-win situations for all the stakeholders because the success of the value chains contributed to the achievement of one's own sector's or own office's mandates (see, e.g., Bitzer et al. 2010).

It is possible that the arrangements created 'proto-institutions' or new rules, technologies, and practices that arise and are diffused beyond the boundaries of contexts and are adopted by other organizations (Lawrence et al. 2002; Drost et al. 2012). Eventually, when these proto-institutions are further diffused to form broad level changes—for instance, if these are mainstreamed in government, civil society, and business practices—then these could be used repeatedly and become institutionalized.

III. Formal institutions

The literature distinguishes formal institutions according to whether they are public-order or private-order institutions.

Public-order institutions include the laws that govern citizens as well as the mechanisms outside of government that govern relations (e.g., professional guilds, associations). In the value chain models, public-order institutions include policies like the Agri-Agra Law that mandates banks to lend to smallholder farmers, the different (and often confusing) property rights regimes over farmlands, the different guidelines on how to receive agricultural support services from various government agencies, and the guidelines of the Department of Agrarian Reform on Agribusiness Venture Arrangements that define the allowable contracts between agrarian reform beneficiaries and investors.[16] Public-order institutions also include the incentives being offered by the Department of Trade and Industry for companies engaged in inclusive agribusinesses.[17] These institutions provide

[16] Department of Agrarian Reform. 2006. "Revised Rules and Regulations Governing Agribusiness Venture Arrangements (AVAs) in Agrarian Reform Areas," DAR Administrative Order No. 09, Series of 2006. Accessed August 8, 2018. http://media.dar.gov.ph/source/2018/09/05/ao-2006-09.pdf.

[17] Lopez, Elyssa Christine. "5-Year Tax Breaks for Agribusiness and Tourism Firms Partnering with Micro Suppliers." Entrepreneur Philippines, September 27, 2017.

rewards and sanctions to parties and partners-beyond-the-chain, but their relevance and effectiveness vary.[18]

Aside from rewarding and sanctioning, public-order institutions are also used for contract enforcement. However, these are only effective if state apparatuses like courts and regulatory agencies are perceived to be strong to do their functions. Public-order institutions also include mechanisms outside government that provide an institutional frame for governing relations. These include the mechanisms employed by firms (Williamson 1975), merchant coalitions (Greif 1993), and community organizations (Ostrom 1999). These institutions are seen in the value chain models particularly in the Jollibee Group Foundation, Catholic Relief Services, and National Livelihood Development Center coalescing to develop and implement the FEP. FarmKoop, a farmer's federation, is tapped by Unifrutti and farmer's cooperatives to draft contract farming agreements.[19]

Private-order institutions apply to arrangements between exchanging parties. In the models studied here, these are the contracts between the lead firms and the farmer's groups. These spell the buying prices, the cost to be shouldered, and other terms. These contracts allow the farmers to gain access to financing from microfinance

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https://www.entrepreneur.com.ph/news-and-events/5-year-tax-breaks-for-agribusiness-and-tourism-firms-partnering-with-micro-suppliers-a00178-20170927 (inactive as of September 2019).

[18] Major banks are still wary of lending to smallholders, even if they are part of inclusive value chain models and despite being partners of lead firms. Similarly, they are willing to pay the penalties under the Agri-Agra Law. There is limited availability of agricultural extension services and infrastructure like roads, telecommunications, and irrigation services. There is also a lack of viable crop insurance. Banks claim that these are some of the reasons why farmers are unbankable. In all the models, there are limited government support services for smallholders. These gaps are often sourced by partners-beyond-the-chain to improve the capacity of smallholders. The agrarian reform program and the continuing transfer of agricultural lands to heirs have made land sizes smaller. This requires the need for farmers' organizations to create economies of scale.

[19] FarmKoop is a farmers' federation that provides, among others, legal services to contracting parties. It drafted the contract growing agreements between Unifrutti and select farmers' groups.

institutions and in key instances, these opened the way for farmers to receive lumpy support services such as the Kalasag farmers receiving trucks and onion hangar from government offices.

