Chapter 11

Aid for Trade and Global Value Chains (GVCs): Engaging with High-value Agriculture GVCs and Developing Trade[1]

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11.1 Introduction

Aid for Trade (AfT) can be used to enhance global or regional value chains by working with the private sector and focusing on alleviating the binding constraints, or market failures, that hold back the appropriate functioning of value chains. For example, AfT can improve logistics, infrastructure or services. The research and analysis presented in this chapter assesses the role of AfT in assisting the integration of agricultural producers in sub-Saharan Africa (SSA) into high-value agricultural global value chains (GVCs).

Since the 1980s, when the latest phase of globalisation began, characterised by the fragmentation of global production across countries, agricultural producers in SSA have been increasingly integrated within the global trading system through their participation in GVCs, including through their integration within high-value agricultural GVCs such as horticulture. The rationale underpinning the adoption of some of these export-orientated growth strategies was an implicit assumption by donors that the revenues generated would subsequently be utilised for product and process upgrading, promoting the development of domestic capabilities, increasing productivity and wage-earning opportunities.

All trade takes place within value chains; however, there are different types of value chains, as will be discussed in this chapter. The GVC approach is a distinct methodological tool that focuses on the dynamics of interfirm linkages and international industrial organisation, as opposed to considering the production and export of goods in isolation. This study reviews and makes reference to specific GVCs and country case studies in SSA including Kenya. The country case study of Kenya is focused upon because interventions to facilitate trade and producers' integration within GVCs have been ongoing since before the term AfT was agreed upon among World Trade Organization (WTO) members (in 2005), and there have been some shifts in approaches as lessons have been learnt.

This chapter seeks to explore the following key questions: How has AfT been used to help developing countries tap into high-value GVCs and global production networks? How could the potential benefits of the approach be enhanced, and disadvantages be mitigated? These research questions are assessed qualitatively, first, through reviewing the existing literature, including AfT disbursements, modalities and the support used

to assist different types of producers (and labourers) in participating in high-value agricultural GVCs. Second, the relative success and merits of such an approach are reviewed and assessed; a range of data sources are used, including key-informant interviews undertaken within the country.

This chapter is organised as follows. Section 11.2 discusses recent trends in global production and trade. It then proceeds to discuss how the GVC approach has been adopted by development practitioners to identify the scope for potential intervention. It provides an overview of the different types of AfT and disbursement mechanisms. In section 11.3 we review the existing literature related to the use of AfT and high-value agriculture and link these interventions to specific value chain nodes, objectives and outcomes. We then proceed to focus on the country case study of Kenya in section 11.4. Finally, section 11.5 concludes the analysis and highlights the main policy lessons that can be drawn from this experience.

11.2 Trends in global trade, global value chains and the role of Aid for Trade[2]

The GVC literature became prominent during the 1990s as product- and sector-specific studies were motivated by the need to better understand how producers engage with the most recent process of globalisation and its implications for the development of productive capacity and capabilities. A number of comparative value chain studies across sectors, including agriculture, acknowledged changes in global production and methods of co-ordination and explored what this meant for firms and their labourers (Cramer 1999; Dolan et al. 1999; Daviron 2002; Ponte 2002).

The GVC approach to analysis takes as its starting point asymmetric trading relations between developed and developing countries. Although the GVC literature continues to develop, both conceptually (e.g. increasing recognition of production networks) and empirically (e.g. by employing more robust research methods), the basic unit of analysis remains the same: looking at production by firms and labourers that are linked to international markets through the GVC lens and assessing their relative returns (e.g. wages, skills development) at a point in time, as well as over time.

The concept of a GVC refers to a configuration of co-ordinated activities that are divided among firms and have a geographical scale (Ponte and Gibbon 2005: 77). To some extent, therefore, the GVC methodological approach follows a casual chain approach to analysis. It therefore focuses on the dynamics of interlinkages and the way in which firms and countries are globally integrated. It raises the question of how producers (firms, regions or countries) participate in the global economy. Analysis goes beyond firm-specific linkages to reveal the dynamic flow of economic, organisational and coercive activities between producers within different sectors on a global scale (Kaplinsky and Morris 2001: 2).

Some types of GVC governance may facilitate rapid producer upgrading, whereas others may hinder this process. For example, engaging with global agribusiness

Table 11.1 Key determinants of global value chain governance

Governance structure	Complexity	Codification	Capabilities	Degree of explicit co-ordination
Market	Low	High	High	Low
Modular	High	High	High	
Relational	High	Low	High	
Captive	High	High	Low	
Hierarchy	High	Low	Low	High

Source: Adapted from Gereffi et al. (2005)

by smallholders may initially mean a rapid transfer of knowledge and expertise as producers are integrated within supply chains. Although this may mean that producers are upgraded at a point in time it does not necessarily mean over time. Table 11.1 summarises a classification of governance structures identified by Gereffi et al. (2005) with reference to the relationships that exist between firms organised within GVCs.

