

Private Sector Development through FDI Linkages

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OUTLINE

1. Introduction & global context
2. Challenges & concepts
3. Strengthening the private sector through FDI linkages
4. The FDI Linkages Approach
5. Country projects: Cambodia, Viet Nam
6. Key messages – Q&A

1. Trade & Competitiveness Global Practice

Goals:

- expand market opportunities
- enable private initiative
- develop dynamic economies

4 functions:

- boost the volume and value of trade
- enhance investment climate
- improve competitiveness in sectors, and
- foster innovation and entrepreneurship

Global portfolio of about 500 projects implementing ~8.5 billion USD



1. The Global Context

- Today, more goods and services reach consumers through sales by foreign affiliates than by trade alone

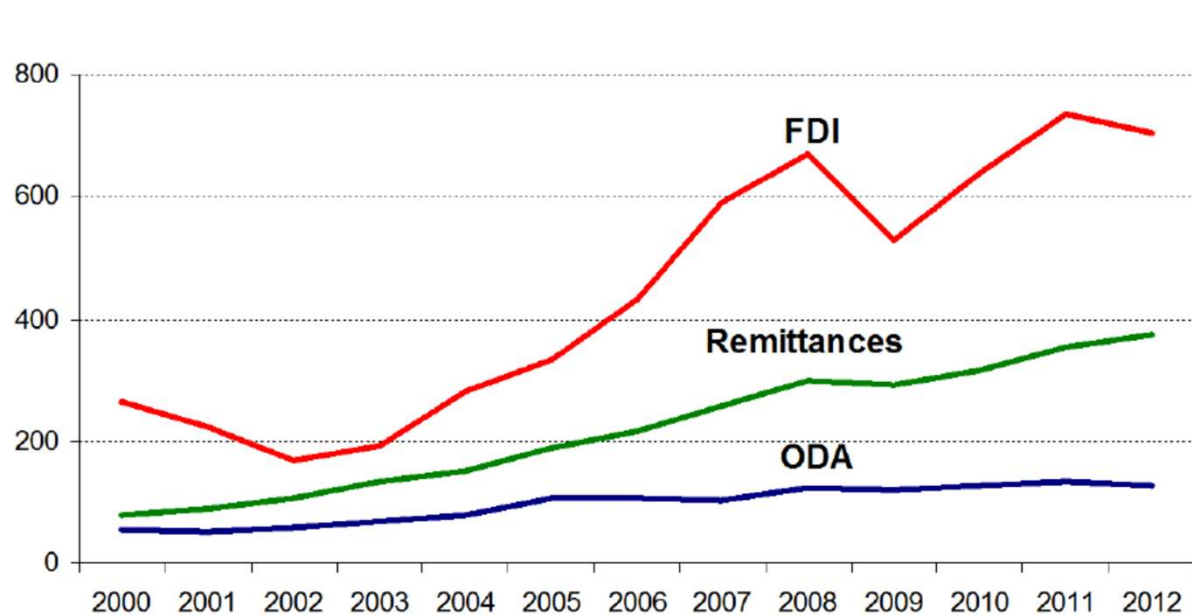
- There are roughly 100,000 MNEs worldwide, each with an average of 9 foreign affiliates. In 2014, MNE foreign affiliates accounted for:
 - 1/3 of global exports
 - Employment of 75 million
 - Sales of approximately US\$36 trillion worth of goods and services, with an added value of more than US\$7 trillion



- The interaction of domestic and foreign investment has also facilitated:
 - technology and know-how transfer
 - upgraded local skills and competitiveness
 - new management practices and better organizational arrangements
- The key question facing countries is *how to insert themselves into the international economy in a way that maximizes the benefits*

1. FDI is an important source of development finance

FDI, remittances, and ODA to developing economies 2000-2012 (in billion USD)



Source: UNCTAD for FDI and remittances and OECD for ODA.

Note: ODA from DAC members.

1. Different Types of FDI



**Strategic
Asset
Seeking**

**Natural
Resource
Seeking**



**Market
Seeking**



**Efficiency
Seeking**



2. ECONOMIC POLICY CHALLENGES

Why should governments care?

Policy goals:

- Growth
- Jobs
- Competitiveness
- Exports
- Innovation
- Structural transformation
- ...



FDI is more than money:

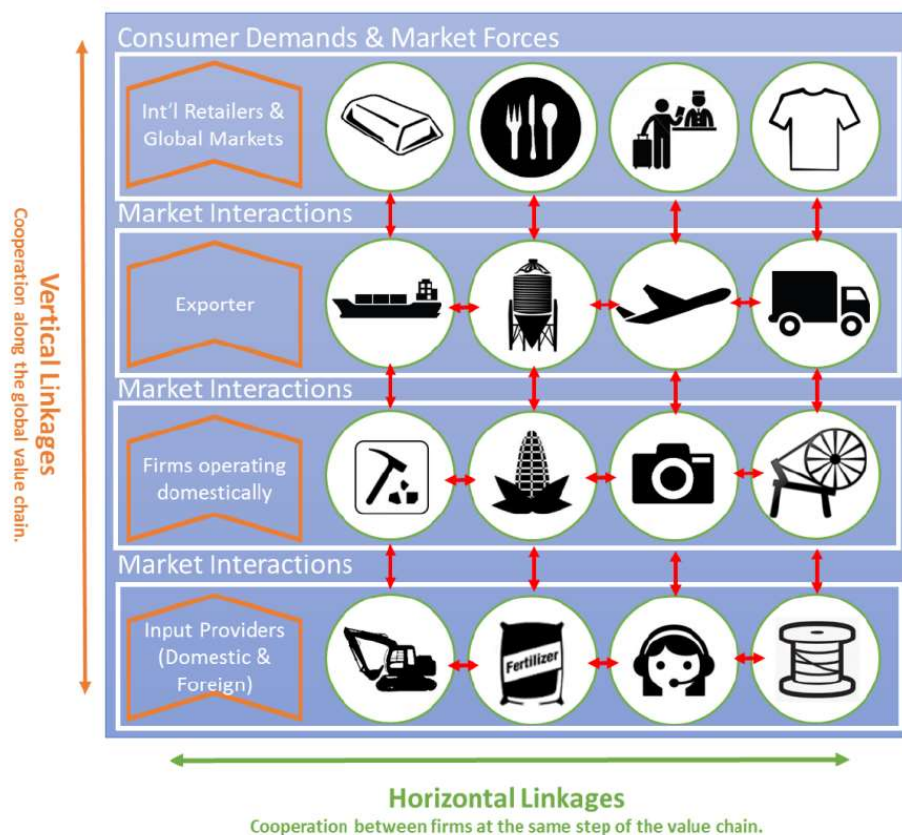
- Embedding investors
- Increasing domestic business activity and value-added
- Transferring of technology & skills
- Upgrading local economy & raising productivity
- Providing access to domestic and int markets
- Fostering economy diversification



