

**Sales Channels, Governance, and Upgrading in Floriculture Global Value Chains:
Implications for Ethiopian-owned Floriculture Firms**

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Center of African Economies

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Sales Channels,
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Ayelech Tiruwha Melese



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ABSTRACT

Floriculture is a dynamic industry that has transformed from a regional business, where both production and consumption were concentrated in Europe, to a global business organized in global value chains. Although the Dutch still lead the industry, particularly through the Dutch auction, developing countries have strengthened their position as producers in the chain. While consumption in traditional markets remains important, new demand has emerged in the global South. This working paper explains the dynamics and main features of the floriculture global value chain, different sales channels and governance structures, and their implications for how supplier firms in developing countries learn and build technological capabilities. Governance structures in the floriculture global value chain are not only shaped by buyer requirements and auction's institutional rules but also by national and international regulations. The paper argues that there is no static governance structure in the Dutch auction, the dominant sales channel, but rather that buyer-supplier relations in the Dutch auction can move from market-based governance to relational network governance in which unpackers play a crucial role. There are also new governance modes emerging beyond the Dutch auction, such as in online trading as well as in emerging floriculture global value chains in the global South where direct sales channels prevail. The paper further argues that the effort of supplier firms to capture higher value and/or to secure a 'better deal' cannot be understood only as 'upgrading' or moving up in the 'value ladder', as firms appear to use a mix of strategies and move in a variety of directions—up, down and deepen, which enable them to optimize their gains, minimize risks and stabilize income flows.

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African-owned firms building capabilities in global value chains (AFRICAP)

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Sales Channels, Governance, and Upgrading in Floriculture Global Value Chains: Implications for Ethiopian-owned Floriculture Firms

Introduction

Floriculture is a dynamic industry that has transformed from a regional business, where both production and consumption were concentrated in Europe, to a global business organized in global value chains. Although the Dutch still lead the industry, particularly through the Dutch auction, developing countries have strengthened their position as producers in the chain. Five countries dominate the industry on the producer side, with four of them being developing countries: Colombia, Kenya, Ecuador and Ethiopia. Apart from participating in the global value chain, these four countries are increasingly taking over the long-standing position of the Dutch in exporting flowers. While consumption in traditional markets remains important, new demand is emerging in the global South.

The aim of this working paper is to understand the ways in which governance structures in floriculture global value chains (GVC) shape the learning and upgrading of supplier firms in developing countries with a focus on Ethiopian owned flower firms. This task requires knowledge of the key features of the floriculture GVC, their governance structures, and how it influences firms' strategy in building capabilities and upgrading. There is a limited literature on the floriculture GVC, and even less that focuses on upgrading and learning among locally owned supplier firms in developing countries. Moreover, most of this literature is not up-to-date in terms of the contemporary features of the global value chain. Therefore, the paper also fills these gaps in the literature using new empirical material collected between June 2016 and October 2017 that involved interviews with different actors at the Dutch auction, a survey carried out with all Ethiopian owned flower firms, and initial firm histories with a sample of firms in Ethiopia's floriculture sector.¹

The first part of the paper summarizes the development of the floriculture GVC, focusing on the major producer countries. It describes how the regional-based flower trade, concentrated in advanced countries, evolved into global value chains in which functions are dispersed and developing countries are participating. It also explains core market features such as specialized market segments (florists, web-shops) and unspecialized

¹ I interviewed the 'unpackers' used by 90 percent of the Ethiopian owned flower firms selling to the Dutch auction, and the online traders residing at the auction, although independent from it, which are used by the majority of the Ethiopian firms. I also carried out interviews with people at the Dutch Development Cooperation involved in training developing country supplier firms to improve their performance in exporting, who directly assisted Ethiopian owned firms in floriculture through a capacity development program. All of this research was carried out for my PhD thesis and as part of the AfriCap project. The paper also draws on previous fieldwork conducted intermittently on the Ethiopian floriculture industry since 2007 for different projects, including my masters thesis, some of which was published in Melese and Helmsing (2010).

market segments (supermarkets, gas stations) in relation to the two main market channels: auction and direct sales. While the Dutch auction, preferred by the specialized segment, continues to play a dominant role in the floriculture GVC, the market share of the direct sales channel, which is largely used by the unspecialized segment, is growing. Even specialized wholesalers seem to engage increasingly in the direct sales channel. Additionally, new demand has emerged in the global South that is opening up additional opportunities for supplier firms in developing countries to engage in direct sales channel. There is also a rapidly emerging trading system (online-trading) linked to direct sales that appears to be competing with the Dutch auction while also using the auction's strategic resources. Thus, the line between the auction and direct sales channels is increasingly blurred.

The second part of the paper presents factors that shape governance in the floriculture GVC, discusses the prevailing governance structures, and shows the complexity of upgrading in the floriculture GVC. It describes the role of the Dutch auction, buyers, and non-chain actors and institutions that influence governance in the floriculture GVC. It does so by focusing on the traditional markets as well as tracking the new destinations (largely the Middle East) of flowers exported by Ethiopian owned firms. The auction channel is the most important channel for Ethiopian owned firms, but their participation in the direct sales channel is increasing. Governance in the Dutch auction is commonly portrayed in the existing literature as market based, but studies tend to underestimate, or overlook altogether, the role of the unpacker who has become a kind of *gatekeeper* at the auction and supports more relational governance forms. Supplier firms and unpackers need strong coordination and close interaction in order to achieve mutual success. The intensity of coordination might decline as supplier firms build higher capabilities, but the relationship remains crucial as it strengthens market position and it can also be used by the supplier firm as a stepping stone towards direct sales with specialized wholesalers as well as with *online traders*. The governance in the direct sales channel to the Middle East can be considered market based, but it also involves significant personal relationships geared towards building trust and networks that are needed to secure sales and market positions.

The second part of the paper also discusses upgrading in the floriculture GVC. Generally upgrading in the global value chain approach is concerned with the 'upward move' of supplier firms in order to capture higher value in the value chain. The four conventional typologies of upgrading—product, process, functional, and inter-sectoral or chain upgrading have been increasingly criticized for failing to adequately accommodate the empirical reality. This is not only because some of the dimensions cannot be classified distinctively from each other and upgrading activities may not lead to capturing higher value, but also because upgrading in the floriculture GVC is more diverse than generally conceptualized. In order to maximize rewards, stabilize income as well as balance risks and benefits, Ethiopian supplier firms appear to be selectively deepening capabilities that enable them to move in various directions. End-markets clearly play a crucial role in

upgrading trajectories. For example, Ethiopian owned flower firms try to maximize rewards and stabilize income by strategically playing all directions: moving ‘up’ (meeting stringent requirements of Western European markets); moving ‘down’ (adding product portfolio to cater to less stringent end-markets such as the Middle East and Southern Europe) as well as moving ‘horizontal’ to sell in similar end-markets but through different market channels or in the same sales channel using sub-channels. In doing so, they do not necessarily drop higher end-markets to enter lower ones.²

Part I: Floriculture Global Value Chains

This part of the paper discusses the development of the floriculture GVC. It briefly traces the evolution from regional flower market to the global value chain, explaining the main features, major players, and dynamics in market channels. Flowers are traded in two market channels: auction and direct sales. The Dutch auction is the most dominant one worldwide, and the Netherlands remain a global hub of floriculture trade. However, since 1990s the direct sales channel has grown rapidly in traditional markets (European, North American, and Japan) as well as elsewhere. Although direct sales are often associated with Western supermarkets, other retailers and wholesalers are increasingly engaging in direct sales channels in various end-markets including European and Middle Eastern markets. Furthermore, the Dutch auction appears to be hosting a new trading system that is seemingly in direct competition with the auction. The new trading system (online-trading) is used by most of the Ethiopian owned flower firms, alongside the auction. These various market channels and end-markets have distinct and overlapping characteristics that offer opportunities as well as challenges to suppliers. The Ethiopian suppliers engage in a number of these channels and end-markets by continuously trying to weigh risks and gains of each channel and market.