IV. Informal institutions

Informal institutions such as social norms, customs, and traditions specify what actions are regarded by a set of people as proper or improper and their accompanying rewards or punishments affect the costs and benefits which individuals consider when exercising choice (Coleman 1990, 243; 1987, 135). Social norms and networks facilitate collective action (Woolcock 1998) and these are important in the formation and continuous operation of farmers organizations like cooperatives. For Scott (1976), many social arrangements, patterns of reciprocity, and work sharing mechanisms serve as insurance to tide rural dwellers who live on subsistence (see also Lipton, 1969: 341). For these farmers, social units and mutual assistance can provide help during difficult times. For social insurance or 'safety-first' and other reasons, farmers choose to organize and sustain groups.[20]

Informal institutions also make promises credible. Reputation is particularly important in incentivizing conformity to agreements. In the small agricultural communities[21] observed in the study, people knew each other, and their reputation as sellers or buyers was known and shared by community members. Past behavior provided signals about their ability to commit to present and future contracts. These reputation-based institutions are seen in the communities where the models operate. In the SKK RPC model, the farmers' expectation that they can sell again to the rice processing center, which they own and will eventually manage, incentivizes loan repayment and participation in gatherings. This is aided by the feeling of shame and guilt at the prospect of disappointing the Catholic priests who work at making

[20] The importance of informal institutions in the setting up and operation of farmers groups in the value chain models has yet to be analyzed.

[21] Group size ranges from a cluster of 15 members (FEP) to a plantation owned by a group of farmers with around 1000 farmers (Unifrutti).

the RPC successful. In the Unifrutti model, the expectation that the parties (smallholders and lead firm) will conduct business again in succeeding cropping seasons (and that other firms will shy away from accepting "reneging" farmer groups) make the parties, particularly the smallholder farmers, think twice about shirking from contract farming agreements.[22]

An important aspect of the FEP model was overlapping relations among the farmers. This is similar to what Evans (1995) describes as 'polyvalent individual ties' or different types and degrees of relations among individuals.[23] In the case of Kalasag and Cluster Four of Sudlon, the farmers did not simply choose their family members; they selected relatives who are neighbors, who are close to them, and who are considered as longtime friends. This choice also reduced the transaction cost because the farmers must have worked together in the past and already know each other's work ethics, live or farm near each other, and have relations of trust. These types of social networks support the operations of markets (Evans 1995).

The works of Zucker (1986), Akerlof (1997), and Ostrom (1990; Poteete and Ostrom 2004) on social homogeneity/heterogeneity are consistent with the multivalent ties seen in FEP communities. The greater the number of social similarities, the more people can assume that they have common background expectations and that they can therefore be relied upon to keep their promises (Zucker 1986). In

[22] This expectation did not hinder some farmer's groups to pole-vault by selling to spot buyers.

[23] Among Kalasag farmers, approximately 70% of the 92 members are related by blood and at the same time, considered as friends, neighbors, and classmates. In Sudlon in Cebu, Cluster Four is composed of 16 members, of whom 50% are members of the same family. The other half are close friends and neighbors. This also explains why in this cluster, the leaders are willing to extend a helping hand, beyond the requirements of their roles, to their members. The cluster leader, his sister, and the cluster secretary, shared that one of their stressful moments is when the Lamac MPC's truck was on its way to Sudlon and a farmer who was set to supply vegetables for the day has not yet harvested his/her vegetables, for whatever reason. When those (few) instances happened, cluster leaders and neighbors helped harvest the committed supply (without being paid labor fees).

his study on social distance, Akerlof (1997) saw the effects of social heterogeneity: people interact less and less as the dimensions (blood and ethnic ties, language, culture, religion, education, income, wealth, occupation, political rights, and geographical distance) along which they differ increase. Poteete and Ostrom's (2004) analysis of the case studies from the International Forestry Resources and Institutions (IFRI) research network nuanced the effect of social homogeneity on collective action. They showed that the degree of homogeneity is important due to its effect on distribution of interests and ability to mobilize resources. However, while Ostrom is silent on the effect of a traditional figure of authority, North's discussion on institutional change (1990) suggests that discontinuous changes, such as a local leader or a datu's demise, could lead to a disruption in the group's stability.