2. WHAT ARE FDI LINKAGES?

Definition & types of linkages

- FDI linkages are economic relationship between domestic companies and foreign investors along (vertical) or between (horizontal) value chains.
- FDI linkages constitute important channels through which information, material, money, technology and other resources flow between companies in an interdependent relation, creating spillover effects



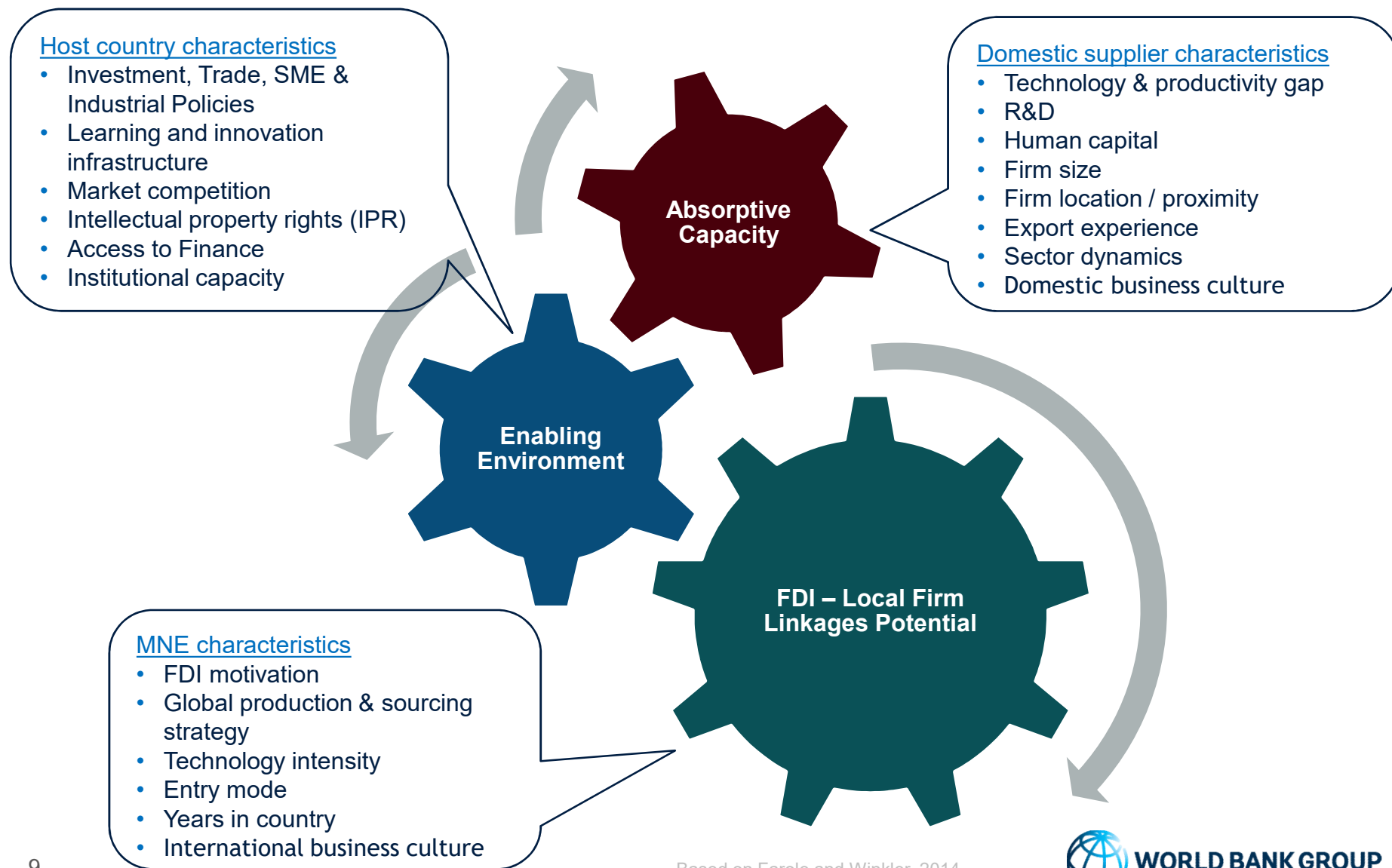
Backward linkages describe the process of how a company in a given sector purchases its goods, services, products, or supplies from a company in a different sector (inputs).

Forward linkages describe the process of how a company in a given sector sells its goods, services, products, or supplies to a company in a different sector (outputs).

Horizontal linkages are longer-term cooperative arrangements among firms that involve interdependence, trust and resource pooling in order to jointly accomplish common goals.