Development and major players

Floriculture, specifically cut-flower, is today one of the most dynamic global industries that connects developed and developing countries through production and trade. By the mid-2000s, the industry had evolved from a supply-driven regional market to a highly sophisticated and demand-driven global value chain (Labaste 2005). In the first half of the twentieth century, cut flowers were grown and traded only within developed countries. Patrick Labaste (2005:42) refers to this as an *immature market* in which flowers were mostly consumed for special occasions (weddings, funerals, and holidays) and to a lesser extent for own/personal use. Demand was met by the local or regional growers and specialized outlets, such as florists, which were in close proximity to consumers. Thanks to the continued prosperity of the global North, flower consumption increased rapidly and

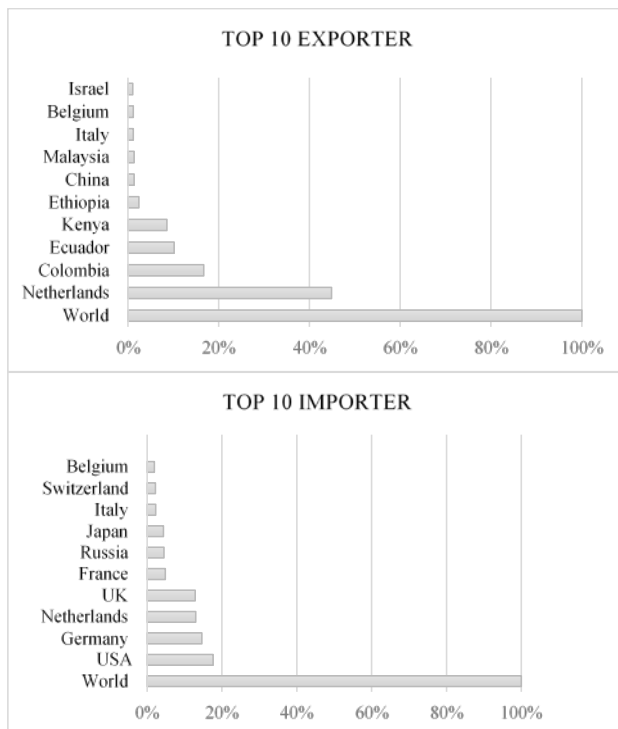
² A more detailed discussion of Ethiopian-owned firms and an assessment of their capabilities and upgrading trajectories is contained in Melese (2017).

generated year-round demand. Although the growth was seen in both *special occasion* and *own-use* consumer markets, it was mainly driven by the creation of new demand for own-use. As a result, both specialized and unspecialized market segments continued expanding; the former refers to outlets that carry flowers and plants as their primary products, such as florists and web-shops; whereas, the latter refers to outlets that carry flowers as one of their many different products/assortments, such as supermarkets.

The local/regional suppliers could not satisfy the new year-round demand due to rising production costs. Most consuming countries have an unfavourable climate for cultivating off-season flowers and adjusting the climate through technologies led to higher production costs. In addition, the costs were pushed up by rising wages and stricter environmental policies in those countries. Consequently, in order to increase their profit margin, firms from rich countries relocated some functions to countries with competitive advantages such as areas with agro-ecological potential (close to the equator) and cheap labour. This move denoted a conversion of regional based trade into a global configuration through fragmenting activities and relocating them across different borders in the world. For instance, North American flower companies moved their production to Colombia and Ecuador while keeping marketing and distribution centres at their origin (Sawers 2005; Arbeláez et al 2007). Similarly, European companies relocated to Sub-Saharan African countries such as Kenya and more recently to Ethiopia. Such capitalist mobility and emergence of new production destinations was intensified by the increased liberalization of policies and various bi-lateral and/or multilateral trade agreements since the 1960s.³ The major exporters in the past decades in ranking order were The Netherlands, Colombia, Kenya, Ecuador and Israel, but in recent years this ranking changed as the position of Israel weakened while Ethiopia emerged as a prominent exporter (see Figure 1).

³ For example, structural adjustment program, the U.S. Andean Trade Promotion and Drug Eradication Act, Cotonou Agreement- a non-reciprocal free trade agreement (Dolan and Sorby 2003; Patel-Campillo 2010; Keane 2013; Conlon 2015).

Figure 1 Top 10 countries of floriculture exporter and importer, 2016



Source: Author's construction based on the ITC's calculations (product: 0603).

Floriculture production consists of various types of plants such as cut flowers, foliage, potted plants, garden plants, flowering leafy and so on. After breeders develop new flowers, licenced propagators reproduce the varieties in the form of cuttings, seeds, or bulbs that can be an input for commercial production by growers located in various parts of the world. Breeders are largely from advanced countries such as the Netherlands⁴ and usually have experiment centres in important production regions. Similarly, commercial propagators and 'cutting' producers are largely owned by Western multinationals but increasingly operating in developing countries in the form of vertically integrated or captive joint ventures (Evers et al 2014). Overall, developing countries' participation in the floriculture GVC is predominantly in the production side but less in breeding and propagation.

⁴ Dutch breeders account for more than 35 percent of all applications for community plant variety rights. See <https://www.hollandtradeandinvest.com/key-sectors/horticulture-and-starting-materials/horticulture-facts-and-figures> (last accessed on November 23 2017).

The floriculture trade mainly comprises four groups of flowers: flower bulbs, cut foliage, cut-flowers and living plants. Cut-flowers, particularly roses, are the most globally traded flowers, followed by living plants and flower bulbs, which are often traded within advanced countries (Rabobank 2015). The Netherlands is the leading exporter in all types of flowers, while developing countries largely export cut-flowers, especially roses.⁵

Colombia is the leading flower exporter among developing countries. The country discovered its flower export potential in the 1960s as a result of an economic cooperation program called Alliance for Progress that took place between the United States and Latin American countries, with Colombian and US entrepreneurs setting up the first flower farms (Arbeláez et al 2007; Conlon 2015). Despite the protectionist efforts of the US growers, Colombian flower exports thrived, reaching US\$ 1.312 billion in 2016, and exports to the US accounted for over 78 percent of the total value of global exports with the remaining share going UK, Japan, Canada, Russia, The Netherlands, and others (Mendez 1991; ITC 2016⁶). The success of the Colombian flower sector is largely related to the role played by the association of Colombian flower exporters (Asocolflores) and innovation of entrepreneurs, alongside favourable government policies that helped to create a critical mass in the industry (Arbeláez et al 2007; Conlon 2015).

The Ecuador flower sector attempted to develop around the same time as the Colombian one, but it only become successful from the 1980s when a second phase of pioneering took place. This was partly because the initial Ecuadorean flower firms were not able to tackle logistic, infrastructural, and quality problems. Later, however, multiple national and global factors such as policy reforms, USAID support, and spill-over effects from and linkages to Colombian exporters positively influenced the Ecuadorian flower sector, as did changes in the global market (Sawers 2005; Arbeláez et al 2007). As a result, flower exports from Ecuador reached over US\$ 802 million, with the US as the main destination (48 percent) followed by Russia (14 percent) and the Netherlands (8 percent) (ICT 2016).

With regard to the Sub-Saharan Africa, the Kenyan floriculture industry plays a leading role. It was built based on the horticulture growing experience of the colonial period, where in the 1950s European farmers produced vegetable and fruits for export, primarily to United Kingdom. Later, the farmers began growing flowers but gained limited success to export markets, partly due to the absence of proper infrastructure and logistics (Whitaker and Kolavalli 2006). In the late 1960s, the sector was dominated by a single large Danish investment, but its success later attracted many European, Asian, and Kenyan investors. Since the 1980s, the sector has experienced growth as the government made some important interventions to support large scale investments and as investors exploited their existing linkage with European markets (as a result of horticulture exports), tariff advantages, and political affiliation (Ibid). Moreover, forming sector specific institutions such as the Horticultural Crops Development Authority and Kenyan

⁵ In this paper, floriculture and cut-flowers/flowers are used interchangeably.

⁶ See <http://www.intracen.org/itc/market-info-tools/trade-statistics/> (last accessed on 3 November 2017).

Flower Council helped to resolve collective action problems and to bolster the sector. In 2014, Kenya flower export value stood at US\$ 553 million, with the Netherlands as the major buyer (52 percent) followed by the United Kingdom (19 percent). Countries like Australia, Russia and Germany are other important destinations of Kenyan flowers. In 2016, Kenya was the fourth largest cut-flower exporter worldwide and the largest in Sub-Saharan Africa followed by Ethiopia.

Ethiopia's floriculture industry that was pioneered in the 1980s by public owned horticulture farms and re-launched by domestic private firms in 1990s, successfully positioned itself as an important player due to the efforts of local entrepreneurs, targeted industrial policy, and development cooperation.⁷ As of 2016, Ethiopia exported US\$ 191 million, with the Netherlands as the major destination (82 percent) followed by Saudi Arabia (4 percent), United Kingdom (3.6 percent), and Norway (3 percent).