11.2.1 GVC governance structures

The five types of GVC typologies are distinguished by their governance structures, which are functions of the complexity of the transaction, the ability to codify aspects of it and the capabilities of producers. Given this classification, the GVC approach considers trade to be embedded in, but also to a considerable extent determined by, specific (but changing) institutional structures and organisational aspects of international trade (Raikes et al. 2000).

However, external GVC governance structures usually remain outside the modelling sphere of 'which GVC takes what shape and why'.[3] The governance structures posited by Gereffi et al. (2005) do not include reference to external structures, including those negotiated by governments for private actors, but rather focus on the internal structures between firms and private actors. That is, it is fair to say that the GVC literature is not wholly satisfactory in respect of the links between different types of internal and external chain governance (see Keane 2012).

For example, the depth of liberalisation of trade and finance undertaken by countries in SSA since the 1980s has determined the type of actors and firms involved with production and trade within GVCs. Since contract farming is a form of vertical co-ordination between firms, it means that attention must be paid to how global agribusiness accesses smallholder supply and the terms of sale. This means taking account of the playing field negotiated by governments for private sector actors. Much of the more recent debate about how producers and farmers in SSA engage with buyer-driven GVCs highlights the tensions caused by, on the one hand, achieving rapid process upgrading for some types of producers but, on the other, raising barriers to entry for others. However, the literature is divided on the circumstances when smaller, and poorer, producers (and farmers) are excluded from rather than included in high-value GVCs.

Adherence to the standards required to access higher-value markets may act as a catalyst and spur to productivity (Jaffee 2003), as well as increase incomes for producers and wage-earning opportunities (Humphrey 2003). At the same time, this upgrading process may marginalise other producers who are unable to meet such demanding requirements (Dolan and Humphrey 2000). One response, therefore, is to improve the organisation of producers to reduce the diseconomies of scale which result if procuring from individual producers. This would require purposive actions to be undertaken by the government with private sector collaboration.

This suggests that an understanding of the nature of value chain governance, as well as the permanent structural changes which may result, is crucial to understanding the dynamics of barriers to entry and creation of rents. Increased co-ordination, when it is forthcoming between value chain nodes, could be temporary and necessary in order to drive through innovations within a value chain at a point in time. The mechanisms through which co-ordination and the complexity of information is conveyed between actors trading within GVCs could, however, also become permanent and embedded within the external governance structures surrounding trade: either as *de facto* market access requirements, or as benchmarks for which *a priori* capabilities are needed before being included within a GVC.

In effect, therefore, governance structures, both internal between firms but also external and negotiated by governments for firms, may serve as barriers to entry and a force for exclusion as well as inclusion. These structures may result in the creation of rents for some types of producers relative to others, which may be influenced by government action to facilitate entry and participation within GVCs.

The export of products within the category of horticulture (such as green beans and cut flowers) has formed the basis of export diversification strategies for many countries in SSA (Humphrey 2003). The growth of the horticultural industry in Kenya, in particular, is regarded as one of the major export success stories in SSA (Jenkins 2005). Investment into the sector has taken the form of outsourcing production through developing contractual relations between firms across borders.

Movement into high-value agriculture GVCs has in some cases been facilitated by preferential market access into developed country markets. The tariff rent made available through preferential market access to some groups of countries, relative to others, has provided a form of locational advantage to attract investment. Preferential market access into the EU market is recognised as having played a significant role in the development of the industry in Kenya during the 1990s (Stevens and Kennan 2000). This level of access has so far been maintained, as a result of the initialling in 2007 of an Economic Partnership Agreement (EPA) between the East African Community (EAC) and the EU – which is a reciprocal free trade agreement (FTA).

There are current uncertainties though – since, at the time of writing, the EPA is yet to be signed and ratified. The external trading environment has, therefore, changed: before 2007, Kenya benefited from preferential market access under the Cotonou agreement, a non-reciprocal trade agreement. Stevens (2001) argues that

trade analysis suggests that past EU trade policy effectively excluded many of the most important global suppliers from the UK market. However, this advantage has been eroded over time, as the Cotonou agreement has expired, and as a result of the proliferation of FTAs more broadly. The role of trade preferences therefore plays an important role in terms of determining some of the power relationships inherent in GVCs, as a variable part of external governance structures.

11.2.2 The role of Aid for Trade

It is increasingly recognised that countries may need further assistance to tap into the modern export sector, beyond the tariff rent made available through the granting of a unilateral trade preference. Reductions in tariffs and non-tariff barriers (NTBs) have not always resulted in increased flows of trade; therefore, partly in response to this, AfT was developed as an instrument to assist countries in addressing other supply-side constraints, as discussed in detail by Basnett et al. (2012). Since then, attention has shifted towards increasing the effectiveness of AfT. Table 11.2 provides an example of the co-ordination and market failures whose elimination may assist countries to tap into modern sector exports, including high-value agriculture. We have then linked these types of interventions to AfT categories. We discuss some of the challenges of operationalising these interventions in the following section.