2. WHAT DETERMINES THE POTENTIAL FOR LINKAGES?

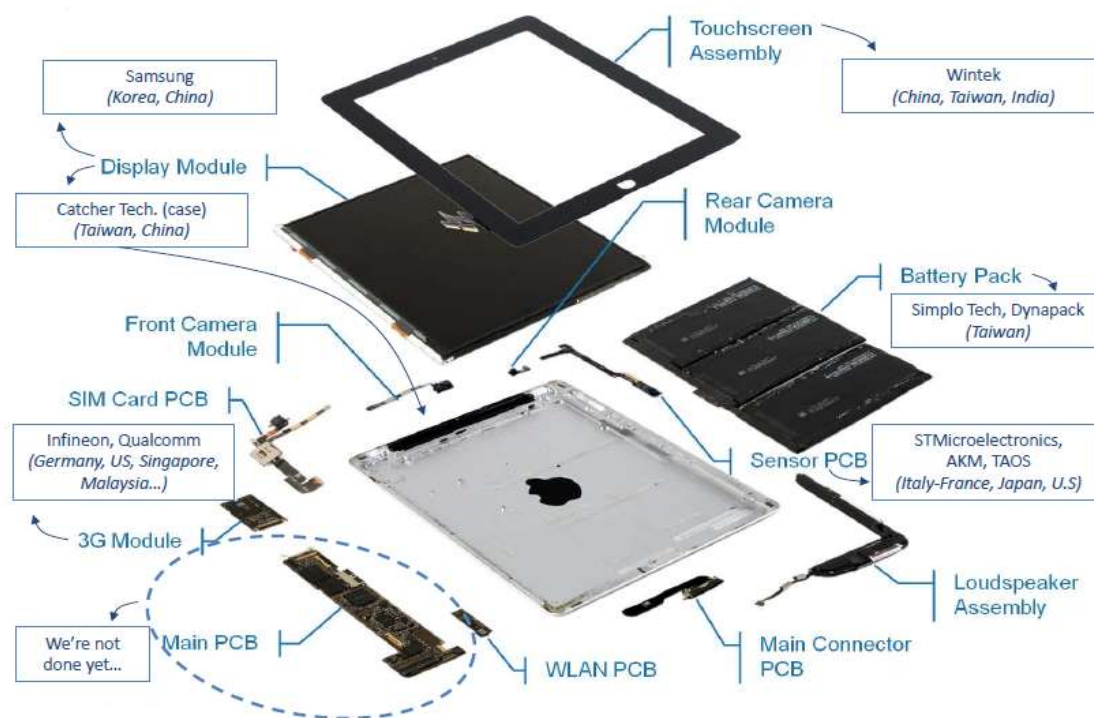
Some mediating factors



3. INCREASING DVA THROUGH LINKAGES

GVCs offer new linkages opportunities

- Changes in production structures offer new opportunities for former 'outsiders' to become integrated in production networks and global markets. Research shows that GVC integration has strong potential for productivity-gains via spillovers.
- GVC characteristics and linkages opportunities are strongly influenced by lead firm strategies (e.g. intra-firm transactions constitute around 50% of US imports and 30% of US exports - Antras 2015).
- However, the subsequent flow of goods, services, people, ideas and capital, also increased complexity and risk of GVCs.



*Inputs for
Apple's iPad 3*

3. INCREASING DVA THROUGH LINKAGES

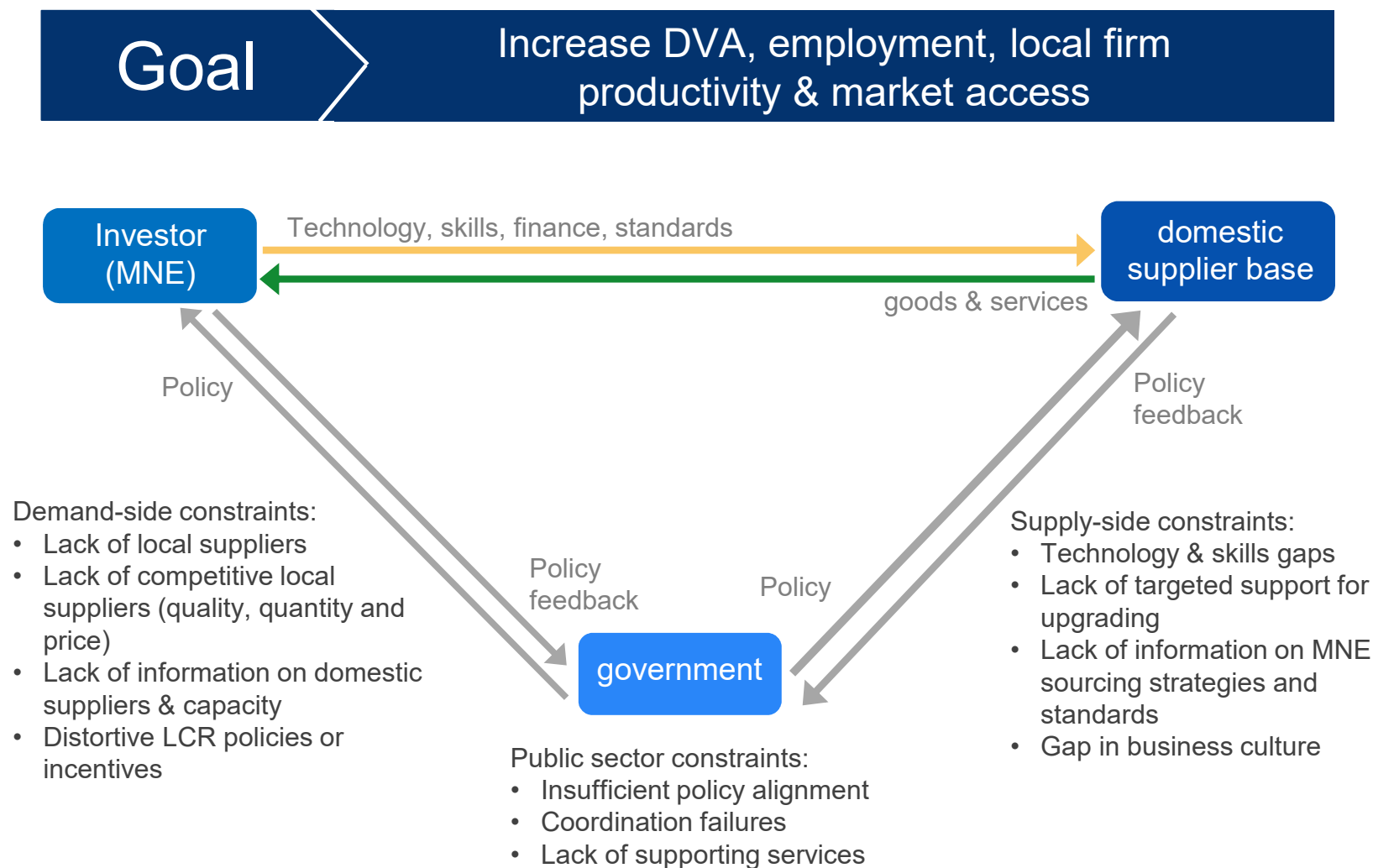
Efficiency-seeking investment requires world-class players