As the trend of the major four exporters show, geographical proximity appears to influence the pattern of the global floriculture trade. The leading producers for Latin American countries largely cater to the North America market, which is dominated by retailers and supermarkets that usually buy their flowers from importers and distributors located in or near Miami international airport: the major entry point for Latin American flowers to the US market. Sub-Saharan African countries such as Ethiopia and Kenya mainly export to European countries, where the largest consumers and traders reside. Asian markets such as Japan are also largely catered by regional players such as South Korea, Malaysia and China; however, Latin American and Sub-Saharan African countries have been entering Asian markets gradually (JETRO 2011; Rikken 2012). The Japanese market is dominated by wholesale markets located throughout the country, and recently its traditional auction system has been dwarfed by the growth of direct sales. Imported flowers are brought into the country by specialized importers that distribute it to wholesalers and retailers.

The Netherlands, one of the traditional producer and consumer countries, traces the origin of its flower industry back to the tulip business in the seventeenth century, but the modern development is more directly linked with horticulture clusters of Aalsmeer and Westland. This is where Dutch farmers began growing horticulture in glass houses and where they collectively (in cooperatives) established marketplaces (auctions) around the mid-nineteenth century (Gebhardt 2014). The successful development of the industry continued into the present period due to the efforts of actors in the clusters (innovations in hard and soft technologies ranging from production, marketing to distribution) supported by government policies (Tavoletti and te Velde 2008; Patel-Capellio 2011). In 2016, exports of cut-flowers stood at over US\$ 4 billion and were largely traded within Europe (Germany 30 percent, UK 14.8 percent, France 12.5 percent, Belgium 4.3 percent) with a smaller share exported to Russia, US and other countries. The Netherlands also re-

⁷ For a summary of the evolution and development of the floriculture sector in Ethiopia, see Melese (2017).

exports the flowers it imports from the aforementioned major exporting developing countries. The Dutch auction (presently Royal FloraHolland) played a central role in nurturing and disseminating network-based knowledge throughout the clusters (Levelt 2010; Gebhardt 2014).

Notwithstanding the strong position of the Netherlands in the floriculture GVC, the role of the four developing countries has been increasing. According to the Rabobank (2016), in the last decade, Ethiopia, Kenya, Colombia, and Ecuador have been taking the share of the Netherlands in global trade, and their aggregate export share (44 percent) surpassed the share of the Netherlands (43 percent) in 2015. However, this statistic should be used cautiously, as there appears to be some discrepancies in the data. Rabobank's calculations were based on UN-Comtrade data as well as Royal FloraHolland and Rabobank data itself, but the export data of Ethiopia reported by UN Comtrade differs significantly from the data from Ethiopian official reports. UN-Comtrade's data showed an overstatement by more than 200 percent.⁸ Nevertheless, the aggregate export share of the four developing countries showed growth in the past years but it is still far from exceeding the share of the Netherlands, which stood at 47 percent in contrast to 36 percent (ITC, 2015).

Global demand for cut flowers grew consistently since the 1980s but then slowed in the aftermath of the global financial crisis that began around 2008 and affected all major consumer countries. Flowers are a luxury product, and thus they tend to be sensitive to changes in disposable income. Growth in the global floriculture trade continued to be unstable after 2009, and the large drop in flower consumption had not fully recovered by 2016 (Rabobank 2016). In some end-markets, consumers switched to low value products such as short stem and small head size roses known as sweethearts, which benefited the unspecialized segment of the global market such as supermarkets and Do It Yourself stores. Flower farms that produced intermediate and high-quality flowers for specialized segments, such as Ethiopian owned flower firms, were adversely affected by the global financial crisis.

Additionally, with the increase in the number of flower exporting countries, the year-long demand is now met by an abundant supply, resulting in increasing pressure on profit margins and stiff competition worldwide. At the same time, buyers' requirements became more stringent in order to differentiate products as well as address perceived and/or real consumer concerns about safety and sustainability that emerged in the global value chains. Consumers and non-governmental organizations increasingly began demanding more information about the products they consume, including information on labour and environmental issues. These factors led to stronger chain coordination and control within the floriculture GVC, which had important implications for supplier firms' capabilities and upgrading opportunities. As discussed in subsequent sections of the working paper, the degree of coordination and types of governance vary by end-markets, sales channels,

⁸ See <https://comtrade.un.org/data/> (last accessed 21 November 2017).

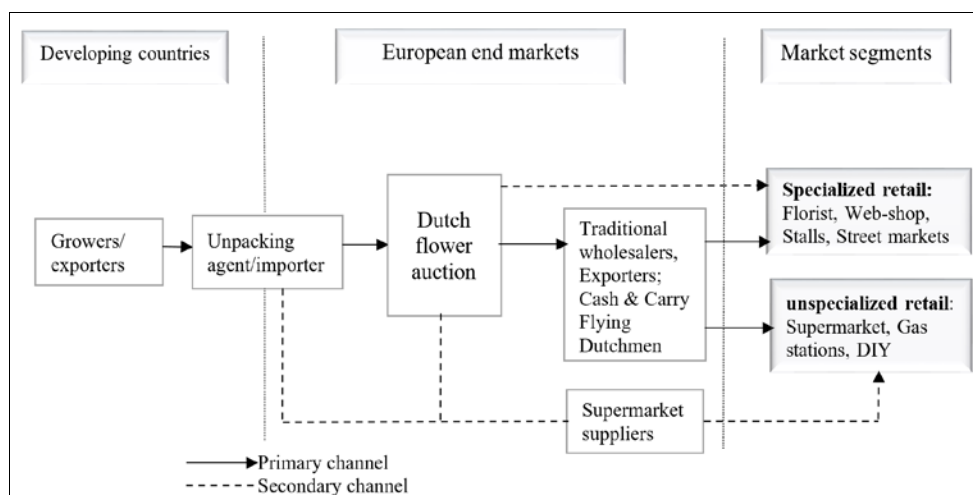
and market segments. The next section presents the main market channels and market with a focus on the chains in which Ethiopian owned flower firms are inserted.

Sales channels and market features

Although there are several floriculture auctions across the world, the Dutch Royal FloraHolland auction plays the most influential role. It is the largest flower auction in the world with an annual turnover of 4.6 billion Euros and trading around 60 percent of the worldwide cut-flowers and 40 percent of living plants in its four auction houses (Aalsmeer, Naaldwijk, Rijnsburg, and Elde) in the Netherlands (Royal FloraHolland 2016; USDA 2016). It is also the favoured market channel used by the specialized buyers (e.g. florists), which are dominant in Europe with a market share of around 66 percent (CBI 2015). However, as discussed below, the direct sales channel is rapidly growing in European and other end-markets.

Figure 2 depicts market channels through which flowers from developing countries reach European consumers in the European Union and European Free Trade Association. As mentioned previously, consumers with special demands often buy flowers from specialized outlets such as florists and web-shops; whereas, for their *own use*, consumers tend to buy (usually impulsively) from unspecialized outlets such as supermarkets and gas stations. In a simplified form, Figure 2 demonstrates the most common ways in which flowers from developing countries end up on the shelf of European florists and supermarkets. Exported flowers are received by an unpacking agent or import department of the auction and get processed and auctioned (at the Dutch auction channel). Various types of big buyers participate in the auction (traditional wholesalers, cash-and-carry wholesalers) and distribute to specialized outlets (florists, flower web-shops, stalls, street markets). However, unspecialized outlets such as supermarkets also buy from the auction to supplement their direct sourcing or as their only source. Alternatively, unpackers or importers bypass the auction and directly get in contact with different unspecialized retailers such as supermarkets, gas stations and Do It Yourself stores (direct sales channel). Importers might also have direct contacts to specialized outlets such as traditional wholesalers and florists. The shortest supply chain can be achieved through direct sales when retailers like supermarkets skip importers and directly engage with exporters from developing countries to source flowers.

Figure 2. EU and EFTA market channels for cut-flowers



Source: Adapted by the author from CBI (2015; 2016).

The evolution and market features of the two market channels (the Dutch auction and direct sales) are closely intertwined, so they are discussed simultaneously. The Royal FloraHolland was established in 1912 by the cooperative of Dutch flower growers with the aim to increase the bargaining power of growers against the rising power of buyers. This led to a new way of organizing the flower trade, moving from informal and individual-based transactions to a formal trade agreement with a guaranteed payment mechanism through a collectively established intermediary system: an auction (Patel-Capellio 2011). Through the auction system, small growers were able to enjoy safer and fairer trade terms than before. As a result, the cooperative began to grow quickly because it was able to attract a large number of members. Although buyers attempted to boycott the new system that eroded their power to dictate the terms of trade, an act of the Dutch government prevented this from happening. In 1916, the government enacted a rule that made using the auction system mandatory, which officially transformed the buyer-driven floriculture value chain into a producer-driven one.