Table 11.2 Market failures affecting entry and participation with GVCs, and responses

Type	Examples	Responses	AfT category
Co-ordination	Externalities, complementarities ignored; linkages not exploited; no policy coherence	Capacity building for industrial policy	Trade development; trade-related infrastructure; building productive capacity
Technology: developing, adapting and adopting	Incomplete and imperfect information; network externalities	Promotion of technology transfer and adoption	Trade development and trade-related infrastructure
Skills formation	Externalities, imperfect information	Co-ordination and/or subsidies for training	Building productive capacity
Environment: protection, conservation, cleaner technologies	Negative externalities not accounted for	Product and process standards and regulations	Trade policy and regulations

Source: Adapted from te Velde and Morrissey (2005)

11.3 The use of AfT to help producers to enter and participate in high-value agricultural GVCs[4]

The following section briefly reviews the available literature on the assistance provided to producers in relation to entering, and enhancing participation in, the horticultural GVC in Kenya. Most recent estimates suggest that approximately 60 per cent of Kenya's horticultural exports are sourced from smallholders, including those under contract farming arrangements. The sector is estimated to comprise around 240 large-scale producers and 150,000 smallholder farms (Mbithi 2009). This is a fairly high share, given the concerns that were raised in the 1990s regarding the potential exclusion of smallholders from high-value GVCs as a result of the introduction of more stringent standards. For example, Dolan et al. (1999) documented how, by the 1990s, the demands for capital and technological capabilities had excluded smaller producers, who were unable to meet technical requirements. This finding was further substantiated by Minot and Ngigi (2004), who reported that Kenya's largest exporter at that time, 'Homegrown', had reduced its smallholder sourcing to less than 10 per cent, with the remaining 90 per cent being supplied directly from owned units.

The horticultural chain became increasingly dominated by large retailers by the late 1990s (Dolan et al. 1999). As a result of these shifts, production shifted away from smallholders towards large farms, many of which were owned by exporters. This is because sourcing from directly owned units means that firms are able to exert greater control over production processes and are better able to comply with quality, environmental and social standards. Larger farms also have the necessary scale to buffer major investments in, for example, irrigation systems as well as other relevant technologies.

It is the consolidation of the marketing nodes of the horticulture GVC, for example through supermarket mergers and acquisitions, that results in a buyer-driven and therefore hierarchical governance structure, as discussed in section 11.2. In striving for achieving economies of scale at nodes of production, some backward vertical integration took place between exporters and producers. This transformation meant that, during the 1990s, arm's-length and market-based relations between independent firms were replaced with more hierarchical governance structures, with transactions being undertaken mostly on an intrafirm basis. Standards were harmonised across retailers in the UK and Dutch markets through the introduction of the EurepGAP standard (now known as GlobalGAP).

Because this private voluntary initiative raised the standards bar, there were concerns that smaller producers would not be able to overcome the technical as well as financial barriers associated with obtaining certification and complying. In order to avoid the potential marginalisation of smallholders from the horticulture GVC in Kenya, donors intervened to cover the costs of compliance associated with the standard. At that time, donor support was crucial in subsidizing the certification process for smallholders and therefore ensuring their continued participation in the horticultural GVC. However, it remains debatable how far the programmes supported by donors also subsidised exporters (and indeed buyers), given that it is difficult to assess whether the benefits accrued mainly to farmers or retailers (FAO 2006).

Despite these concerns, the more stringent export requirements associated with the horticulture GVC have resulted in significant investments in efficiency and productivity in the sector; Kenya is often referred to as a country which has been able to transform the challenges of adhering to standards in production into opportunities (Henson and Jaffe 2006). We discuss the case study of Kenya and the broader implications highlighted by its experience in more detail in the following section.

11.4 Upgrading producers to meet standards in Kenya[5]

GlobalGAP, previously known as EurepGAP, is an example of a private voluntary initiative agreed by retailers in order to 'reassure consumers about the environmental impact of farming, and engender a responsible approach to worker health and safety as well as animal welfare' (Ellis and Keane 2008: 29).[6] The code of practice was initially launched in 1996 by a group of 11 British and Dutch retailers with the objective of creating a single private sector standard for ensuring the food safety and quality of fruit and vegetables from seed to farm gate.[7]

Although the standard helps to avoid multiple audits of standards required by buyers through providing a standardised monitoring of these standards, it also goes beyond mandatory market access requirements. Although some of the standards included within GlobalGAP may be defined as being private voluntary initiatives, they have effectively become a prerequisite for market access and inclusion within the GVCs that supply retailers in the UK and the Netherlands (the market structure of which exhibits oligopolistic tendencies). Most European buyers of agricultural products now demand evidence of certification as a prerequisite for doing business. Thus GlobalGAP has a major influence on how horticulture GVCs are structured, including in Kenya.

11.4.1 Initial donor interventions

There are two options for certification. Option 1 is more stringent and requires compliance with all control points. Most large-scale growers opt for this. Most small-scale growers take the second option, which is less stringent, but requires quality management systems (QMSs) to be put in place (see IIED and NRI 2008). Most donor efforts have been devoted to certifying small holders organised as groups under GlobalGAP Option 2 (group certification). Under this option, farmers have to develop their own technical teams and QMSs.

