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INVESTMENT PROMOTION IN AN ERA OF GVCs:

Maximizing impact through business linkages

The emergence of global value chains (GVCs) has created a new role for foreign direct investment (FDI) in development strategies. Smart industrial policy is no longer only about developing specific sectors, but about developing specific tasks and activities within them that competitively fit into the global organization of production. A focus on building partnerships between domestic small and medium-sized enterprises (SMEs) and local affiliates of transnational corporations (TNCs) can play a key role in upgrading the local supply of developing countries and their capacity for value addition. However, such business linkages often do not just happen by themselves. Investment promotion agencies (IPAs), as well as trade promotion organizations (TPOs) and regional development institutions when they have an investment promotion mandate, are crucial for activating benefits from FDI for their country through proactive linkage promotion and smart relationship management.

The IPA Observer series is prepared by the Investment Promotion Section of UNCTAD's Division on Investment and Enterprise (DIAE). Its objective is to show examples of strategic and operational best practice in investment promotion from agencies worldwide to practitioners and governments in developing countries, with a view to share lessons that are practical and replicable for their investment promotion agencies (IPAs).

DEVELOPMENT IMPACT OF AFTERCARE SERVICES

Foreign affiliates of TNCs are the major actors in GVCs, with more than 80 per cent of global trade now taking place as part of the supply chain operations of TNCs. By opening access to GVCs, proactive aftercare services can play a key role in developing the skills, know-how and local value addition capacity of SMEs in developing countries. The benefits of pursuing such a development strategy can be sizeable. According to the UNCTAD World Investment Report 2013, developing countries that, over the last 20 years, managed to increase both their participation in global value chains and the value addition by domestic SMEs to products destined for GVCs experienced GDP per capita growth of 3.4 per cent on average, compared to only 2.2 per cent for developing countries that merely increased their GVC participation without upgrading their domestic value addition capacity. Effective aftercare services are one key element that make the difference. On average, some 28 per cent of the GDP of developing countries is now contributed directly by their participation in GVCs, including even in many least developed countries (LDCs).

GROWING ROLE OF IPAs IN LINKAGE PROMOTION

The creation of mutually beneficial TNC-SME business linkages for greater local value addition is by no means automatic. Factors behind corporate decision-making on outsourcing of value adding activities to local SMEs and on purchasing inputs domestically or abroad are a function of many determinants.[1] In the past, host Governments often relied on policies such as local content requirements and mandatory technology transfer provisions to create linkages with domestic firms. Apart from the restriction of most such measures under World Trade Organization law, local content quotas have become largely ineffective and meaningless as a policy tool in the face of highly complex value chains tying firms into integrated transnational production networks regionally

[1] IFC (2007). Business Linkages: Lessons, Opportunities and Challenges. Washington D.C.

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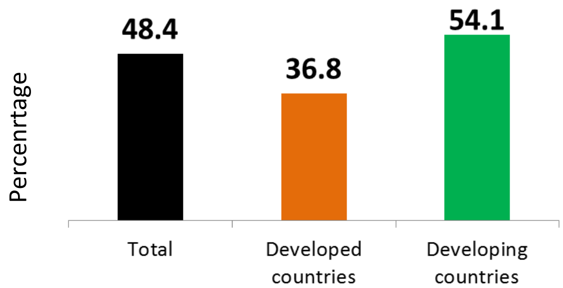
and across the globe. The approach of many Governments has therefore shifted to working in partnership with the private sector, where policies consist of removing obstacles to greater interaction between TNC affiliates and SMEs in the local economy.

