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Institutional Change in Value Chains: Evidence from Tea in Nepal

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Summary. — Local conditions in developing countries have long played a part in determining whether their small-scale firms can benefit from deepening their participation in global value chains (GVCs). Institutional theory allows us to characterize these local conditions not simply as particularistic oddities but rather as elements of an institutional matrix that affects the livelihoods of chain participants. However, the institutional dimension of GVC analysis has been traditionally neglected in the literature, to the detriment of our understanding of the impacts of upgrading in GVCs. This study aims to remedy this failure by illustrating how institutional context mediates between value chain upgrading and the livelihoods of chain participants. It particular, it seeks to elucidate how value chain upgrading spurs a process of change in the institutions that govern the livelihoods of suppliers in developing countries. This examination sheds light on the more general question of how value chain upgrading sometimes helps, but sometimes hurts, the welfare of chain participants. This theoretical contribution to the value chain literature is based upon an institutional analysis of primary qualitative data from more than 80 small-scale tea farmers in Nepal, some of whom had upgraded from conventional to organically certified production. Our study finds that value chain upgrading launches a process of institutional change that can be summarized in a general typology. The typology highlights how rules, strategies, organizations, and informal norms affect whether a given upgrading intervention yields livelihood benefits in a particular place. Upgrading can yield positive impacts in chain-linked livelihood dimensions, such as price, and yet induce negative changes in other livelihood dimensions, such as risk, and thereby yield overall adverse livelihood implications, in a process we dub "immiserizing upgrading". These findings contribute to advancing the conceptual literature on global value chains (GVCs) by suggesting a general typology for cycles of institutional change that influence livelihood outcomes. The typology provides a framework to analyze such processes that is also of use to development practitioners seeking to understand the conditions under which upgrading worsens or improves the welfare of value chain participants. The research findings provide an interesting window into how certification schemes interact with the daily lives of the rural poor.

Key words — Asia, Nepal, global value chains, institutions, upgrading, tea

1. INTRODUCTION

Under what conditions do small-scale firms in developing countries benefit from deepening their participation in global value chains? The diversity of evidence brought to bear in the academic and policy debate on the matter suggests that the impact of participation in global value chains is by no means uniform (cf. McCullough, Pingali, & Stamoulis, 2008). Suppliers in developing countries have adopted upgrading strategies in an effort to improve their position in the chain and capture more value added in production. Although it is often assumed that upgrading strategies will be advantageous to those who adopt them, evidence suggests that this is not always the case. Studies indicate that upgrading can adversely affect the welfare of chain participants (Ponte & Ewert, 2009; Rossi, 2013). More generally, upgrading efforts interact with local institutions and strategies in a process that generates heterogeneous welfare outcomes for chain participants. A product upgrade that improves quality and prices, for example, interacts with local labor institutions and internationally defined product quality rules, which in turn affect profitability.

Owing to the weak conceptualization of institutions in the global value chain framework, however, we know relatively little about the interplay between institutions and value chain upgrading (Neilson & Pritchard, 2009). The importance of the institutional context has been acknowledged in the literature, where it is considered the fourth pillar of analysis (Gereffi, 1999), yet theoretical and empirical work on institutions in value chains has been neglected. Indeed, on the basis of their review of the literature, Neilson and Pritchard (2009) argue that institutional analysis within the global value chain framework "tends to appear wooden and simplistic" (p. 47). The research presented here aims to remedy this failure by examining how institutional context mediates between value chain upgrading and the livelihoods of chain participants.

A growing literature has highlighted how local conditions influence whether value chain upgrading impacts positively or negatively on the welfare of upstream suppliers (Mitchell & Coles, 2011; Ponte & Ewert, 2009; Rossi, 2013). Institutional theory allows us to characterize local conditions not simply as particularistic oddities but rather as elements of an institutional matrix that constrains and facilitates economic interactions (North, 1990). This paper contributes to the literature on institutions in value chains by building a stylized typology of how value chain upgrading changes the local institutions that govern the livelihoods of suppliers in developing countries. This theoretical contribution to the value chain literature is based upon an institutional analysis of dozens of field interviews with producers whose livelihoods have been affected by upgrading. When a buyer decides to upgrade to higher-quality strands of the value chain, for example, this can affect their rules for purchase and payment frequency, which in turn affects the sale options of suppliers. Institutional change can thus have knock-on effects on livelihoods, such as through wastage of suppliers' agricultural product or unem-

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ployment of garment workers. Indeed, these unintended effects may be so negative as to generate an overall negative livelihood impact from the upgrading effort in a process this paper dubs "immiserizing upgrading". When livelihoods are compromised, household welfare can bear the brunt of the impact; as such, the rest of this paper uses a livelihood perspective to understand welfare. The typology provides a framework to analyze such processes that is also of use to development practitioners seeking to understand the conditions under which upgrading worsens or improves the welfare of value chain participants.

The analysis is developed by examining how insights from economic theories of institutional change resonate in a value chain case study of small-scale tea farmers in Nepal. Findings suggest that upgrading sparks a cycle of change. Firstly, it induces changes in the institutions that govern the livelihoods of upgrading farmers. This in turn encourages the crafting of new livelihood strategies, the formation of organizations to support these strategies, and shifts in informal norms. This transformation affects whether value chain participants benefit or lose from upgrading. Yet it also generates new opportunities that can lead to another cycle of upgrading and institutional change. Analysis thus indicates that suppliers' institutional context, and their strategies, influence commodity system dynamics.