The IIED and NRI (2008) estimated that on average £1,000 was required per small-scale grower to ensure compliance, a major investment which would have meant the exclusion of many producers unable to cover such high costs. However, in the cases they analysed, these costs were spread over stakeholders: 36 per cent borne by small-scale growers; 44 per cent by exporters; and 20 per cent by external agencies (donors). They also found that the recurrent costs associated with compliance were on average £175 per annum, with 14 per cent paid by the growers themselves and the remainder by exporters. The most challenging criterion in the implementation process of GlobalGAP was reported to be the record-keeping requirements associated with the demand for traceability of produce and chemical applications.

Non-recurring costs, however, vary according to the size of farms and number of employees etc. For example, Henson and Jaffe (2006) estimated non-recurring costs to be in the region of US$450 to $510 for outgrowers (with 15–20 acres) who supply exporters and from US$75,000 to $100,000 for integrated producer/exporters (with 1,000–1,800 acres). These costs vary from less than 4 per cent of annual sales for producer/exporters to 6–11 per cent for smaller producers. Although initial investments may be substantial, they may be recovered over time through the ability to access a higher-value market. According to survey results, Asfaw (2008) points out that the initial costs of investment by individual farmers may be paid off within three years (with donor support and finance) or seven years (without).

Despite this, UNCTAD (2008) notes that certification remains an immense challenge for most producers in SSA, requiring investments at both macro and farm levels. Even with donor interventions, the ability of some producers to remain within the horticulture GVC, particularly in Kenya, has been rather limited. For example, based on case study and survey data, the IIED and NRI (2008) point out that, between 2003 and 2006, 60 per cent of Kenyan growers were dropped from compliance schemes owing to problems with implementation. Of those able to attain certification, 15 per cent were subsequently dropped by their exporter, as the costs of maintaining their certification were not matched by the level of income obtained.

Many Kenyan exporters have significantly reduced their involvement with small-scale growers since the introduction of GlobalGAP in mid-2003. This is because recurrent costs remain high relative to average smallholder margins. The results of a survey by Asfaw et al. (2007) of adopters of EurepGAP and non-adopters empirically demonstrates that resource-poor farmers with limited access to information and services hardly comply with the food safety standards. The sustainability of donor interventions to subsidise certification processes has, therefore, been called into question.

11.4.2 Successes and continued challenges

The sustainability of donor interventions in the sector should be analysed in two ways: first, in relation to the continued inclusion and participation of some producers within the horticulture GVC; and, second, in relation to the potential spillover effects that may result from participation in the horticulture GVC, even if this participation is not sustained over time. Donor assistance in meeting the standard has delivered benefits for some producers, such as training as well as infrastructure development. Some of the benefits reported by the IIED and NRI (2008) for African smallholders include the following:

- continued ability to profit from preferential market access;
- non-financial benefits, such as improved field hygiene, better knowledge about pesticide use and improved farm management capabilities;
- learning about good agricultural practice; and
- transferring this knowledge to family farms.

However, what is clear is that the benefits of GlobalGAP certification for producers depend on the institutional context, and the extent to which private and public actors collaborate in the development of producer organisations to reduce transaction costs and enhance potential spillover effects. Although compliance with the standard enables the effective management of the risks associated with the spread of plant/animal pests and the incidence of microbial pathogens or contaminants (see UNCTAD 2008), and this learning may have long-term benefits, the ability to embed such knowledge within institutions – and therefore enhance institutional memory and national knowledge systems – requires collaboration between private and public sector actors.

An alternative approach for donors, therefore, could be to focus on strengthening public organisations so that capacity is built both to undertake certification processes and to reduce transaction costs. The ability of producers to reduce recurrent costs is a means by which smallholders continue to be included within the horticultural GVC; this may be achieved through the strengthening of producer organisations. It is in this sense that Henson and Jaffee (2006) view standards as catalysts for development if compliance is viewed as a strategic issue to overcome. The World Bank, in its World Development Report 2008, also finds this.

Notwithstanding these propositions, however, it is important to note that, even when producers have been upgraded and comply with the standards, and Kenyan producer organisations are accredited to undertake certification and to audit firms, this is not always recognised by buyers in end markets in the EU. We discuss these more recent challenges in the following sections, where we also highlight recent shifts in donor as well as government interventions in the sector. Before doing this, however, we first provide an overview of the cut flower value chain in Kenya, as a sub-sector of horticultural production.

11.4.3 Structure of the cut flower GVC

This analysis is based on the results of field work and a number of key informant interviews undertaken in and around Nairobi between September and October 2012. Three types of cut flower firms were identified, which vary in size, ownership and the functions they undertake. These are:

- **Type 1**: small firms;
- **Type 2**: medium-scale firms; and
- **Type 3**: large multinational enterprises which specifically grow for auction.