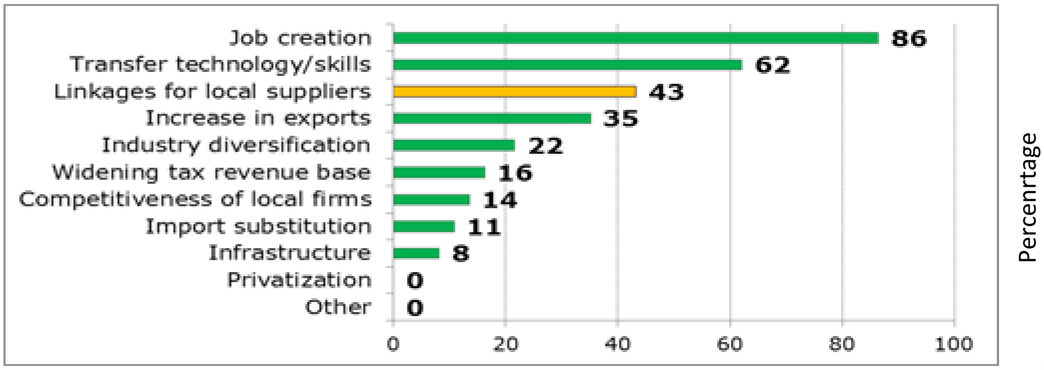
In recent years, there has been a steady rise in the number of IPAs that have been called upon to participate directly in business linkage promotion activities, either as lead agencies or sharing that responsibility with other institutions, such as SME development agencies. This contrasts sharply with the situation little more than a decade ago, where only a handful of IPAs were involved in this kind of activity. [2] Globally, nearly half of all IPAs now also carry a local SME development mandate, with that figure ranging from roughly one-third in developed countries to more than half in Africa and nearly two-thirds in Asia (figure 1).

Figure 1. IPAs whose mandate also includes the promotion of local SMEs[3]



Creating linkages with local firms has steadily increased in priority to become one of the top three strategic objectives of IPA promotion activities in developing countries. Today, More than 40 per cent of IPAs target foreign companies specifically based on their potential to link up with the local economy (figure 2).

Figure 2. Strategic priorities of IPAs in developing countries [4]



As a matter of fact, IPAs have many qualities that give them a strategic role in supporting the formation of new business linkages between local SMEs and foreign TNC affiliates as well as the deepening and upgrading of existing ones. Their day-to-day business is to attract foreign investors and provide aftercare services, which means that IPAs have access by mandate to international firms and ought to have a good grasp of their business needs and the reasons why they seek to do business in the host country. Many have a mandate to influence legislation and policies concerning FDI and the overall investment environment. They also routinely engage in networking activities and support programmes to disseminate information, to broker technology partnerships and to support the upgrading of local SME capacity.

[2] UNCTAD (2006). A Survey of Support by Investment Promotion Agencies to Linkages. New York and Geneva.

[3] UNCTAD (2013). World Investment Report 2013. IPA Survey (based on 62 responses).

[4] Ibid

Successful IPAs have adopted insights gained by SME development agencies that have applied value chain thinking to their work for a long time. To maximize opportunities for local value addition from FDI and to use investment promotion as a door opener to global markets for domestic SMEs through GVCs, IPAs need to understand and navigate global value chain dynamics.

CASE STUDIES OF LINKAGE PROMOTION

1. Uganda, brokering partnerships and advocating for success

Since 2005, the Uganda Investment Authority (UIA), the country's national IPA, has engaged in a very successful business linkage initiative in partnership with Enterprise Uganda, a high-profile local entrepreneurship development centre. The programme, formalized through a Memorandum of Understanding under the overall leadership of the Ministry of Finance, began by defining the responsibilities and contributions of each partner, whereby Enterprise Uganda focused on SME upgrading according to the stated requirements of TNCs and UIA sensitized and secured the commitment of TNCs and engaged in policy dialogue to improve the national enabling environment.[5]

A value chain diagnostic conducted jointly by UIA and Enterprise Uganda identified several target sectors, including agribusiness, telecommunications and real estate development, and mapped out some promising opportunities within these areas. Among the activities implemented by the programme in these sectors, UIA was specifically mandated to (a) improve the business environment to enable the creation of linkages between TNCs and SMEs, (b) sensitize TNCs, both selected and potential ones, on the importance and benefits of business linkages and (c) promote and share experiences on business linkages with potential investors in order to attract additional FDI.