- FDI related to GVCs tends to be **efficiency-seeking investment**, i.e. FDI aiming at enhancing the lead firm's ability to better position itself and compete internationally
- Lead firms in GVCs are '**world class**' companies, meaning they succeed in competing on the global market
- They equally need 'world class' suppliers and inputs to retain their market edge
- Key decision factors:
 - Economies of scale / competitive price
 - Compliance with production standards and lead time requirements
 - Solid and stable investment climate (incl. commercial regulation, contract enforcement)
 - Trade regime openness and access to regional trade blocks
- Like in real life, becoming a 'world class' player requires talent, know-how, commitment, hard work and an appropriate environment to perform



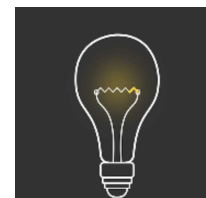
4. THE FDI LINKAGES APPROACH

The typical market failures and constraints

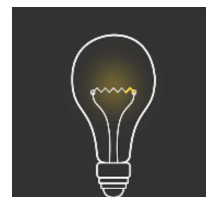


EXERCISE: ASSESSING THE SCOPE FOR FDI LINKAGES

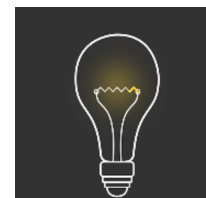
Context: The Government of Utopia is keen to work with the WBG to foster FDI linkages. Hence, the country team requests you and your colleagues to come to Utopia and scope for such an intervention. You have not worked in Utopia before but the local project manager already provided you with a broad picture of what is going on in the country.



What do you do in order to prepare before heading out to Utopia in 2 weeks? Who would you like to talk to while being on mission? What questions would you want to answer?

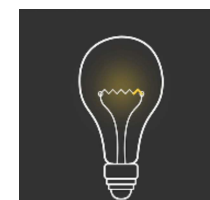
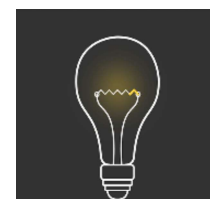


Task: Identify at least 5 issues relevant specifically for FDI linkages that you are going to look into? What data points would you suggest?



STEP 1: DESK RESEARCH

1. **Policy environment & priorities** (development plans, investment strategy, industrial policy, gov's sector prioritization, etc.)
2. **Economic background & rankings** (econ structure, FTAs, GSP status, Doing Business, WEF Global Competitiveness incl executive survey, FDI restrictiveness, etc.)
3. **Institutions** (IPA, EDA, ministries, business support infrastructure, chambers, etc.)
4. **Tools** (incentives published, SME support, supplier database, etc.)
5. **Partners & relevant work underway** (surveys, TA, studies, WBG projects)
6. **Literature briefing & press review**



STEP 2: PRE-MISSION DIAGNOSTICS

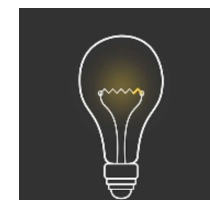
C O N T E N T:

- Foreign Direct Investment (FDI)
- Economy & Trade
- Sector assessment
- Linkages, GVCs & DVA



P U R P O S E:

- Better choice of meetings to set up
- More informed and focused discussion on mission
- Opportunity to use mission to verify/clarify certain issues emanating from the diagnostics



STEP 3: SCOPING MISSION

Foreign investors:

- MNEs and tier 1 suppliers in sectors with a critical mass of FDI
- MNEs with high local sourcing numbers
- MNEs with supply chain development programs
- Investor associations: AMCHAM, Eurocham, JBIC/JETRO, etc.

Local private sector:

- Local companies already supplying to FDI
- Local companies already exporting
- Local companies previously have or try to supply to MNEs
- Local chamber of commerce or industry associations



Government:

- Ministry/Agency leading implementation of relevant policies
- FDI promotion agency
- Enterprise development agency
- Ministry responsible for private sector development, incentives, SEZs, etc.
- If exist: Public institute to support firm upgrading

Other sources:

- Development partners active in this areas
- Any other organizations hosting a supplier database
- Any other organizations providing matchmaking services
- Any other organization providing firm upgrading support

5. Economic Development Challenges: Cambodia & Viet Nam

- Period of high growth and increasing FDI inflows, esp since mid-2000s
- FDI drives economic development and rising income
- Mostly efficiency-seeking FDI in manufacturing, very concentrated in few sectors and in low-value added activities (e.g. apparel, assembly)
- FDI linkages have not yet materialized and no targeted efforts were made so far
- Successful examples in the region: Thailand, Malaysia
- Challenges: weak skills and productivity local economy, low value addition and diversification (middle income trap!), information gap, FDI operating in enclaves;
- Economic integration (ASEAN Free Trade Area) provides new opportunities and threats



FDI EXAMPLE: SAMSUNG IN VIET NAM

Samsung Vietnam prioritizes local part suppliers, but few qualify

The localization rate “mostly represents the *foreign direct investment (FDI) suppliers*, while there are indeed very few 100 percent Vietnamese businesses supplying parts to Samsung.”

“Although the FDI businesses are supplying parts to Samsung, what is important is the fact that the *employees there are Vietnamese*.”

Shim suggested that the *Vietnamese government* offer preferential treatments to *enable local businesses to improve their competitiveness*.

Samsung Vietnam prioritizes local part suppliers, but few qualify: general director

TUOI TRE NEWS
UPDATED : 09/28/2014 10:46 GMT + 7



Print
Email

Samsung is willing to partner with local part suppliers but there are in fact few qualified businesses, the general director of the electronics titan's Vietnam complex has said.

Samsung “will prioritize placing orders at *local businesses if they are able to meet three standards*. These standards include product quality, delivery time, and price.”

“Samsung has recently submitted a list of 170 different types of spare parts the company thinks Vietnamese businesses are capable of making [but] no Vietnamese part suppliers are able to grab the chance as they are even *unable to meet Samsung standards* to make a smartphone charger”.