Although there are number of clusters of cut flower production in operation, the following bullet points briefly summarises their breakdown in terms of the major hubs and their ownership structure:

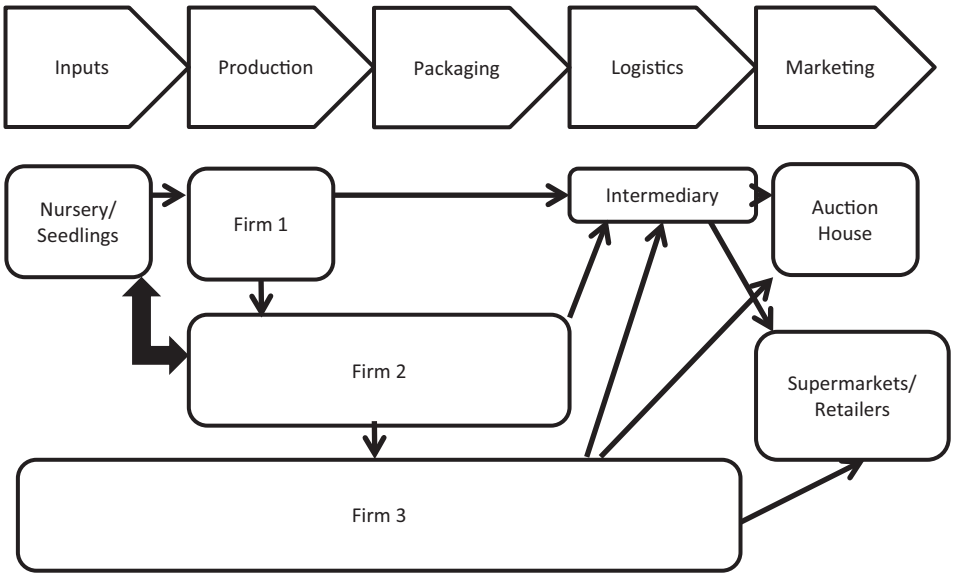
- **Lake Naivasha**: consists of approximately 35 per cent domestic Kenyan farmers; the other 65 per cent are Dutch and other foreign growers (Israeli and Indian). In this area the size of farms is estimated to be large.

- **Thika**: 70–80 per cent Kenyan growers; the rest foreign. The area contains rather more medium-sized growers.
- **Nakuru (and other)**: mostly Kenyan small-scale growers; farm sizes are relatively small (approximately 5–10 ha).

Most of the cut flowers produced in Kenya are destined for auction houses in the Netherlands (65 per cent) and others supply retailers in other EU markets, notably the UK.[8] An estimated 97 per cent of total flower exports are from the largest firms, most of which are owned by foreign investors (Bolo 2008). The reasons for this are the highly capital- and knowledge-intensive nature of the industry, in addition to the need to forge strong links with buyers and retailers. For example, it is estimated that capital investment in flower production requires at least US$50,000 per hectare in addition to access to marketing networks (Bolo 2008); these requirements have confined most small-scale growers to summer flowers that can be grown outdoors and which do not require such heavy investments in greenhouses as roses, the major flower exported.[9]

Figure 11.1 presents a stylised overview of the cut flower value chain in Kenya. Given some of the similarities that are apparent between how the cut flower GVC and the garment sector operate, in terms of the functions undertaken, we have used a similar overview to that developed by Gereffi and Frederick (2012). This is because, as is the case in the garment GVC, there is a clear division across firms in terms of the functions they undertake, and therefore their functional capabilities. Figure 11.1

Figure 11.1 Cut flower value chain in Kenya



Source: Field work and key informant interviews

therefore identifies the relative position of the three types of firms identified in the cut flower GVC and provides an overview of the functions they undertake. Table 11.3 then discusses these in more detail.

The number of firms in operation has reportedly been stable since around 2006.[10] However, there is some evidence of accumulation processes under way which are changing the structure of the industry. For example, the smallest firms (Type 1 firms) are increasingly being bought out by medium-sized firms (Type 2 firms) as some consolidation across nodes of production is taking place. A number of more medium-sized suppliers have been brought under new contractual arrangements as a result of a recent merger between two of the largest cut flower farms in Kenya.

Because of continued inconclusive negotiations for the EPA with the EU, there are reports of relocation by some of the larger growers (Type 3 firms) to countries such as Ethiopia (which will continue to receive a trade preference in the EU market even if it does not sign and ratify an EPA with the EU, because it is classified as a least developed country). As previously mentioned, investment by Israeli and Dutch flower growers in the sector was initially attracted to Kenya in the 1990s by its preferential access to the EU market relative to other countries. The strategy adopted by some Dutch growers, of beginning production in Ethiopia, forms part of a diversification strategy: to increase the number of suppliers and reduce the market power of Kenya.

Where large firms have left, other large firms in Kenya have typically taken over, which has meant that production has become increasingly concentrated amongst the largest and best-connected firms (in relation to end markets).[11] These processes, to some extent, mean that a new period of consolidation within the sector seems to be under way, while at the same time the Kenyan government is becoming more involved in the sector. The following sections describe in more detail the response of donors and governments to these shifts.