However, the Dutch flower growers were threatened again by the emergence of developing countries as important producer countries, and in 1994 the Dutch government banned foreign products from the auction to protect Dutch growers. This resulted in a new dynamism in the global value chains as some of the banned firms, especially the East African Flower Company, a Dutch import firm and wholesalers reacted to the ban by setting up their own auction system, the Tele Flower Auction, near the Aalsmeer auction house (now Royal FloraHolland) with an innovative approach that used an electronic system and demonstrating a better capability of meeting buyers' requirement (Levelt

2010; Gabhardt 2014). Furthermore, such protectionist measures actually brought developing country producers and European buyers closer, encouraging direct sourcing especially between Kenyan and UK firms (Levelt 2010; Whitaker and Kolavalli 2006). This development was critical not only in changing the relative position of the Dutch auction in the global value chains and the growth of direct sales, but also in changing the strategies of the Dutch auction, as a cooperative owned entity, negotiating the interest of growers, and that of the institution itself (run by professionals, not necessarily growers)—which were sometimes in conflict (Gabhardt 2014). The auction was pressed by the competition to adapt and innovate. It became more open to cater to the global supply (from members of the auction and non-members), and continuously upgraded its services in multiple areas of product assortments, marketing and distribution in a fashion that addressed buyers' requirements while positioning itself as a leading importer and (re)exporter. These changes resulted in an increased membership and strengthened the position of the Dutch auction in global trade, which was further consolidated through the merger of the two biggest auction houses, FloraHolland and Bloemenveiling Aalsmeer, that became Royal Floraholland, and when two years later, the Tele Flower Auction was integrated with Royal Floraholland as well.

During this time, the direct sales channel continued growing, with strong control by a handful of large wholesalers and supermarkets, such as Tesco and Sainsbury's in the UK, Aldi and Lidl in Germany, Carrefour in France, and Royal Ahold in the Netherlands, which directly source from supplier firms in developing countries under their specific requirements. The growth of direct sales is stronger in the UK, where the majority of consumers buy flowers from supermarkets. The UK retailers directly import around 15 percent of the total European Union imports through the direct sales channel (CBI 2015). Thanks to the competition with Tele Flower Auction, the Dutch auction (FloraHolland) appeared better prepared to cater to this trend as it introduced similar technologies and sales arrangements such as the remote buying system (KOA- Kopen Of Afstand)⁹ as early as 1996, which allowed registered buyers located anywhere in the world to buy flowers electronically based on product information. Moreover, the auction also set up a system that enabled direct trade, which is often referred to as FloraHolland-Connect. Suppliers in Ethiopia call it *auction-direct*, recognizing it as some sort of direct sales facilitated by the auction system. The auction continued introducing such services in order to cater to broader types of buyers and to secure a sustainable supply. As the commercial manager of FloraHolland explained, the auction as cooperative will continue serving the interest of its members by providing them a 'marketing platform, guaranteed payment system, and dependable logistics that suits the future markets'.¹⁰

⁹ Although KOA was introduced in 1996, its use significantly increased since 2006.

<http://www.floraculture.eu/2007/04/disconnecting-the-product-from-the-process-only-the-beginning/>. A renown sector specific magazine called Flora Culture International published, on 26 April 2007, an interview with a manager at Bloemenveiling Aalsmeer auction (one of the two largest Dutch auctions before the merger in 2008), who explained how the importance of KOA dramatically increased after several years of its introduction.

¹⁰ Interview with commercial manager of FloraHolland, East Africa, October 2017.

In the Dutch auction, the price is determined by the so-called auction clock system, which is a pressure game where the clock begins at the highest price (given by the auctioneer depending on demand and supply) and then starts counting down. Buyers have only a few seconds to stop the clock in order to purchase specific amounts of the auctioned flower; otherwise, they risk losing their preferred product of specific quality and quantity. Therefore, a supplier/exporter can sell different batches of the same variety of flower at different prices for various buyers. However, in *auction-direct*, buyer and seller can agree on a price outside the auction clock. As Ethiopian owned firms explained, *auction-direct* provides an opportunity for contract-based selling with both fixed and flexible prices. The two parties set fixed prices for a certain variety and volume of flowers, while for the rest of the flowers they agree to apply the daily price of the auction. In the case of direct sales, prices are often negotiated by the buyer and seller, but both tend to use the auction price as a reference. This can be different for long-term partners who might set prices based on a 'cost-price plus' mechanism, which means setting prices based on the sum of all costs (breakeven point) plus a certain percent of the total cost (mark-up) (DLV Plant 2012). In principle, the auction sells all types of flowers with a wide range of quality, but in practice it is suggested to be a better channel for high value products often needed by specialized segments. As a result, roses of large and intermediate head size and stem length tend to fetch better prices in the auction than in direct sales. But, the direct sales channel is also showing increasing demand for high quality roses (CBI 2015).

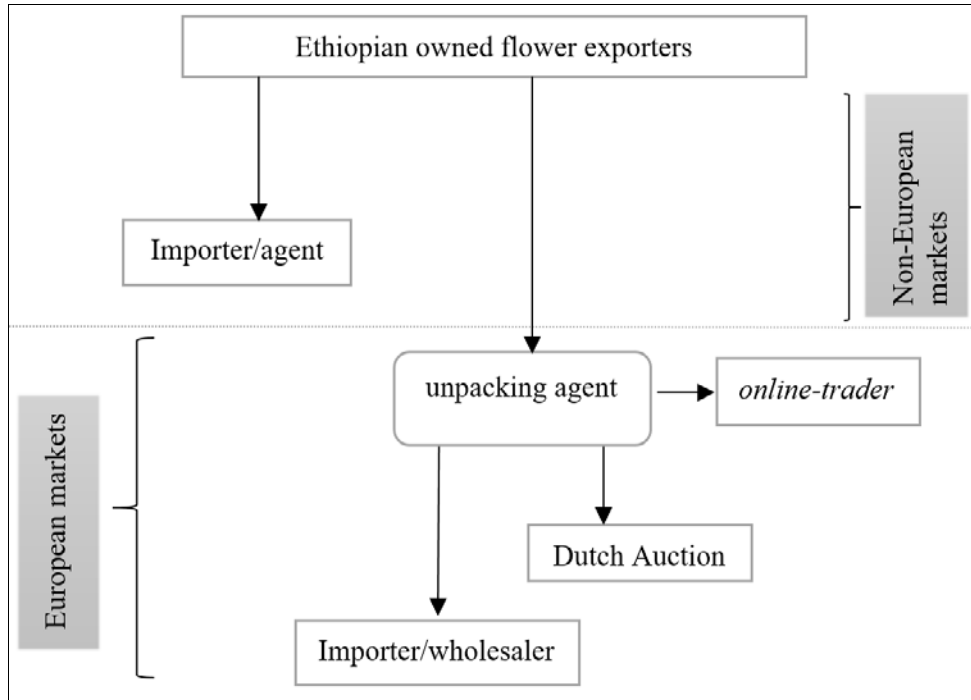
Although the two market channels are often projected as separate and independent from each other, they are usually interdependent and this can be seen more clearly in online trading. One can find the two channels playing complementary roles and cooperating in areas where one would expect the two to be competing. This seems to be part of upgrading processes in line with the auction's strategy to embrace the inevitable change in the global value chain and hence adjust to a rapidly emerging trend - online trading or the virtual marketplace.

Online-traders claims to have a strong capability to predict a daily auction price so that it can offer in advance a slightly higher price to suppliers that are connected with it via its online platform. The supplier decides to permit the *online-traders* to start selling part of its daily shipment via its web-shop before it is even shipped to Europe. If the *online-trader* was unable to sell the entire agreed amount by the time the shipment arrives, the unsold flowers go directly to the auction, and the *online trader* pays for the sold amount via the auction payment system. Although the *online-trader* is directly competing with the auction, it is doing so with the cooperation of the auction by sharing one of its most important competitive advantage, a fast and guaranteed payment system, which is a highly valued service in the eyes of supplier firms.

As Figure 3 shows, Ethiopian owned flower firms sell in both European and non-European end-markets; in the latter they use the direct sales channel, while in the former they use both the auction and direct sales. In addition to processing flowers for the

auction, the unpacking agent plays multiple roles facilitating sales in direct sales and online trading. Online trading is an important market channel for local firms in the Ethiopian floriculture industry.