5. FDI LINKAGES INTERVENTIONS IN CAMBODIA & VIET NAM

Typical linkages project components

1

Strategic Action Plan for FDI Linkages:

- Strategic planning to identify linkages opportunities and policy interventions
- Enhance institutional capacity & coordination

2

Enabling policy environment:

- Remove distortive policies such as LCRs
- Re-align incentives to create a level playing field for local suppliers

3

Connecting MNE & local firms:

- Launch online supplier database
- Improve B2B matchmaking services

4

Upgrading local firms:

- Design and implement targeted supplier development program (SDP)
- Introduce behavioral incentives

5

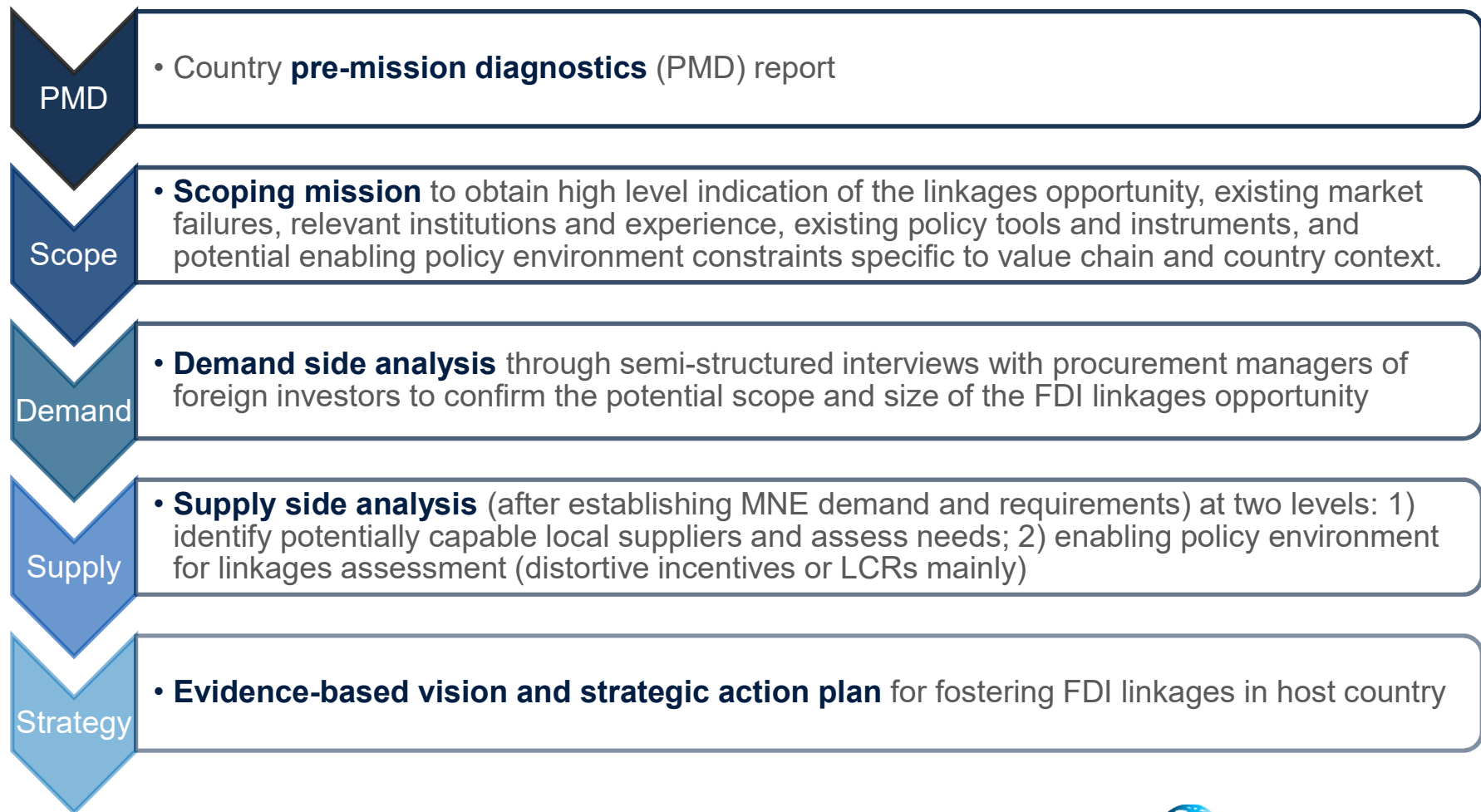
Attracting foreign suppliers

- Ease entry barriers
- Attract international suppliers and capabilities (FDI or NEMs)

5 . FDI LINKAGES INTERVENTIONS IN CAMBODIA & VIET NAM

Assessing the evidence base and identifying priorities

Intervention 1: Design a country specific **strategic action plan for linkages**



TOOL: PRE-MISSION DIAGNOSTIC (PMD) REPORT

Example: Cambodia

CONTENT

Analysis of trends in

- Foreign Direct Investment (FDI)
- Production & Trade
- Sector assessment
- Linkages, DVA, GVCs

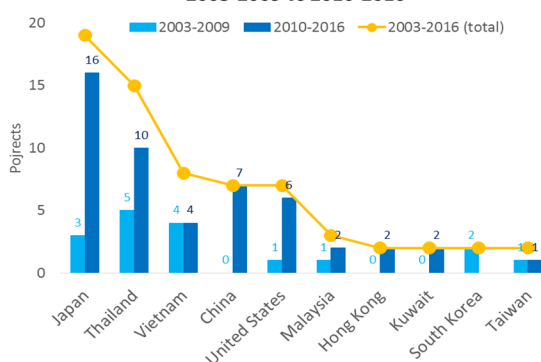
Summary of desk review including

- Current policy environment & priorities
- Economic policy background & rankings
- Enterprise surveys and GVC studies
- Key institutions
- Linkages tools
- Development partners operating in country
- Press clippings