Shifts in donor interventions

The results of firm-level interviews and a review of current major donor activities, notably those undertaken by the Netherlands and the UK, suggests a change in donor interventions in the sector:

- firstly, towards supporting the inclusion of medium-sized enterprises rather than smaller ones;
- secondly, promoting private sector development more broadly; and
- thirdly, addressing more generic measures and NTBs at borders through adopting a corridor approach and establishing one-stop border posts.

The vacuum left by donors in the provision of support for smaller firms is increasingly being filled by the public sector as the Kenyan government has geared up efforts to ensure the inclusion of smaller producers. However, this process goes beyond simply supporting certification procedures – which have presented new challenges – to include the promotion of cluster development and the better organisation of smaller producers.

Table 11.3 Functional capabilities of cut flower firms

Functional capabilities	Description of activities
Type 1: sub-contractor/assembler **Product**: foliage/summer flowers/roses **Supplier tier**: marginal supplier	Small Indian/African firms are integrated into the cut flower GVC through acting as sub-contractors to larger firms (Type 2) or intermediaries based either in Kenya or overseas markets (predominantly in the Netherlands or the UK). This is a form of sub-contracting in which the Type 1 firm is responsible for the supply of the product up to its final destination (free on board, f.o.b., see below), exporters or Type 2 firms. In general, Type 1 firms are relied upon to provide products on an as and when basis and may have more than one buyer in the end market, as shown in Figure 11.1. In some cases, inputs may be supplied by Type 2 firms to Type 1 firms depending on the sub-contracts specified and end product specified.
Type 2: package contractor/assembler **Product**: roses and/or foliage/summer flowers **Supplier tier**: preferred supplier; may sub-contract	Medium-scale firms tend to rely on their intermediaries, based either in Kenya or in overseas markets, to supply end markets. However, they have greater functional capabilities than Type 1 firms, both growing and packaging to specification. They may also have their own nurseries and use these to supply other firms with plant varieties. These firms tend to have set annual contracts with their buyers for specific volumes. They may, however, also develop more informal linkages with Type 3 firms and supply on an as and when basis; similarly, they may in turn sub-contract Type 1 firms to fulfil their buyers' requirements. Generally, Type 2 firms operate on an f.o.b. basis and are responsible for the supply of the product up to its final destination. This means that, for the quoted price, goods are delivered on board a ship or to another carrier, via an intermediary, at no cost to the buyer.

(continued)

Table 11.3 Functional capabilities of cut flower firms (continued)

Functional capabilities	Description of activities
Type 2: package contractor/assembler **Product**: roses, and or foliage/summer flowers (bouquets) **Supplier tier**: preferred supplier and may sub-contract; or niche supplier	Type 2 firms may be preferred suppliers to their buyers or they may be niche suppliers. For example, Dutch auction houses typically require a steady supply of high-volume and high-quality roses. In comparison, retailers may require specific products, such as bouquets, which require both roses as well as summer flowers/foliage. Some firms may supply both markets, or specialise in the supply of one rather than the other. We have specified these differences in Figure 11.1.
Type 3: full package provider **Product**: roses **Supplier tier**: strategic supplier; or niche supplier	Large multinational enterprises typically not only have their own nurseries integrated within their supply chains but also tend to be vertically integrated, taking care of production, packaging and logistics as cost, insurance and freight (c.i.f.) suppliers. This means the price invoiced or quoted by Type 3 firms includes insurance and all other charges up to the named port of destination, or named place (carriage and insurance paid, c.i.p.) in the country of destination such as a warehouse. A full package supplier carries out all steps involved in production; this includes the selection, purchasing and production of materials; the completion of production; and delivery of the finished product to the buyer – predominantly Dutch auction houses but they may also include supermarkets/retailers, as indicated in Figure 11.1. Type 3 firms may sub-contract Type 2 firms in order to fulfil their buyers' requirements.

Source: Field work and key informant interviews

Shifts in governance

There has been an increase in efforts to provide agricultural extension services to different regions across Kenya; this includes the provision of services provided by Kenya's Horticultural Crops Development Authority (HCDA) across all provinces. The HCDA was established in 1967 and grants licences to buyers and sellers of horticulture. More recently it has begun to provide support to growers and traders so that they do not need to resort to arbitration. It does this through, for example, witnessing contract signing. It therefore tries to foster relationships between small-scale growers and medium-sized firms in terms of adhering to best practice.

Although all buyers and sellers in Kenya must be registered with the HCDA, not all growers are registered with producer organisations such as the Kenya Flower Council (KFC), formed in 1996, or the Fresh Produce and Exporters Association of Kenya (FPEAK), formed in 1975. Both organisations are private initiatives designed to increase the lobbying power of the industry as well as improve co-ordination between firms in terms of learning about and sharing best practice, including in relation to certification issues. Both are self-regulating bodies.[12] Their members pay fees for industry representation, which includes market access issues.

Government intervention in the sector is likely to increase in the future as a result of the implementation of the Horticultural Bill, which is considered by most industry representatives to be a long time coming, given that the industry has developed for more than 20 years without an explicit policy. A horticultural development fund will be created; the HCDA will manage part of this fund, in addition to other public and private partners. The objective is to extend the coverage of the HCDA so that it has a representative body in each province of Kenya.