Figure 3. Simplified market channels for Ethiopian owned flower firms



Source: Created by the author.

The floriculture GVC literature generally focuses on analysing the two market channels as depicted in Figure 2, with developing countries producers supplying Western consumers, and the direct sales channel is predominantly conceptualized from the perspective of supermarkets in Western countries (Riisgaard and Hammer 2009; Gebreeyesus and Sonobe 2009; Taylor 2011; Zylberberg 2013). This is not surprising due to the dominant role of Europe in the global industry as well as in trading with developing countries. However, there are other types of buyers in the direct sales channel that are growing in importance for smaller supplier firms that largely produce for specialized market segments. Thus, it is necessary to go beyond the conventional focus on supermarkets and to examine direct sales in the context of other buyers in traditional end-markets as well as in emerging markets. The market in the Middle East is dominated by specialized importers who create links with producers/export agents in different parts of the world and supply to local wholesalers and retailers (CBI 2016). Although there is no consumption data on the Middle East market, CBI's interview-based research predicts growth in flower consumption due to a young and growing population with higher income per capita, especially in the United Arab Emirates which is a trade hub for the region (via Dubai flower centre). The trade data also shows that in 2016 the region imported flowers

valued at US\$ 150 million, with over 60 percent of going to Saudi Arabia and United Arab Emirates, and that flower imports increased 85 percent compared to imports in 2012 (ITC website). Uncovering these dynamics is important for understanding the contemporary floriculture GVC, as it denotes growing demand in the global South and alternative outlets for producers in developing countries. In addition, traditional wholesalers are increasingly leaving the auction to engage in direct sales channel. As mentioned previously, these wholesalers are typically the suppliers to specialized retailers such as florists, gardening centres, street markets and web-shops, which are dominant flower outlets in Europe.

According to Ethiopian owned flower firms, some of these wholesalers engage with them in contract-based sales where the price is sometimes fixed and costs are lower than in the auction as it passes through the same process but without auction fees. The Middle East end market involves even lower costs and usually offers better prices compared to the European market. For instance, in the auction channel suppliers are responsible for ground transportation of flowers from the airport to the auction house; whereas in the Middle East the responsibility of the supplier is until the airport of the destination country, and sales are usually based on contracts with fixed price. But since there is no system that can guarantee payment for suppliers, sales are only based on advance payment until a certain level of trust is established. This indicates that suppliers who engage in such diversified end-markets/ market channels are exposed to different prices, opportunities to learn and build their capabilities but each has its risks and challenges. These issues are explained in more detail in the next part of the paper.

Part II: Governance and upgrading in floriculture global value chains

In global value chains where chain actors and activities are organisationally and spatially dispersed, governance is key to bring products from production locations to consumption. Governance is therefore a key concept in the global value chain approach that originates in the work of Gary Gereffi (1994).¹¹ In general, governance is the art of re-integrating globally fragmented functions and creating a competent supply base through various coordination, control, and normalization mechanisms. The original focus was on inter-firm relations as governance is assumed to be exercised by the so called ‘lead firm’ in a

¹¹ Gereffi (1994) in his original work on global commodity chains identified two types of chains: producer-driven and buyer-driven chains. Producer-driven chains are mostly found in technology and capital intensive industries where large firms (lead firms) keep the core functions in-house and outsource labour intensive functions to suppliers that are vertically controlled (often through ownership) and coordinated by the lead firm. Whereas, buyer-driven chains were more common in labour intensive sectors in which large firms (lead-firms that are often buyers and not producers) exercise chain governance without having ownership over suppliers. Instead, they tend to do so through specializing in functions like designing, branding, marketing and retailing where barriers to entry are relatively higher. However, based on the studies conducted since Gereffi’s work, there has been a debate on the relevance of the dichotomy between producer-driven and buyer-driven and new governance typologies have been developed such as the one described above (see the discussion in Gibbon et al 2008). The author still finds the buyer driven concept useful for the floriculture GVC but combines it with newer governance typologies, particularly the 5-fold classification or market, modular, relational, captive and hierarchy.

value chain. Subsequent studies show that there can be more than one lead firm and several forms of governance in the same sector and even in the same value chain (Gibbon and Ponte 2005; Gibbon et al 2008). In addition to the importance of inter-firm relations, international and national regulations and public and private non-firm actors such as NGOs can influence governance (Gibbon 2003, Riisgaard and Hammer 2008, Helmsing and Wellema 2011).

The governance structure exercised in a GVC distinguishes one chain from another, and more importantly, it influences the learning and upgrading possibilities of supplier firms (Humphrey and Schmitz 2002). Gereffi, Humphrey, and Sturgeon (2005) identified five possible types of governance: market, modular, relational, captive, and hierarchy. The intensity of coordination and control increases as the chain governance moves from market-based to hierarchy. According to the authors, there are three core factors that determine the type of governance that is exercised in global value chains: the complexity of information and knowledge transfer, the extent to which the knowledge can be codified, and the capability level of the supplier. The inter-firm relationships that are based on economic interest usually involve formal and informal interactions that can lead to trust-based governance, which is embedded in inter-personal networks (Bair 2008).

In the floriculture GVC, the Dutch auction as well as retailers and other buyers set requirements and standards in order to improve competitiveness through product differentiation and innovation, as well as to comply with public and private regulations. These requirements and standards dictate to a different degree what, how, and under what conditions to produce, sell, and deliver. Suppliers strive to meet those requirements and standards in order to sell their products in specific end-markets and sales channels. In some chains buyers and suppliers work more closely in non-market coordination, which often increases opportunities for learning by suppliers. In the case of the auction GVC where suppliers from developing countries are inserted, its major coordination and governance is achieved via the institutional rules of the auction, which can be considered a minimum standard for the entire floriculture GVC. But there is another layer of governance and coordination in the auction GVC that is exercised between unpacking agents and supplier firms, as shown later in the paper. Studies on the floriculture GVC, however, tend to ignore the relations between the supplier and the unpacker and generally recognize governance in the auction GVC as market-based; whereas inter-firm relations in the direct sales channel (usually referring to European supermarkets) are described as relational network governance.

In this paper it is argued that there is no static governance structure in the Dutch auction, and the experience of Ethiopian owned flower firms indicates that governance in the auction channel can be described as a dynamic process that can evolve from market-based to relational networks. Before elaborating this argument, factors that shape governance in the floriculture GVC are discussed. As noted earlier, governance and coordination in these chains are influenced not only by chain-actors, most importantly lead firms, but also

by non-firm institutions such as national legal requirements, international regulations, and sustainability initiatives.

Factors shaping governance

In the floriculture GVC, two national and international legislations are identified as the most important in shaping the chain coordination and governance. The first one is legislation on plant health which specifies phytosanitary requirements of plants that can enter a specific countries or markets. For instance, flowers that are exported through either of the market channels to European markets need to comply with phytosanitary requirements, requiring that exporters get phytosanitary certificates from the National Plant Protection Office (NPPO) in exporting countries which is internationally designated to issue the certificate. Some countries apply this rule more strictly than others. For instance, local firms in Ethiopia indicated that Japan and certain states in the US have near zero tolerance for pests and often require fumigation, whereas enforcement of such regulations can be weaker in the Middle East.

The second regulation is concerned with intellectual property rights. Plant breeders are protected by the International Union for the Protection of New Varieties of Plants (UPOV). Member countries are required to provide legal instruments to enforce breeders' rights. However, the enforcement of the regulation differs across member and non-member countries. For instance, Western countries tend to observe it more than countries in the Middle East. The Dutch auction protects the intellectual property rights of breeders by preventing market access to suppliers who do not pay royalties. Producing countries are also advised to observe breeders' rights, but Ethiopia has no laws to regulate these rights and according to some key informants in the Ethiopian flower sector, the absence of such regulation has had negative impacts on the sector as it discourages breeders to sell their best varieties in the country while it encourages variety theft by some growers who sell on unregulated markets.

Apart from national enforcements, breeders exercise the right to control their varieties and proper usage. In doing so, they shape supply and demand and hence price through managing access to varieties. For example, they issue varieties only to preferred growers in exclusive agreements for a certain period so that the demand of those varieties exceeds the supply enabling both the breeder and the firms to enjoy higher returns on their investments. Apart from such buying power, relationships and trust are believed to play important roles in accessing varieties (Levelt 2010; DLV Plant 2012).