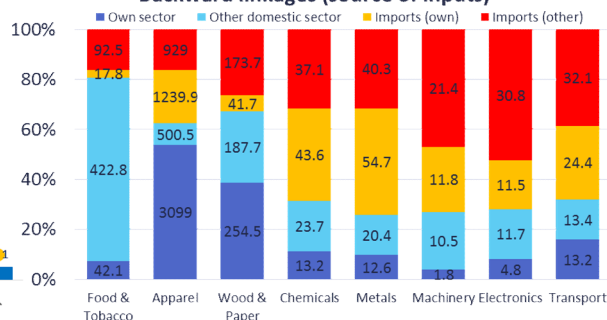
PURPOSE

- Synthesize the analysis and desk review findings to highlight potential opportunity sectors
- Bring new analysis and insights to the client during scoping mission
- Better choice of meetings to be set up and more focused discussions during mission concentrating on high potential areas
- Opportunity to use mission to already verify/clarify certain issues emanating from the diagnostics

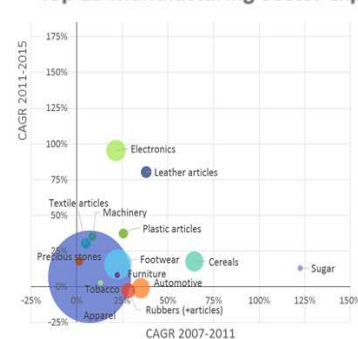
Sources of Manufacturing FDI,
2003-2009 vs 2010-2016*



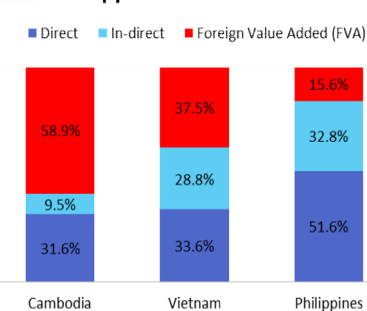
Backward linkages (source of inputs)



Top 15 Manufacturing sector exports



Apparel value-added



TOOL: DEMAND-SUPPLY GAP ANALYSIS

Methodology

1. MNE demand survey

Which specific goods & services would foreign investor prefer to source locally?

Focus on MNE sourcing strategy, barriers to sourcing locally, supplier development, potential relocation of international suppliers, and specific inputs and capabilities

.....



2. Domestic Supplier assessment

For which demand is there suitable local supply capacity/availability?

Understand whether missing linkages stem from (1) information failures or (2) missing existing capacity and establish local firm-sample with potential to supply MNEs (applying filters)



3. Strategic Action Plan

Does the policy environment promote local linkages?

Identify and highlight any MF or policy or regulatory constraints that hamper linking MNE to domestic firms

.....

What linkages interventions are most suited to increase local sourcing by MNEs in the short, medium, and long term?

By comparing the MNE needs (1) and the local firm capacity (2a), enabling policy environment shortcomings or constraints (2b), determine what policy tools and interventions are required to improve the linkages situation

5 . FDI LINKAGES INTERVENTIONS IN CAMBODIA & VIET NAM

Responding to coordination failures

Intervention 2: Ensuring an enabling policy environment for linkages



Policy dimension

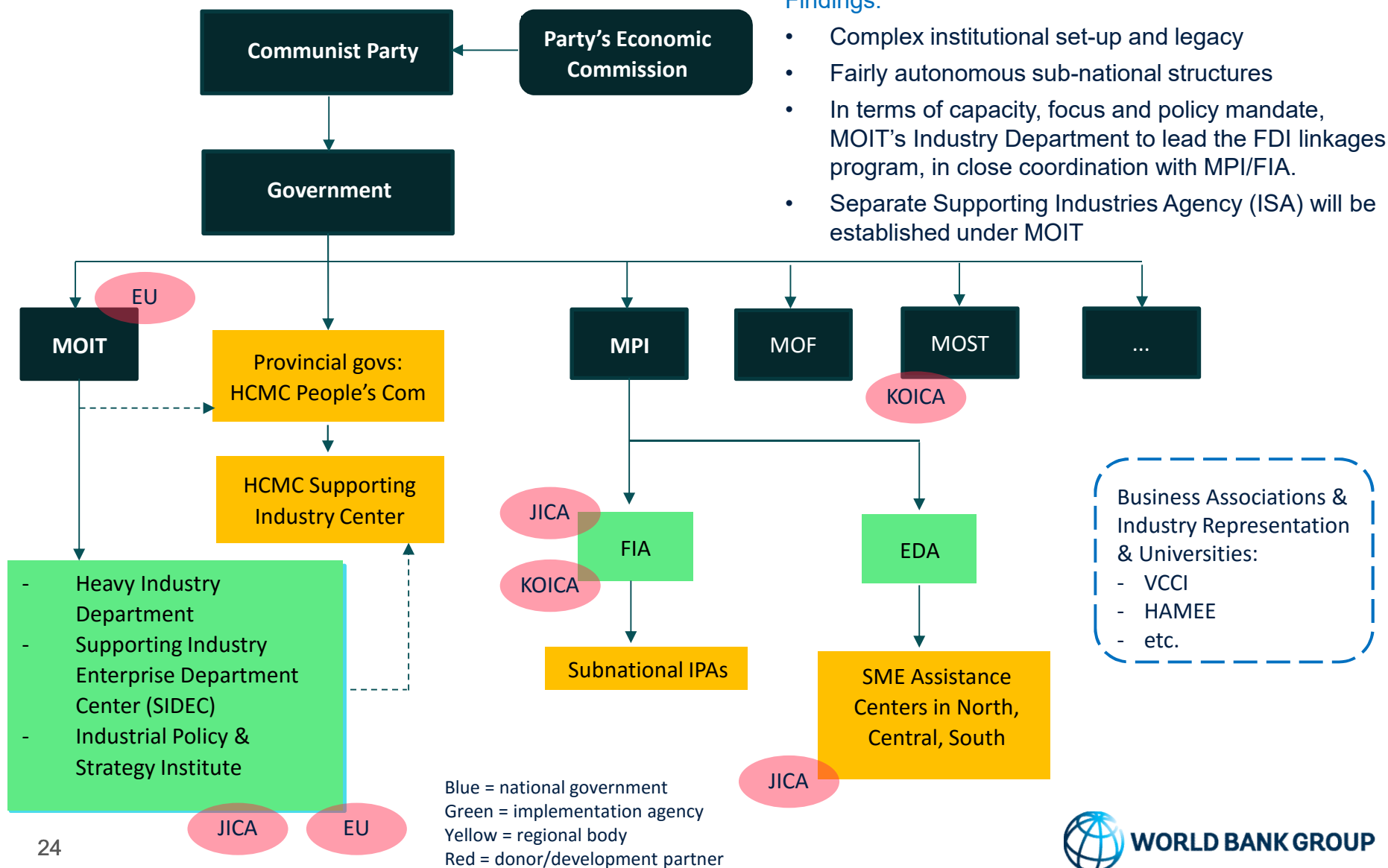
- Identify and remove distortive policies such as local content requirements
- Identify and re-align any distortive incentives schemes for linkages
- Strengthen awareness for policy coherence in areas relevant to linkages (trade, investment, and SME policy, private sector development, innovation, industry, etc.)
- Engage business, especially MNEs, in joint action planning