As a consequence, UIA identified more than 30 TNCs and held sectoral meetings to make them aware of the importance and benefits of business linkages. These meetings led to six TNCs signing MOUs with Enterprise Uganda, namely the National Housing Corporation Company (NHCC) and Roofings Limited in real estate development; Mobile Telephone Network (MTN) and Celtel Network in telecommunication services; and Kinyara Sugar Works Limited and Uganda Breweries LTD in agribusiness.

UIA also channelled policy concerns raised by linkage partners to relevant forums and authorities including the Presidential Investors Round Table. In particular, UIA championed the design of tailored support measures and was instrumental in the resolution of two issues involving Kinyara Sugar Works Limited, a Mauritian foreign investment group, and Kinyara Sugarcane Growers Limited (KSGL), its Ugandan foreign affiliate. One of the areas in which UIA's intervention yielded a positive response is related to a withholding tax that was erroneously levied on Ugandan sugarcane farmers, and which was one of the obstacles impeding the growth of KSGL's outgrower base. After a series of meetings with the Ministry of Finance, the mistake was acknowledged and the amount of 1.2 billion Uganda shillings (approximately US$700,000) was refunded. Another area in which UIA's intervention yielded a positive response was the prioritization of improvement of the road infrastructure requirements in the outgrower areas feeding Kinyara Sugar Works. UIA held a meeting with the Ministry of Works to underline the importance of road infrastructure within the project area and stimulated the creation of a public–private partnership arrangement to improve local road conditions, reducing the lead time of transporting farmers' outputs to market. Once these obstacles were removed, Kinyara Sugar Works and KSGL signed a long-term partnership agreement under which the farmers, with additional capacity-building support from Enterprise Uganda, were able to match Kinyara Sugar Works' growth plans and quality standards, based on a purchasing guarantee by the company as an additional incentive to KSGL's membership base of more than 2,500 small farmers.

Uganda's experience, therefore, highlights the role IPAs can play as a trusted partner and "honest broker" to all sides as an important success factor. Rigorous monitoring and evaluation have helped communicate the success and win the support of additional TNC partners, with the result that, today, the initiative continues on a fully financially self-sustaining basis. "Our success would not have been possible without our local partners and suppliers – hence our support for the business linkages programme", said Noel Meier, CEO of MTN Uganda, at the time of joining the initiative the country's largest taxpayer. However, donor funding – in the case of Uganda by the Swedish International Development Agency – played an important early role

[5] The Ministry of Finance administered a contribution of US$400,000 by the Swedish International Development Cooperation Agency. UNCTAD also made available additional funding through the local UNDP office.

in bringing the initiative to scale. Ms. Maggie Kigozi, who at the time led the process as CEO of UIA, stated: "We already had good success with the linkages programme but we can and should do more to build the skills of Ugandan SMEs."

2. Argentina, building a national partnership for regional development

A business linkages programme in the province of Tierra del Fuego, Argentina's most vibrant manufacturing hub for electronics, presents a clear case of how national stakeholders can work together to help the local industry capitalize on FDI. Tierra del Fuego, which contributes 20 per cent of Argentina's GDP, has a large electronics industry: in 2011, 100 per cent of air conditioners and 83 per cent of monitors were manufactured in the province. However, large electronic goods manufactures still import many of their components, excluding local SMEs from participating in the value chain.

In response to this challenge, a group of national and regional stakeholders partnered to establish a business linkages programme in 2011. The programme identified opportunities for import substitution in the electronics industry of Tierra del Fuego through linking large electronic goods manufacturers to local SME suppliers of electronic components. The institutional drivers of the programme include the Federal Investment Council (Consejo Federal de Inversiones, CFI) – Argentina's federal investment promotion agency which, along with being the chief financier of the programme, also has a main role in developing the overall business linkages strategy; the Secretary of Economic and Fiscal Development of Tierra del Fuego, which assumes a monitoring role for the programme and coordinates various activities, including meetings with the private sector; and the Empretec Argentina Foundation, which provides technical assistance for strengthening the competitiveness of local SMEs, including the facilitation of technology transfers and product upgrading and also collaborates with CFI on developing the overall business linkages strategy.