The Dutch auction (including *online-traders*) has minimum requirements or institutional rules regarding pre-treatment, quality, bacteria content and ripeness (opening stage) of flowers. Part of these rules emanate from national legal requirements related to plant health, while others are product specific and geared towards meeting market requirements. Flowers that meet the minimum requirements are then sorted in different

quality groups. For example, rose sorting is done based on length, weight, and maturity. Growers are responsible for self-grading and for the reliability of the information they provide with their flower lots. While the auction makes random checks in relation to meeting minimum requirements, the importing department unpacks the flowers and ensures that the supply meets the basic professional level of the auction. Supplier firms are required to pay auction fees, and if they are members of the auction, the fees might be lower, but they are obligated to sell all their production via the auction channel. Otherwise, they are subject to pay the so-called NAT commission (commission on non-auction turnover).¹²

Besides the institutional rule, there are certain ‘unwritten requirements’ at the auction that overlap with specifications in the direct sales channel such as compliance for certain sustainable initiatives or certifications. Furthermore, the auction’s rule dictates that supply and demand determines auction prices; however, in practice prices can be influenced by the capabilities of a supplier in appearing regularly at the auction clock with consistent quality and volume, unless it is a special occasion such as Valentine’s Day or Mother’s Day when demand exceeds supply and all suppliers enjoy relatively high prices. Suppliers with a good track record in consistency and reliability have a better chance to establish direct relations with buyers (like in the *auction-direct* channel) and negotiate over prices.

The specifications of buyers in the direct sales channel depend on their end-markets and market segments. Generally, buyers’ specifications in the Middle East are not as extensive as in Western end-markets, and there is a stark variation in consumer taste between the two regions that shapes buyers’ requirements. For instance, buyers in the Middle East prefer classical varieties of roses at relatively matured stage or higher opening stage (e.g. stage 4), while the Western markets require roses of early opening stage (opening stage 2).¹³ In the Western direct sales channel, targeting both specialized and unspecialized market segments, product quality requirements are generally the same as in the auction, but retailers usually have additional specifications such as guaranteed vase life, quantity per variety, and packaging specifications (DLV 2012; CBI 2016). Moreover, reliability and consistency are more strictly required along with flexibility, but these attributes are important in the Middle East market as well, especially with big buyers. Such specifications can be considered as a precondition to engage in direct sales channel, especially to Western retailers. Flowers with buyers’ specifications in terms of varieties, quality, and quantity should be delivered at a specified time and place so that

¹² Flower exporters who are members of the auction are required to sell all their export via the auction channel but if they choose to sell part of the export in another channel, they need to report their turnover sold in non-auction channels and pay commission over it to the auction. In order to enforce this rule, the auction’s regional offices regularly visit members’ farms and estimate export volume of each farm. If the actual export volume via the auction significantly deviate from the estimation, the auction can initiate an investigation and demand a member farm to settle the outstanding commission (if any) or block it from the auction and membership until the amount is settled.

¹³ Opening stages refer to the maturity level of roses. Roses with an early opening stage (stage 2) have a tighter flower head with less visible colour and it opens slowly and can have longer vase life, while the opposite is the case for roses with an advanced opening stage (stage 4).

buyers/retailers can cater to consumers with fresh flowers without having a need to store them. This means that managing lead-time (the time between placement of order and delivery of products at retailer's shelf) is more crucial in the direct sales channel (especially for supermarkets), which implies that supplier firms need to have a strong capacity in process planning (production to delivery) and logistics capabilities that enable them to control the 'push-pull' forces simultaneously: pushing out shipments from exporting country and pulling in to end-markets (Labaste 2005).

Moreover, suppliers need to be flexible as buyers' specifications can change frequently. As a result, buyers in Western supermarkets tend to be involved in value chain coordination and work closely with suppliers to improve logistics and cool chain management. Large supplier firms may even prefer setting up a vertically integrated system through joint ventures with freight forwarders and opening their own importing, marketing and distribution centres at end-markets (Labaste 2005). As mentioned before, however, there are other types of direct buyers in the Western direct sales channel that target the specialized market segments such as traditional wholesalers. According to Ethiopian owned flower firms, their requirements overlap with the Dutch auction but have some similarities with European supermarkets as well, especially in requiring, consistency, reliability, and consumer labels (certificates).

Sustainability initiatives and certification are important governance mechanisms in the floriculture GVC. There are various types of environmental and social standards but MPS-ABC and GLOBAL-GAP, which are business to business (B2B) standards, are the most widely adopted. Their primary concern is good agricultural practice and environmental protection, but MPS has incorporated social issues through MPS-SQ (Socially qualified). The other standards are commonly known as consumer labels to imply that, unlike the B2B, they are communicated to consumers, include labels such as Fair Flowers Fair Plants (FFP), Flower Label Program (FLP), Fairtrade Labelling Organization (FLO), and Ethical Trade Initiatives (ETI). Most of these standards cover more (sometimes exclusively) social issues than B2B standards, while at the same time addressing environmental concerns (Riisgard 2011).

The two main market channels have different approaches towards certifications. The auction does not require certification but most of its suppliers are certified for MPS-ABC, which was developed by the Dutch growers. Recently the auction started displaying the Flowers Fair Plants consumer label on the auction clock, which is communicated not only to buyers at the auction but also to consumers at florists or retail stores, creating room for product differentiation for both suppliers and buyers. Therefore, suppliers appear to be encouraged to comply with different certifications to build their reputation. In the direct sales channel to Western end-markets, suppliers are usually required to take on different standards, especially consumer labels. In doing so, buyers and suppliers can differentiate products and expand their reach into niche markets such as organic and Fairtrade. However, according to Ethiopian owned firms, direct sales to the Middle East and some

Southern European countries do not require compliance to sustainable initiatives as widely as the traditional markets in Europe and North America.

Compliance for such standards requires considerable investment in setting up management and organizational systems that enable implementation and monitoring of issues like good agriculture practice, labour conditions, hygiene, and safety. There are also recurrent costs related to monitoring and control. Sometimes, the cost increases with the number of certificates as each of them requires different monitoring mechanisms and audit protocols. But at the same time, adopting certificates to a certain extent can enable suppliers to improve product and production processes alongside improving access to different end-markets and segments. In 2010, 28 of the total 77 firms in the Ethiopian floriculture industry adopted one or more of these international standards, but MPS was by far the most dominant certificate (Gebreeyesus 2014). Similarly, the data that I collected in 2016 shows that of the 14 Ethiopian owned firms, 11 of them reported to be certified at least for MPS-ABC and among these, four of them were certified for both business-to-business and consumer labels. Only three have no certificates or only the local industry specific standard (Bronze Level).¹⁴ Table 1 summarizes the general criteria and processes that are required to be certified for business-to-business standards such as MPS-ABC and GLOBALGAP as well as consumer labels such as FFP and Fairtrade.

¹⁴ The Ethiopian flower industry (via the Ethiopian Horticulture Producers and Exporters Association) has its own sector specific code of practice (Bronze, Silver and Gold levels). Bronze Level is considered as a legal minimum, Silver Level was recently benchmarked with GLOBALGAP, and Gold Level requires more stringent compliance in relation to environment and labour. The local standards are not discussed in detail here as they have a limited role in relation to end-markets, but their content largely overlaps with business-to-business international certificate schemes.

Table 1. Capabilities required to get Business-to-Business and Consumer labels

B2B certificates	Consumer labels
<ul style="list-style-type: none"> ○ Computerized database system ○ Higher management capacity ○ Stronger monitoring and control system ○ Ability to appropriately use, regularly measure, and record performance related to consumption of water, energy, pesticide, and fertilizers ○ Proper waste management and disposal procedure ○ Proper safety system and hazard prevention ○ Storage and inventory system ○ Basic workers' health and safety (provision of protection equipment- glove, uniform, protective shoe etc) 	<ul style="list-style-type: none"> ○ All or most of capabilities required for B2B ○ Human resource policy and record keeping ○ Social compliance monitoring system ○ Observing local and international regulations (e.g. national labour and social protection regulations, ILO labour standards) ○ Regularly training labour force ○ Allocating time and resource for active labour union, premium committee ○ Paying sufficient wage to cover basic needs ○ Conductive working environment (clean and separate toilet, canteen, changing space, uniform, gloves, etc) ○ Emergency health care service (first aid facility) ○ Gender sensitive labour conditions (sexual harassment prevention policy, maternal leave, child care facilities etc)

Source: Based on author's fieldwork, 2014 and Riisgaard (2011)

Governance in floriculture GVC

As indicated earlier, the literature on the floriculture GVC generally identifies governance in the auction channel as market-based, which is characterized by loose relationships between buyers and suppliers; whereas direct sales, especially driven by European supermarkets, is perceived as strongly coordinated and is considered as relational network governance (Wijnands 2005; Gebereyesus and Sonobe 2009; Gebereyesus and Sonobe 2012; Zylberberg 2013). Most of these studies base their argument on some of the factors or requirements discussed above, but without providing a detailed analysis about the chain governance at the auction. The exception is Wijnands (2005), who argues that the complexity of the transaction in the auction channel is low as the specifications are straightforward with a higher codifiability of product and processes. Thus, Wijnands

concluded that governance at the auction is market-based and might move to modular, but in both cases switching costs remain low. However, Wijands only took into account the institutional rules of the auction and did not consider the role of the independent unpacker, who is often hired by suppliers from developing countries and who can act as a *gatekeeper* to the auction channel. Similarly, Taylor (2011) argues that governance in the floriculture GVC generally is trust-based, but in the auction channel, it can move back to market-based when a breach of trust occurs. However, his analysis focused on the level of exchange and did not look at inter-firm relations and its effect on suppliers' capabilities.