'Risky trust' or the giving of trust when one sees that the other is vulnerable (Bruni and Tufano 2017) is another concept that resonates in one of the models. In the La Frutera case, the late Datu Toto Paglas told John Perrine of Unifrutti that he would protect him (and his family and investments) with his own blood. John Perrine met with Datu Paglas without bodyguards, which made him physically vulnerable at the time. This showed him to be both trusting and trustworthy for the datu.

Aside from social norms and reputation, therefore, the models illustrate how informal mechanisms like polyvalent ties, social ostracism, social heterogeneity, and risky trust can motivate or incentivize trusting and trustworthy behavior. Such mechanisms, while not strictly found in the standard reputation narrative of NIE, are useful concepts in analyzing the community-based institutions.

V. Interactions between formal and informal institutions

Apart from identifying formal and informal institutions, it is also important to know how institutions interact with one another. Do formal and informal institutions supplement or supplant each other? One view is that formal ones replace informal institutions as group or community size increases and as socially homogenous communities become more diverse (Keefer and Knack 2005). Another view deals with how formal rules become informal norms if it will give a higher expected pay-off when the other player's move is uncertain, also called a risk-dominant strategy (Desierto and Nye 2011). Public-order formal rules could also strengthen the enforceability of private ordering agreements, in what is called "private ordering in the shadow of the law" (Dixit 2007, 41).

In the communities where FEP was implemented, formal and informal institutions appeared not to replace but to supplement each other. The polyvalent ties and social homogeneity of communities put farmers who are respected as clan or community heads in leadership positions. Other informal leaders (e.g., family heads who do not have position in the cluster or cooperative) were also visible. They helped enforce, through social norms, values and principles like cooperation, being faithful to one's promises, and steadfastness during difficult situations. They were also knowledgeable about the behavior of individuals. Early attempts[24] at running the FEP, where only formal rules were utilized, encountered problems. Clusters that subsequently survived were those where the members "have shared a past and expect to share a future" (Ostrom 1990, 88). In Kalasag's expansion to another barangay, the chairman's sister was one of those relied upon in choosing possible members given her residence in the barangay. In turn, she coached the 'associate members' in their advance from their 'newbie' stage. She encouraged them to be faithful in keeping their production agreements with the prospect of larger onion allocations from the cooperative.

It can be surmised that putting priests who are trusted and well-loved by communities as general manager and chairman of the SKK

[24] This is the so-called 'Cluster One problem.' To illustrate: Ligaya was part of Cluster Two, which provided buffer to the first cluster. When the price of Lamac MPC / FEP was higher, Cluster One members sold their vegetables to Lamac MPC, but when the prices of traders were higher, they sold to the traders. Ligaya felt that they were not committed to a long-term relationship with Lamac MPC and with institutional buyers like Chowking because they had other market options and most of them can cover their own farm financing requirements.

Farmer's Corporation contributed to a supplemental interaction of formal and informal institutions. However, it is also possible that without the `formal benefits' of the SKK RPC like the higher buying price and farmer's majority ownership, the informal mechanisms might not have been sufficient to pull the farmers away from their traditional buyers (trader-lenders and the spot market).

Prices are a crucial consideration in market exchanges. If the agreed price is continuously or repeatedly lower, smallholders, who have lesser economic power, find it difficult to keep their part of the agreement. Banana growers who have contracts with Unifrutti are enticed by the continuing attractiveness of selling to Chinese spot buyers who have lower fixed costs than lead firms like Unifrutti. Some of them have pole-vaulted in the face of continuously rising spot prices.