CFI and the Empretec Argentina Foundation designed the programme to be implemented in two stages. The first stage (concluded in 2012) consisted of a value chain diagnostic which surveyed the local electronic industry, including a survey of imported electronic inputs and potential local suppliers. The study aimed at evaluating the possibility of replacing imported electronics local ones supplied by regional and national SMEs. The second stage, still at inception, through existing support measures. For this stage, the Industrial Promotion Law will be the main support measure available to companies operating in Tierra del Fuego. It will provide SME suppliers with the technical assistance needed for industrial upgrading and will facilitate their access to financing tools as a means of linking them with large manufacturers in the province.

In order to support the first stage of the programme, an Advisory Board was created to set up a strong institutional framework based on a partnership agreement among key organizations at the national and regional levels, including CFI, INTI (Instituto Nacional de Tecnología Industrial) and Banco de la Nación Argentina from the public sector, as well as the main association of producers of electronic goods such as AFARTE (Asociación de Fábricas Argentinas Terminales de Electrónica), CADIEEL (Cámara Argentina de Industrias Electrónicas, Electromecánicas y Luminotécnicas) and CAPI (Cámara Argentina de Industrial Plástica) from the private sector. Thanks to the active involvement of all partners, almost all electronic producers located in the Special Customs Area in Ushuaia and Rio Grande subscribed to the programme, as well as 120 local SME suppliers located in the Province of Tierra del Fuego and throughout the country.

The project identified and selected companies that could create linkages in the short term, but also those who had the potential to meet linkage requirements in the medium or long term. The Secretary of Industry of Tierra del Fuego, Juan Ignacio García, a key advocate of the programme, stated that there were already several companies that had started buying parts [from SME suppliers], several projects in the pipeline, and others that it was anticipated would materialize in the future.[6] Local SMEs are now supplying large manufacturers with some electronic components such as power cables and memory cards. Moreover, two local medium-sized suppliers of electronic components, Megatech and Inarci, decided to create a joint venture to produce all remote controls for the air conditioners produced in Tierra del Fuego. It is expected that by the end of 2013, 1,500,000 units of remote controls for air conditioning, applicable to all brands, will be produced entirely in Argentina, as the housing and buttons will be provided for the first time by a domestic company specialized in plastic injection. In the longer term, it is expected that a critical mass of domestic firms will be upgraded to become suppliers of more complex inputs, such as components for

[6] See http://www.cfired.org.ar.

computer hardware utilizing nanotechnologies. This shows, therefore, how IPAs can effectively drive economic growth by mobilizing the right institutional partnerships and seizing value chain opportunities in remote geographic areas or completely new sectors.

3. Viet Nam, joint trade and investment promotion through linkages

In Viet Nam, a national initiative on "Green Production and Trade to Increase Income and Employment Opportunities for the Rural Poor" brought together a coalition of partner institutions to increase trade opportunities and investment linkages for local raw material and handicraft and furniture producers. Vietrade, the country's trade promotion agency which also carries an investment promotion mandate, carried out investment and trade opportunity analysis and provided support to local firm capacity-building. Vietcraft, a private association of handicraft producers, played a key role in network building, product development and trade fair organization. Local governments, communes and associations supported value chain development in four provinces, under the national coordinating authority of the Ministry of Industry and Trade (MOIT).