The lack of policy on the horticultural sector, despite its relative importance in generating employment and foreign exchange, is posited as being a result of the hypersensitivity of the industry (which is also very powerful) to government intervention. The increased attention of the government on the horticultural sector has, to some extent, been driven by external events, which are now also being brought to the fore by firms. These include a severe current account imbalance; the uncertainty surrounding EPA negotiations with the EU; and the concerns raised by some industry representatives regarding loss of competitiveness, particularly notable given initiatives launched by the Ethiopian government to promote the development of its cut flower sector, including attracting Kenyan investment.

In the absence of an explicit government policy specifically designed for the cut flower sector, the KFC has developed its own regulations and guidelines for the sector. The KFC is also an accredited certifier of a number of private voluntary standards. The new policy embodied in the Horticulture Bill is viewed positively by the KFC as providing some leverage for forcing the government to act to support the sector better. There are a total of approximately 120 growers of cut flowers in the sector, of which around 70 are members of the KFC. Although the KFC does not represent all registered growers,

it accounts for around 60–70 per cent of the volume of exports from the sector. Its members employ 90,000 individuals directly and around 500,000 indirectly in other types of services provision.

The reorganisation of the sector, as a result of mergers and acquisitions, has led to new concerns being raised by workers, including in relation to increases in workloads without commensurate increases in pay. The Horticulture Bill will include a minimum level for wages in the sector and provide for a wages council to effectively review levels in the sector. The inclusion of this is expected to mitigate claims made against the sector in relation to wage levels, particularly for entry-level workers, which are considered inadequate in relation to costs of living.

Although prompted by structural changes within the sector, the introduction of these new policy measures is also being brought about by changes in governance structures more generally within the current administration. There has been limited capacity to implement trade policy in Kenya effectively during recent years (see Were et al. 2010). The current ongoing governance reforms are two-fold. First, they entail devolution of power. Second, they also mean constitutional reform and the creation of an independent judiciary, etc. This is expected to result in the creation of a much more formidable civil service with the governance capabilities to both design and implement an effective trade strategy. This is particularly important given ongoing trade policy challenges related to EPA negotiations as well as to more recent upgrading challenges.

Overcoming other upgrading challenges: testing governance structures?

One limitation of interventions in the sector to date is that they have still not adequately addressed asymmetries in the trading relations that exist between producers and buyers within the cut flower GVC. One example is the fact that the certification processes undertaken by the KFC for quality standards are still not recognised as equivalent to the dominant standard used in auction houses in the Netherlands. This means that:

- producers in Kenya still have to cover the costs of audits undertaken by Dutch certifiers, in addition to those undertaken by the KFC;
- the resultant effect is an increase in costs for exporters;
- this reduces their relative competitiveness vis-à-vis Dutch producers; and
- moreover, it can also mean discretion over whether producers are certified or not.

A situation could therefore be said to be arising whereby donor efforts to reduce costs of certification and overcome other NTBs which prevent the ability of traders to access markets are being undertaken without due consideration of the actual requirements of the buyers.

These more recent challenges related to the effective participation of producers within GVCs show how these lie outside the direct control of governments.

A question therefore arises about how the KFC can achieve mutual recognition by auction houses in the Netherlands, which effectively operate as a private members' club. The most that the Kenyan government can do is to try to facilitate this process. This could provide a new role for AfT to assist in creating space for dialogue between producers and buyers, and would also require the creation of more effective public–private dialogue mechanisms.

Obtaining a more secure supplier position?

The evidence from stakeholder interviews and market share analysis suggests that only the largest firms (Type 3) have managed to move from being solely contractors towards directly supplying buyers and retailers. In both the UK and the Dutch market, Kenya has been able to increase its market share for cut flowers. The increase has been much more pronounced in the Dutch market than in the UK; in the Netherlands, Kenyan growers accounted for almost 50 per cent of supply in 2010, and 44 per cent in 2011, the latest year for which data are available. See data presented in Table 11.4. This increase in market share has been accompanied by an increase in unit values, which suggests that, over time, Kenyan firms may have also been upgrading their position, for example by selling higher-value products; this has also been accompanied by an increase in market share.

As discussed by Kaplinsky and Readman (2005) and Kaplinsky et al. (2009), use of unit values and market shares combined provides an indicator of relative upgrading performance by firms. The logic for this, as discussed by Kaplinsky et al. (2009), is that firms engaging in successful product innovation, whether minor alterations or more substantial changes in product design and performance, can expect to receive higher prices for their output. However, because higher prices may also reflect inefficiencies