Meeting institutional rules of the auction is not sufficient to be successfully inserted into the auction channel. It is also important to ensure consistency in quality, volume, and presence at the auction (reliability) as well as to comply with certain sustainability initiatives. These in turn increase the complexity of the transactions. Moreover, although to a certain extent the knowledge and information in the floriculture GVC can be codified, there is tacit marketplace knowledge that requires close interactions and learning-by-doing even when suppliers have a high level of capabilities, as is the case of Dutch growers in the Netherlands (Levelt 2010). Furthermore, as Gebhardt (2014) argued, the Dutch auction is ideologically and structurally built on a network and succeeding in the flower business requires being part of this network. The evidence from Ethiopia also supports these arguments and shows how governance in the auction channel evolves from market-based to relational.

The governance at initial entry of supplier firms to the auction GVC can be considered market-based since the Dutch auction is easily accessible for suppliers with a broad range of capabilities. The auction provides an in-house unpacking service, aiming to increase the accessibility of the auction channel to relatively small size supplier firms that do not have a capacity to hire a private unpacking firm and/or to provide a neutral option for suppliers that might feel power asymmetries with an independent unpacker. Although, the service is very basic: the importing department refreshes the flowers to ensure minimum level of presentation at the auction and communicates the auction's remarks and transaction details to the suppliers. However, this market-based governance evolves as suppliers commit to improve their position in the business and hire an independent unpacker with whom they establish relationships that take them beyond accessing the auction and enable them to gain competences that are necessary to receive a better price. Suppliers, like the Ethiopian owned flower firms who were new to the industry, have limited opportunities to capture a better deal in the auction channel unless they continuously build capabilities in close relationship with unpackers. The literature tends to assume that all suppliers in developing countries are uniformly inserted in the auction GVC regardless of their ownership, yet the reality is different. For example, Dutch owned flower firms operating in developing countries usually have their own subsidiaries at the auction that process their flowers (including unpacking) and do marketing; whereas, Ethiopian owned firms hire private unpackers to get those services, and although the

primary role of the unpacker is to process the flowers, they also do marketing to a certain extent.

As indicated in Figures 2 and 3, there is an unpacking agent between suppliers and the auction. Unless the supplier has its own unpacking unit (subsidiary) based at the Dutch auction or uses the auction's import department, it needs to hire an unpacker to sell via the auction. Conversely, the unpacking agent is dependent on such suppliers, and due to this mutual dependence, the two parties closely interact and coordinate in order to strengthen suppliers' position in the auction channel and capture higher returns for both of them. For instance, apart from their daily communication, Ethiopian owned firms and their unpackers frequently interact face-to-face and work at production sites to improve production processes and marketability of the flowers. As the capabilities of the supplier develop and as basic tacit knowledge is mastered, the relationship between the supplier and unpacker deepens; they exchange information and knowledge about new market dynamics and how to capture value therein. In this chain, modular governance is unlikely since both face high switching costs as building such relationships and trust is difficult and requires a long time. Moreover, unpackers can maximize gains by retaining competent supplier firms that need less coaching and their product need less re-sorting and re-grading. Similarly, as supplier firms have limited social and spatial proximity, they need a well-situated unpacker to get not only quality flower processing services but also a trusted gateway to the dense and socially embedded network around the auction channel.

According to interviews with unpackers at the Dutch auction, developing trust between the supplier and the unpacker is key to achieve their mutual success. In turn, this depends on their close coordination and relationship, which can include deciding which activities to do where and advance planning of shipments and marketing strategies. For example, packing flowers in sleeves adds value, but higher value can be captured if some flowers (short stem) are packed at the supplier end while others at the unpacker end. Similarly, the importance of embedded networks and trust was emphasized by *online-traders* at the Dutch auction. As they explained, in conjunction with suppliers' competence, trust is key for a better price, fixed contract and long-term relationship between *online-traders* and suppliers. Apart from that, suppliers track who is buying their products on the auction clock in order to establish direct contacts that can pave the way to personal relationships and hence to direct trade (*auction-direct*). As discussed above, such moves usually require greater capabilities demonstrated by consistency and reliability in the auction clock.

However, the interest of the unpacker and the supplier tend to conflict when the latter attempts to diversify its sales channel and/or end-markets, because such moves affect the position of the supplier at the auction as it will make it extremely difficult to keep consistency. Even within the auction channel, the unpackers think that diversifying away from the traditional auction clock into sub-channels like *auction-direct* and *online-traders* is not the best option. According to one unpacker, 'The buying game at the auction is a

pressure game...buyers must be in pressure to push the button. Often direct buyers at *auction-direct* are the same one you sell in the auction, by selling them part of your product directly, you lower the pressure to push the button on the clock, then buyers are relaxed so price drops'.¹⁵

Nevertheless, tapping on the accrued knowledge through such relationships in the auction channel enables suppliers to diversify to other end-markets such as the Middle East where suppliers gain relatively better bargaining power, higher price, and/or lower cost, especially if they secure the right contacts and network in the business. Governance in the Middle East value chain can be considered as market-based, but this is not necessarily in the sense of arm's length relations. In fact, personal networks and trust are essential in this end-market chain, but unlike in the auction GVC, it has little contribution towards developing the technical and managerial competence of suppliers. Rather, building trust-based relations and networks alongside flexibility are essential to guarantee payment as well as to secure long-standing contracts with reliable buyers and to expand market positions. As one Ethiopian owned firm owner put it:

...in the Middle East purchasing capacity is already there, it is only about expanding the habits of consuming flowers; now that is also coming up...the nice thing, unlike Europe, the consumer in the Middle East do not purchase flowers anticipating two weeks vase life, it might be just for a day so they buy frequently and they care less for slight mechanical damages...plus they don't care that much how you produce it as long as you deliver the product they ordered....¹⁶

However, according to CBI's market study, there is rising consciousness in the Middle East regarding sustainable initiatives, albeit small, and some buyers favour supplier firms with international business standards as it reflects their professionalism (CBI 2016). Such diverse governance structures in the floriculture GVC have implications for suppliers' strategy for learning and upgrading.

Upgrading in the floriculture GVC

Upgrading in the global value chain approach is concerned with the 'upward' movement of supplier firms within the chain by improving existing operations and taking on more operations in order to capture higher prices. This move is influenced by the governance structure of value chains; generally, stronger coordination and closer relationships offer a better opportunity for learning and upgrading (Humphrey and Schmitz 2002). As shown above, there are several forms of governance in the floriculture GVC, and each has distinct and overlapping features leading to opportunities as well as challenges for suppliers. As a result, supplier firms seem to use a mix of strategies to capture higher prices and/or to reach 'a better deal' (Ponte and Ewert 2009).

¹⁵ Interview with unpacker at Floraholland auction, Aalsmeer, the Netherlands, October 2016.

¹⁶ Interview with an Ethiopian flower firm owner, Addis Ababa, Ethiopia, July 2017.