The initiative used a value chain approach to identify business opportunities for integrating local small firms into regional and international value chains.[7] In sericulture, one of the key subsectors identified, for example, a value mapping exercise found that local entrepreneurs could upgrade in the value chain by enhancing processing technology and upgrading the quality of the silk produced, improving the waste treatment system, diversifying products by creating new designs with better quality and linking actors in the chain and restructuring distribution channels for both domestic (local consumers, foreign tourists) and handicraft importers (including buyers at international trade fairs). Moreover, a number of facilitation measures have been adopted for sustainable production, reducing the use of environmentally damaging pesticides and promoting health and safety standards and improved waste treatment. The initiative also facilitated the development of new product lines by international and national designers, taking inspiration from traditional ethnic styles but giving them a modern tweak to appeal to domestic and international buyers.

A critical element for the success of the initiative has been the mobilization of the right institutional partnerships, such as with local authorities, business associations and trade fairs, to allow local firms access to linkage opportunities beyond traditional markets. For example, the Hao Tien Textile Cooperative is composed of a group of 80 women weavers in a remote location, 200 km away from the provincial capital. Through the initiative, it received support to participate in the "Lifestyle Viet Nam" fair in 2011 and 2012, resulting in orders from international buyers based in Australia and Japan as well as domestic clients from Viet Nam. The cooperative also participated in the "Hanoi Gift Show" in 2011, resulting in the creation of linkages with Hanoi-based exporters such as Greencraft and Kana.

To date, Vietrade has prepared more than 200 local firms to enter business linkages. Demonstrating the value of the initiative, a recent evaluation of Vietrade's support found that around 60 per cent of trained entrepreneurs were able to introduce new products into the market, with 65–75 per cent of them reporting an increase in profits and staff employed.

In order to sustain the achievements of the Joint Programme and further develop the bamboo/rattan and sericulture value chains, two provincial Advisory Boards have been established in Nghe An and Thanh Hoa under the leadership of Vietrade. Objectives include the creation of 5,000 permanent and 8,000 part-time jobs by 2015 and 8,000 permanent and 30,000 part-time jobs by 2020.

LESSONS LEARNED FROM LINKAGE PROGRAMMES

Many successful IPA-led business linkages initiatives analysed by UNCTAD schematically follow a road map that observes four key good practice steps (figure 3). These are explained in more detail below.

[7] The MinOne United Nations Viet Nam (2012). "Taking a Value Chain Approach towards Local Economic Development and Women's Economic Empowerment – A Case Study from Hoa Tien Village, Viet Nam."

Figure 3. Good practice steps in business linkage promotion

SET UP PARTNERSHIPS	
Identify partner institutions (door agencies, SME development centres, business associations, etc.)	Establish institutional framework for partnership setting out objectives and roles of each partner
MAP VALUE CHAIN OPPORTUNITIES	
Map TNC value chain challenges and needs; evaluate capacity of local firms to select target sectors	Select TNCs that require a critical amount of inputs and services that could be sourced locally
TAILOR SUPPORT MEASURES AND ADVOCATE REFORMS	
Identify support measures that create incentives and commitment for both TNCs and SMEs	Facilitate discussions between private sector and policymakers to improve policy-related barriers
MONITOR AND EVALUATE	
Establish M&E system with clear indicators that measure effectiveness and efficiency of the programme	Communicate reports to future prospective stakeholders including foreign direct investors

SET UP PARTNERSHIPS

As highlighted in the cases above, effective linkage promotion often requires partnerships and collaboration between IPAs and multiple stakeholder institutions, including government agencies, local development agencies, donor agencies, private institutions such as chambers of commerce, business associations, BDS providers, NGOs, media institutions, universities, technological institutes, research and development centres and so on. In many cases, collaboration with these partners is a

When IPAs also assume an SME development mandate, this may facilitate implementation of business linkages. Where IPAs work in partnership with other SME agencies, the division of labour is important. IPAs will tend to integrate linkages work in their aftercare programme where, in general, they may wish to concentrate their direct interaction with SMEs on those that are "partnership ready" to become TNC suppliers. By contrast, SME development agencies can help get SMEs off the ground and take them to the point of becoming "partnership ready".