Table 11.4 Kenya's market share in Dutch and UK markets for cut flowers

	Netherlands			UK		
Year	World (US$000)	Kenya (US$000)	Kenya share (%)	World (US$000)	Kenya (US$000)	Kenya share (%)
2000	424,589	92,541	21.8	542,297	34,738	6.4
2001	414,620	98,842	23.8	592,152	45,997	7.8
2002	440,177	116,954	26.6	799,913	53,098	6.6
2003	477,504	150,643	31.5	910,105	58,214	6.4
2004	497,672	178,058	35.8	978,245	84,433	8.6
2005	535,558	205,849	38.4	957,371	94,377	9.9
2006	590,737	246,812	41.8	1,004,890	99,621	9.9
2007	672,374	275,808	41.0	1,133,862	104,541	9.2
2008	821,100	337,324	41.1	1,056,847	132,813	12.6
2009	711,073	300,933	42.3	877,690	112,782	12.8
2010	634,123	295,811	46.6	935,360	85,985	9.2
2011	750,498	329,893	44.0	1,006,189	94,275	9.4

Data reported by Netherlands/UK, based on product code 0603, cut flowers and flower buds
Source: UN COMTRADE database, downloaded 4 January 2013

in production, suggesting a decline in innovative performance, this suggests that an indicator of cost competitiveness is also needed, and for this reason market shares are used.

Although the combined results of analysis of unit values and market shares may be viewed positively, a note of caution is urged within this discussion since, although some firms may have been able to obtain a more secure supplier position, these firms have been identified as those belonging to the Type 3 category as indicated in Figure 11.1. The ability of *all* firms to obtain a more secure supplier position would therefore appear to be rather limited.

Overall it could be said that there is some evidence that some Kenyan firms are moving towards a position of a full package supplier (as defined in Figure 11.1). However, this is not the case for the small and medium-sized firms identified in Figure 11.1. These are the same firms that may also face increased costs in the Dutch market because of the inability of the KFC to obtain mutual recognition of the standards its producers adhere to and those demanded in Dutch auction houses, because the latter are not directly owned but have rather more indirect relations with buyers in their end markets. This barrier to entry could hinder growth for this category of firms; moreover, it could ensure that the productive structure in Kenya remains relatively polarised between very large growers and small growers, with medium-sized firms either reducing in size or being consolidated into larger firms (although much more evidence is needed to substantiate this hypothesis).

11.5 Conclusions

This chapter has shown how the evolution of the cut flower GVC has affected the participation and engagement of producers with this type of trade, which operates within a hierarchical structure of governance with highly consolidated marketing and retailing nodes. It has argued that some of the more recent challenges for some types of producers require a greater consideration of power asymmetries between firms.

In a globalising world where GVCs are increasingly important, the ability to shift goods in and out is essential to a country's competitiveness, and infrastructure and low tariffs matter. However, the cut-flower industry also faces a set of NTBs, such as the need to satisfy stringent private sector standards in Dutch auction houses. We can therefore see a situation arising where donor efforts to reduce costs of certification and overcome other NTBs, which can prevent traders from accessing external markets, are being undertaken without necessarily considering the need to also influence the private relations that exist between firms operating within GVCs. The reasons for this are rather unclear.

A question arises, therefore, about how the KFC can achieve the recognition of its standards by Dutch auction houses (which effectively operate as a private members' club). In effect, these auction houses can set whatever standards they want and so it is up to the KFC to reach an agreement with them. This could provide a new role for AfT. Such an approach might help not only to resolve some of the governance issues that exist between firms and buyers, but also to ensure that such firms are better able

to influence the external governance structures within which they trade. Although the Kenyan cut flower GVC has been in operation for a considerable amount of time, as has been shown in this chapter, only some types of firms have been able to obtain a more secure supplier position over time.

Notes

1 This chapter is adapted from a larger programme of work funded by the Gates Foundation which assesses the role of Aid for Trade in assisting producers integrate with global value chains and reducing food insecurity. The author is grateful for the constructive comments provide by Sheila Page, Senior Research Associate, Overseas Development Institute (ODI), and assistance with trade data by Jane Kennan, Research Officer, ODI.
2 This section draws on Keane (2012, forthcoming).
3 These include other external governance structures such as mandatory standards that producers must legally adhere to in order to access markets.
4 This section draws on Keane (2012, forthcoming).
5 This section is adapted in parts from Ellis and Keane (2008).
6 The protocol defines the elements of good agricultural practices (GAP) and includes standards for integrated crop management (ICM), integrated pest control (IPC), quality management system (QMS), hazard analysis and critical control points (HACCP), worker health, safety, welfare and environmental pollution, and conservation management.
7 See Ellis and Keane (2008) for further information.
8 According to estimates by the Kenya Flower Council.
9 The current stock of investment in the horticulture sector is in the region of 650–750 billion shillings according to estimates by the Horticultural Crops Development Authority.
10 This has also been the case with exports of cut flowers, which have recovered since a reduction in demand was felt immediately after the start of the global financial crisis.
11 Historically, the horticultural sector has always resided within a relatively tight-knit community of a select number of large-scale growers, many with strong contacts in industry in end markets. A number of the largest firms/farms around Lake Navaisha were previously owned by former prime ministers (Kenyatta and Moi), who took over the most productive land left by colonialists.
12 The Chief Executive of the KFC is also the managing director of one of the largest cut flower firms in Kenya (Findlays).

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