Upgrading was originally conceptualized based on non-agricultural industries and classified into four categories: product, process, functional, and inter-sectoral or chain. Process upgrading denotes improving the process of transforming inputs into outputs in a more efficient way; product upgrading is defined as a move to more sophisticated products; functional upgrading is acquiring or switching to new functions in the value chain that require new skills; and chain upgrading is defined as moving into more sophisticated but related chains by utilizing skills accumulated in the previous chain (Humphrey and Schmitz 2002; Evers et al 2014). This conceptualization served as a useful analytical tool in GVC studies but recently criticism has mounted as it failed to adequately accommodate the empirical dynamics uncovered in diverse sectors. Most of the criticism has been on the basis that in such conceptualization upgrading implies necessarily a linear and upward move in the ‘value ladder’ that arises as a consequence of firms’ ‘pro-active’ strategies. It also implies that such moves essentially result in capturing higher gains; whereas, as discussed below, the realities on the ground do not necessarily support those implications (Ponte and Ewert 2009; Tokatli 2013; Plank and Staritz 2015).

The conventional conceptualization of upgrading cannot be strictly applied in floriculture as some of those categories are interdependent and thus difficult to classify distinctively. For instance, in floriculture, product upgrading can be achieved without necessarily requiring a move to more sophisticated products, but rather as a direct result of improved production processes. Moreover, as flowers are highly delicate and perishable products, their ability to earn a good price depends on improved processes beyond the production stage, such as cool chain management and logistics. However, some of such process upgrading does not necessarily result in improved efficiency and might just be necessary to comply with buyers’ requirements.

In the floriculture GVC literature, selling via the direct sales channel is perceived as an indicator for firms’ higher capabilities or upgrading (Gebereyesus and Sonobe 2009, 2012), but this may not necessarily lead to higher prices. As Evers et al. (2014) found in the Ugandan flower sector, suppliers in the direct sales channel faced a continuous decline in prices and profit margins. As a result, some suppliers switched into cuttings (chain upgrading), while others sought to switch to vegetables and fruits to sell in regional supermarkets (chain/inter-sectoral downgrading). Similarly, Barrientos et al. (2015) moved beyond trade between the global North and South and studied the regional dynamics of African horticulture value chains. They uncovered the trend of ‘strategic diversification’ as means of capturing higher value. Firms operating under different governance structures at global, regional, and domestic levels might capture more value and enhance their bargaining position vis-à-vis their European buyers through strategic diversification. Factoring in the costs of transport and compliance with requirements, a competitive net price can be achieved in regional markets for similar quality products. Strategically diversifying to non-European end-markets (regional and domestic) tends to lead to higher benefits for producers who have export experience in the European market

as they already possess the capabilities to meet requirements that are just emerging or yet to emerge in the regional and domestic end-markets.

Local firms in the Ethiopian floriculture industry also follow diverse trajectories of strategic diversification and upgrading and downgrading largely in a reactive manner, with a few exceptions. Most of the firms sell in Western Europe end-markets, while at the same time diversified to Southern Europe, Middle East, and (to a lesser extent) to Northeast Asian end-markets, as the governance in each end market/market channels provides various opportunities to capture higher value or to secure a better deal. However, there are also firms that chose to selectively deepen certain capabilities in order to specialize in lower (Middle East) or higher (auction and *auction-direct*) end-markets. Moreover, intending to minimize costs, some firms move backward to integrate plant propagation (input), which is functional upgrading. To spread risk/stabilize cashflow, and taking into account the potential of domestic market, a number of firms diversified to include vegetables, fruits, and summer flowers (or are planning to do so), which might be considered as chain or inter-sectoral upgrading.

Prior to making any of these moves, however, local firms considerably developed their overall capabilities, as a result of having to meet the institutional rules of the auction as the minimum requirements of entering the global industry, as well as acquiring marketing know-how and improving their production competent through relations with unpackers. But as competition increases in the auction GVC and draws down their profit margin, firms began looking for other opportunities. The Middle East market, which is characterized by loose relation (market-based), was useful because it allowed them to sell some share of their products at a lower cost; this in turn help them to spread risk and stabilize income flow alongside learning about the characteristics of the end market. Yet sometimes this strategy affected their position at the auction channel, as they failed to keep consistency. Thus, in order to sustain their market diversifications strategy, firms adjusted their production processes and increased their product portfolio to cater for both lower and higher end-markets.

Some of the firms indicated the future prospect for functional upgrading in the Middle East end-market such as setting up a marketing center located in the Middle East, which they consider an unviable move in the auction GVC. However, the governance in the Middle East chain provides little motivation to improve organizational and managerial functions, or to improve sustainable practices, which in turn limits market diversification potentials of firms that exclusively focused on this market. For instance, all Ethiopian owned firms that export mainly to the auction or to Europe are certified to international standards, which required that they improve their organizational, production, and labour processes. This is not observed with regards to firms exporting mostly to the Middle East where there are no requirements of complying to any business standards. Although adopting standards does not directly result in capturing higher prices at the Dutch auction, it demonstrates suppliers' commitment to long term business relations and facilitates

access to new buyers in *auction-direct*, *online-trader*, or direct sales with traditional wholesalers. Therefore, suppliers that already successfully operate in the auction governance structure have more possibilities to diversify to new markets (whether more or less demanding ones) than firms that exclusively operate in the Middle East chains.

The above analysis indicates that the effort of supplier firms to capture higher value or secure a better deal cannot be subsumed under the conventional four-fold concept of upgrading. By participating in the auction GVC, firms build a considerable level of capabilities and learn the *nitty-gritty* of the business. Then, mostly due to competition or other shocks, they tend to strategically play all directions to stay in business. These strategies usually involve selective deepening of capabilities to moving ‘up’ by meeting stringent requirements of Western Europe and/or moving ‘down’ by increasing their product portfolio to include less sophisticated products and expanding their end-markets to reach buyers with less stringent requirements such as in the Middle East. They also move ‘horizontally’, by which it means selling in similar end-markets and even market channel but through sub-channels like auction clock and *auction-direct* or online trading. Furthermore, firms strategically move ‘backward’ to integrate important inputs or move to similar chains with less sophisticated products such as horticulture.

Conclusion

Over the past few decades, the global flower trade was transformed from a regional market into a sophisticated demand-driven global market organized in global value chains. Although production increasingly moved to developing countries with competitive advantages in agro-climate conditions and cheaper labour, consumption remains concentrated in European, North American, and Japanese end-markets, even though demand is growing in new end-markets in the global South. Europe, especially the Dutch auction, remains the most important market channel for Sub-Saharan African countries such as Ethiopia and Kenya. However, the importance of the direct sales channel is increasing in both traditional as well as emerging markets, particularly in the Middle East.

This working paper provided an overview of the development of the floriculture GVC, its major players and market features as well as governance structures and diverse upgrading paths. The paper explained governance structures in floriculture GVC that originate from various institutions and chain actors. It argued that governance in the Dutch auction has evolved from market-based to more of a relational network. The existing floriculture GVC literature describes the auction governance as market-based, perceiving the auction’s institutional rules or minimum requirements as the only governance mechanisms in the chain, but this literature ignores the role played by unpackers in the auction channel, which is vital in analysing the chain, especially when the focus is on locally owned firms in developing countries. The auction is relatively easy to access if supplier firms meet the basic minimum requirements, but if supplier firms

wish to remain competitive and learn, they need to engage in relational networks that can be established through the unpacking agents. The intensity of coordination might decline as the suppliers build higher capabilities, but the relationship and network remain crucial to access insider's information and knowledge as well as to pave ways towards direct sales with specialized buyers. Suppliers also utilize the skills they gained at the auction to cater to the direct sales channels in the Middle East, where relations can be considered market-based but also require close interactions and networks in order to build the trust that is needed to trade in the absence of a system that can guarantee payment and to expand market position.

The paper also shows that upgrading is not a linear process but much more diverse than generally conceptualized. The varying governance structures in the floriculture GVC influence the strategies of supplier firms to capture higher value or secure a 'better deal'. In order to maximize rewards, stabilize income as well as balance risks and benefits, supplier firms appear to selectively deepen capabilities that enable them to move in various directions. Supplier firms appear to particularly take advantage of various end-markets and sales channels and related governance structures in the floriculture GVC: moving 'up' (meeting stringent requirements of Western European markets), moving 'down' (adding end-markets with less stringent requirements such as Middle East and Southern Europe) and moving 'horizontal' to sell in similar end-markets but through different market channels or in the same sales channel using sub-channels. The paper has not focused on how the governance structures, especially the relationships and the networks between supplier firms and buyers in various end-markets and sales channels, drive learning and influence the deepening of certain capabilities of supplier firms. This is the focus of the next phase of the research that explicitly examines the impact of different factors—such as GVC governance, firm-specific characteristics, the national institutional context, and relations with foreign firms—on Ethiopian owned flower firms' choices in building capabilities.

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