Institutional dimension

- Identify a suitable lead agency (consider political clout, capacity to influence policy and implementation)
- Enhance institutional capacity to design and implement linkages strategies and deliver relevant support services
- Strengthen coordination and align roles and responsibilities among government actors
- Foster broad stakeholder engagement (private sector, academia, civil society, etc.) in policy dialogue

TOOL: IDENTIFYING LEAD INSTITUTION & MAPPING LANDSCAPE



5 . FDI LINKAGES INTERVENTIONS IN CAMBODIA & VIET NAM

Overcoming information failures

Intervention 3: Connecting MNE's & local firms



Online supplier database:

- Provide online access to high quality local supplier information aligned to the demand from investors
- Highlight local production capacity through individual company pre-screening and company fact sheets
- Recommend suitable suppliers and business partners as part of investor servicing and aftercare efforts
- Build capacity of lead institution to host and maintain a high quality database in the long run
- Reduces local supplier “search and find costs” for MNEs



B2B matchmaking services:

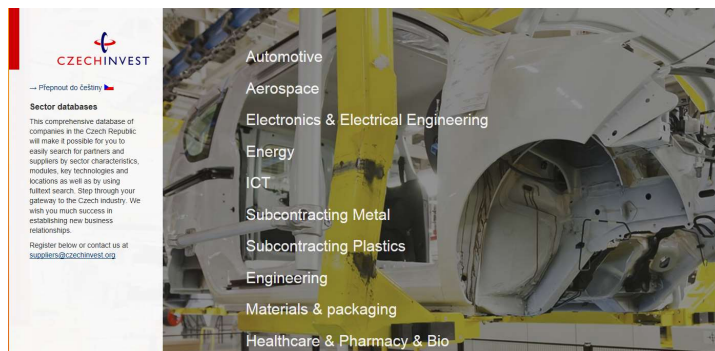
- Build capacity of IPA or other lead institution to provide systematic matchmaking services and ongoing support
- Improve effectiveness of matchmaking services and events (e.g. meet-the-buyer events, company visits, speed-dating, etc.)
- Utilize the direct feedback from investors to design and implement adequate follow-up interventions
- Facilitate contracts with local companies and meetings with business partners
- Preparation of visits to selected local companies

TOOL: SUPPLIER DATABASE

Results from Costa Rica & Czech Republic

RESULTS & TESTIMONY

Czech Republic (CzechInvest)



- CzechInvest's database of local suppliers is the central tool used by its Sourcing Department (performance measured by value of contracts facilitated) to promote linkages.
- It contains more than 3,500 high-quality records of Czech suppliers interested in long-term cooperation with foreign partners.
- Contracts concluded between Czech suppliers and MNEs between 2001 and 2011 amounted to USD 586 million.

Costa Rica (CINDE)

BUSINESS OPPORTUNITIES	SUCCESS STORIES	SUPPLIERS
DESIGN & ENGINEERING	CONTRACT MANUFACTURERS	AUTOMOTIVE SUPPLIERS
Mechania	Microtech	CML-IT
Indetrosa	Irazu Electronics	Zollner
Didea	General Microcircuits	Via Information Tools
	Camtronics	Panduit
	Cram	Hutchings Automotive Parts
	Tico Electronics	Deshler Automotive Parts
	Precision Concepts	Daewoo Bus
		C&K Coactive
		Cook Spring
		Bridgestone Firestone

- CINDE reports that the directory has been a key component in helping companies start operating in Costa Rica.
- In 2015, CINDE attracted a total of 39 new projects in the services, advanced manufacturing, life sciences, light manufacturing and food industry sectors
- Each of the new investors made use of the directory of service providers during their scoping and establishment phases.

5. . FDI LINKAGES INTERVENTIONS IN CAMBODIA & VIET NAM

Addressing the weak domestic supply capacity

Intervention 4: Upgrading local firms

Design and implement demand driven Supplier Development Programs (SDP)

Key criteria:

- Full and active participation of MNEs (OEMs, Tier1s) on a partnership basis throughout
- Demand-driven and competitive
- Identification/selection of companies (SMEs) with potential to be long term suppliers to MNEs
- Comprehensive business reviews benchmarked against MNE/global standards
- Ongoing and customized mentoring/advisory support to secure implementation & help companies help themselves
- Active matching of opportunities, supplier audits, trial orders

Provide behavioral incentives

Scope for incentives:

- assist with **upgrading of local suppliers** in terms of skills, product standards, certification and operational standards and efficiency.
- encourage **MNEs to source locally** or invest in **supplier training / upgrading**.
- encourage **MNEs to partner** with local institutes of higher education, research or technical training.

Common instruments:

In order to help local firms invest in skills, technological and managerial upgrading, the following forms of financial incentives are common:

- Tax incentives
- Grants
- Matching Grants / Cost-Sharing schemes
- Subsidized loans
- Loan guarantees

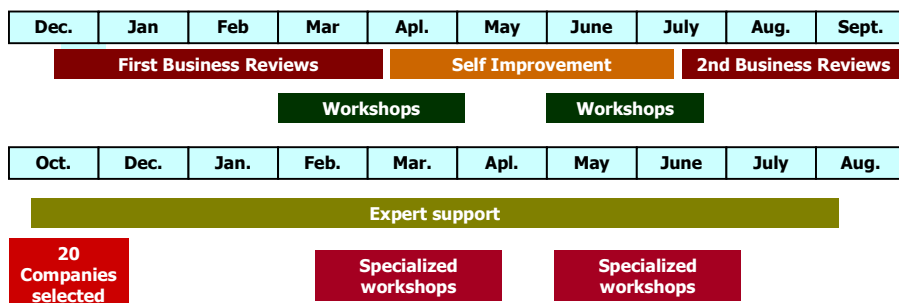
TOOL: SUPPLIER DEVELOPMENT PROGRAM (SDP)

Example: Czech Program

SDP PROCESS

- CzechInvest assigned as lead agency and steering committee including lead MNEs formed
- Accept companies into the program according to agreed indicators
- Experts visit and carry out in-company assessment using a benchmarking model that relates to the specific sector/MNE requirements
- Self assessment carried out by the firms using same benchmarking model.
- Jointly create a business improvement plan.
- After six to eight months second assessment to identify most improved companies.
- Most improved companies provided with individual international consultant support.
- Introductions to potential customers, partners, and sources of technical and financial support.