VI. Self-enforcing institutions

When institutions are self-enforcing, stakeholders—particularly the parties in the exchange—can address issues, settle disputes, and implement agreements. Self-enforcing contracts do not require third-party enforcement (e.g., community elders, courts). Key characteristics of self-enforcing institutions are seen in the models: Contracts are simple, there is continuing utility of the institutions, and credible threat of sanctions.

In the models, both formal and informal *contracts are simple*. As already discussed, when the role of nature cannot be ignored, agricultural contracts tend to be simple and enforceable through the use of reputation (Allen and Lueck 2005). The bundled contracts of the FEP are not complex. But the simplicity of contracts is a result of a long process of building the capacity of farmers to engage in the exchange and building the capacity of local partners like local governments and cooperatives in enforcing agreements. The simplicity of contracts and rules, which generated similar beliefs and shared experiences, contributed to self-enforcing institutions.

Parties to the exchange and the partners-beyond-the-chain generally believe that the partnership continues to be beneficial. They believe that there are public as well as private benefits to the agreements and that therefore, it is in their interest to continue with the exchange and the partnership. Farmers find JFC, SKK Farmer's Corporation, and Unifrutti to be beneficial in terms of their price offers and their assistance to be valuable. Similarly, lead firms continue to benefit from sourcing from smallholders and microfinance institutions find that it is good business to engage in inclusive financing.

Since parties find it beneficial to continue the exchange and partnership, *smallholders take the threat of sanctions seriously*. They fear not being allowed to continue delivering their products or having a lesser allocation in the future. In the FEP model of small communities with polyvalent ties, there is an almost automatic detection of rule infraction, and with it, the triggering of corresponding penalties. In this manner, the need for external enforcement of agreements is reduced.

VII. Ways forward: Assessing the outcomes of new institutions and addressing burning issues

It is too early to evaluate the results of the proto-institutions created by the value chain models studied. Such an assessment would require an in-depth analysis of the various contracts among smallholders, lead firms, and partners. An important consideration in this analysis would be to tease out the individual effects of formal and informal rules. This is crucial given the prevalence of social norms, reputation-based mechanisms, and polyvalent ties in the communities covered by the value chain models.

Three important metrics could be considered as initial assessment points:

(a) *Were expectations regarding transactions in the value-chain relationships realized?*

In assessing value-chain relationships, it is important to uncover and analyze the incentives for stakeholders to abide by their promises. Particularly in regard to informal contracts, what are the motivations and capacities of farmer-members to transmit information regarding the farm-related efforts of neighbors, friends, relatives, and co-farmers? The assessment can borrow from various approaches in looking at motivations. The moral economy approach, for example, would consider the norms of generosity as part of social insurance mechanisms. The interpretivist approach would consider cultural beliefs about generosity begetting more generosity and luck (Aguilar 1998).

Greif (2005) argues that contract-enforcement institutions will only thrive in situations where coercion-constraining institutions are viewed as effective in preventing and punishing abuses from authorities who have information. An assessment of coercion-constraining institutions can be undertaken.

(b) *Is wealth maximized?*

It is important to know how economic value is distributed not just between smallholders and lead firms but among the different partners-beyond-the-chain. Who benefits from the reduced production costs? Who captures the benefits from better information?

(c) *Are transaction costs reduced?*

Are the costs of enforcing market exchange, acquiring and coordinating information, and monitoring contracts truly reduced (as hypothesized)? Did new costs surface? Who are bearing these and why? An analysis of the transaction costs of enforcing property rights can also be relevant particularly as a contribution to studying the banana plantation contracts in Mindanao.

Further studies on the role of the state, on group size and characteristics, and on replicating and upscaling inclusive value chains will also be beneficial in deepening the understanding on inclusive models and contracts. ■

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University of the Philippines Center for Integrative and Development Studies (UP CIDS).

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