The following section develops the conceptual framework for the paper through an exploration of the relevant literature on value chain upgrading and institutional change. Section three provides a background on the case study of the tea value chain in Nepal and methodology. In section four, institutional data from the case study is analyzed, discussing the process of change in Nepal. Section five derives a general typology for institutional change in value chains and analyzes. The last section concludes and draws policy lessons.

2. VALUE CHAIN UPGRADING AND INSTITUTIONAL CHANGE THEORY

Shifts in the governance of global trade flows are reconfiguring the livelihoods of small-scale producers in the global south. In addition to producing for local markets, or for wholesale markets, small-scale firms face opportunities to participate in coordinated international supply chains. The Global Value Chain (GVC) literature (Gereffi, 1994, 1999; Gereffi, Humphrey, & Sturgeon, 2005) has studied these chains, tracing the interactions between actors along a product's trajectory "from its conception and design, through production, retailing and final consumption" (Leslie & Reimer, 1999, p. 404). According to Gereffi's classic framework (1994), chains are characterized by how their input–ouput relationships are structured across space, as well as how they are governed. Subsequent scholarship in the GVC tradition has focused on governance, and particularly how product and information exchange is coordinated by lead firms. Gereffi *et al.* (2005) identify a range of types of chain coordination, with uncoordinated spot market-type exchange on one end and on the other the very tight, vertically integrated exchange that occurs within a corporation. Between these two extremes are forms of coordination that address the particular informational demands and supplier capacity of the chain. When the chain involves the exchange of highly complex and easily codified information from buyers to weak suppliers, then the authors suggest that a "captive" form of coordination will emerge. In captive chains, suppliers are dependent on buyers, who in turn monitor their suppliers intensely.

Recent value chain literature has highlighted that there may be synergies between the type of chain coordination and the tendency of chain actors to adopt strategies to improve their position in the chain. These strategies, which are known as "upgrading" efforts in the global value chain literature, are initiated because a rent has been identified, or because actors see an opportunity to mitigate risks or avoid volatile international prices (Kaplinsky & Morris, 2001). In their study of aquaculture in Asia, for example, Ponte, Kelling, Jespersen, and Kruijssen (2014) find that captive coordination tends to encourage process upgrading, wherein inputs are more efficiently transformed into outputs, as well as product upgrading, when agents shift to a new, higher value thread of the value chain. Other types of upgrading, including to new roles (functional) and products (inter-chain), are found in other types of chains. Although early scholarship focused on upgrading to improve market power and thereby access higher incomes, subsequent work has highlighted how it can also alter the control and decision-making power producers have over the terms and conditions of their participation in value chains (KIT, Faida MaLi, & IIRR, 2006; Riisgaard, 2009) and the rights and entitlements of workers ("social upgrading") (Barrientos, Gereffi, & Rossi, 2011; Rossi, 2013). Impacts of upgrading range from income to poverty (Mitchell & Coles, 2011), gender (Laven & Verhart, 2011), and livelihoods (Neilson & Pritchard, 2009), and not always for the better. Downgrading, such as moving to a downstream function or less demanding thread of the chain, could actually be advantageous (Ponte & Ewert, 2009). Adopting different managerial models, supplying different end markets, improving efficiency, and meeting social and environmental standards could also yield benefits (Ponte *et al.*, 2014). Upgrading could also worsen welfare, including by worsening some livelihood aspects while improving others; as noted in the discussion later in the text, these strategies can be described as "immiserizing" upgrading efforts.

When firms undergo product upgrading, they can find themselves in tightly coordinated chains driven by strong lead firms. Lead firms in value chains use governance mechanisms such as production standards to exert control over the transmission of knowledge, information, product, and finance to and from suppliers. Yet at each node of the value chain, standards, as institutions for coordination in value chains (Bingen & Busch, 2006; Busch, 2011; Henson & Humphrey, 2010), intersect with local economic institutions. As such, upgrading, governance, and institutions have to be seen together in order to understand welfare impacts (Ponte & Sturgeon, 2014).

Unfortunately, the institutional dimension of analysis has been neglected in the value chain literature, obscuring our view of this interaction (Neilson & Pritchard, 2009; Ponte *et al.*, 2014). Indeed, one researcher has suggested that Gereffi saw the institutional framework surrounding the value chain as the "conditions under which control over market access and information are exercised on a global plane" (Gibbon, 2001, p. 347). Conceiving of the institutional framework in which the value chain is embedded in this passive fashion is problematic.[1] A richer conceptualization of institutions is offered by Global Production Network (GPN) theory. According to GPN thought, each stage of the production process is embedded in a web of networks and institutions across the social, economic, political, and environmental spheres. In this vision, commodity systems are "multi-dimensional, multi-layered lattices of economic activity" (Henderson, Dicken, Hess, Coe, & Yeung 2002, p. 442). Other conceptual approaches to commodity production similarly deploy nonlinear multi-dimensional systems frameworks (Lazzarini,