Time scales



RESULTS



Performance improvement (initial 21 months):

- companies' internal & external performance improved measured against international benchmarks (EFQM & MNE checklist)
- 80 % of improvements attributed to the program

Bottom line (18 months on):

- 15 companies gained new contracts of \$18m annually
- Only 4 of 45 participating companies reported no direct business benefits from the program

Percentage sourced in Czech Republic:

	2000	2001	2004
 BOSCH	0	8	n/a
 CELESTICA	5	10	17
Matsushita	4	9	10
SIEMENS VDO <small>A u t o m o t i v e</small>	0	1.5	2.5

TOOL: BEHAVIORAL INCENTIVES

Example: Singapore

Incentives to MNEs

Research Incentive Scheme for Companies (RISC)

encourages the development of research and development capabilities and technologies through the support of projects in the areas of science and technology.

Training Grant for Company (TGC)

encourages manpower capability development in applying new technologies, industrial skills and professional know-how through the support of training programmes for companies' employees.

Productivity Grant (PG)

encourages firm-level projects which aim at improvements to energy, water, land or labour efficiencies through transformation efforts to enhance companies' operations or involving adoption of technologies.

Incentives to local firms

Capability Development Grant (CDG):

- Capability Development Grant (CDG): up to 70 percent costs (e.g. consultancy, training, certification and equipment costs)
- large scale upgrading projects in areas such as increasing productivity, process improvement, product development and market access.

Productivity and Innovation Credit:

- 400% tax deductions up to \$400,000 or 60% cash pay out up to \$100,000, for investments in innovation and productivity improvements
- The six activities covered under PIC include:
 1. Research & development
 2. Registration of IPRs
 3. Acquisition and in-licensing of IPRs
 4. Acquisition or leasing of prescribed automation equipment
 5. Training of employees
 6. Approved design projects

5. . FDI LINKAGES INTERVENTIONS IN CAMBODIA & VIET NAM

Maximizing the linkages potential and closing supply gaps

Intervention 5: Attracting international suppliers and new technology & skills

Remove market entry barriers

- Remove any **existing legal or administrative barriers** to market entry by competitive foreign suppliers of goods or services.

Example: Turkey

Removed minimum investment and additional screening requirements imposed on foreign investors in 2003



3 years after the reform more than **USD 1.47 billion** in additional FDI generated

Attract international suppliers

- Implement a **targeted investment promotion campaign** to attract and facilitate new investment by foreign suppliers that:
- Look to relocate and establish in proximity of Lead firm/MNE
- Would **fill existing local supply chain gaps** as identified during demand analysis phase.
- Realize **new DVA-opportunities**, such as downstream processing opportunities.

Facilitate Non-Equity Modes of market entry

Non-equity modes (NEM) of market entry such as franchising, outsourcing, licensed manufacturing or management contracts require compliance with **international standards and certification** and thereby promote local firm upgrading and skills development.

Remove any **legal or admin barriers** to establishing such schemes for forward linkages (e.g. barriers to repatriation of royalties or management fees, intellectual property protection, labor laws)

FILLING CRITICAL SUPPLY CHAIN GAPS

Example: VITEC Group in Costa Rica

Challenge for the investor	Action / Countermeasure
<i>Plastic injection moulding: VITEC found some capable companies for plastics, however they were oriented to the medical industry with vary large volumes, soft commercial grade resins and low dimensional precision. VITEC's product require very hard engineering grade resins, low volume, high complexity and high precision.</i>	<ul style="list-style-type: none">• Unsuccessfully tried with different companies in the first years, providing direct engineering support, training, etc.• VITEC convinced an English supplier to start a subsidiary operation in Cartago (next door). This supplier now provides 90% of the plastic components to VITEC's operation.

RESULTS

The new “in house” machining operation contributed not only to fill the gap in technology. It helped to “raise the bar” for local suppliers and also create other unplanned opportunities in the production value chain:

- *CAD/CAM software and programing development (Mecsoft)*
- *Collaboration with technical schools and universities (INA, ITCR, UCR)*
- *The “Vitec Academy” to train supplier operators in house*
- *Increased volumes create opportunities to supply raw material such as bar stock. New suppliers of raw material and cutting tools arise (Soluciones Integrales, COPRE, ToolTech).*
- *Good quality and manufacturing practices been shared with local suppliers*

6. KEY POINTS

- FDI is a strong driver of structural change and growth. Countries with the highest rate of increase in GVC participation experience 2% higher per capita income growth.
- Efficiency-seeking FDI is a key vehicle for GVC participation. An estimated 80% of global trade now occurs within international production networks of MNEs.
- Benefits from FDI don't materialize automatically – requires a tailored strategy and dedicated implementation:
 - **Bring in foreign investors** as key stakeholders of linkages interventions, providing guidance to program design and implementation, and necessary market-pull.
 - **Concentrate linkages interventions primarily on tradable sectors** (goods and services). Though, country characteristics and political economy considerations around e.g. extractives might at times justify linkages programs involving non-tradables as well.
 - Support must **go beyond matchmaking programs** to address constraints faced by local businesses to connect to foreign firms. Help local firms achieve “**qualified supplier status**”
 - A **clear division of roles and responsibilities** and a **strong government agency** leading the overall coordination and implementation is key to making these programs work



Thank you

Economic Development Days – May 2017

Vienna University of Economics and Business (WU Wien)