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DEVELOPING BUSINESS LINKAGES

Note by the UNCTAD secretariat*

Executive Summary

Strengthening the competitiveness of domestic enterprises, particularly small- and medium-sized enterprises (SMEs), is vital for developing countries to fully benefit from international trade and investment opportunities. It will also help to achieve the development goals contained in the Millennium Declaration. The establishment of business linkages between small- and medium- sized enterprises (SMEs) and transnational corporations (TNCs) is one of the best ways for local firms to enhance their competitiveness as they can obtain critical missing assets, such as access to international markets, finance, technology, management skills and specialized knowledge. A variety of initiatives exists to support the development of linkages between local firms and foreign affiliates. They range from purely donor- and government-driven programmes, to public-private sector partnerships and purely private sector-driven programmes, including totally independent supplier development programmes carried out by TNCs in their own self-interest. This note identifies the key drivers and success factors of linkages promotion programmes that could enhance the competitiveness of SMEs in developing countries. In this regard, it discusses best practices and policies that help to create an enabling business environment for linkages to enhance the foreign direct investment (FDI) development impact in host countries. It also outlines core elements, main development phases and support mechanisms needed to design and implement a successful programme focusing on backward linkages with suppliers.

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INTRODUCTION

1. Only a limited number (less than 10 per cent) of small- and medium-sized enterprises (SMEs) in developing countries are well prepared for the new conditions and the increased competition of the global markets (UNCTAD, 2004). An emerging opportunity to reap the potential benefits of global trade is represented by the establishment of business linkages between SMEs and transnational corporations (TNCs).

2. As shown by UNCTAD research, these linkages represent one of the best ways for SMEs to enhance their competitiveness and acquire a series of critical missing assets, such as access to international markets, finance, technology, management skills and specialized knowledge (UNCTAD 2001, 2005). However, specific linkages promotion programmes only have a chance to succeed if a conducive policy environment is set up.

3. UNCTAD has carried out a series of case studies which show that a variety of initiatives to promote linkages exists, from purely donor- and government-driven programmes to public-private sector partnerships and purely private sector-driven programmes, including totally independent supplier development programmes carried out by TNCs in their own self-interest (UNCTAD, 2005b and Ruffing, 2006). There is a need, however, to better understand what kind of policies, institutions and concrete mechanisms can be put in place in order to promote mutually beneficial linkages between SMEs and transnational corporations (TNCs).

4. This note, based on a report prepared by David Lovegrove and recent UNCTAD research, country case studies and feedback from technical assistance projects, addresses these issues. It first reviews the policies and relevant best practices that favour business linkages and identifies the main drivers and stakeholders of linkages promotion activities. It also outlines core elements that need to be considered to design and implement a successful business linkage programme focusing on backward linkages with suppliers. The objective is to facilitate experts' discussions on how to ensure effective implementation of development-oriented business linkages programmes in developing countries, with a view to preparing guidance on this issue.

1. Creating an enabling environment for business linkages

5. The establishment of business linkages between SMEs and TNCs is one of the best ways for local firms to enhance their competitiveness because they can obtain critical missing assets, such as access to international markets, finance, technology, management skills and specialized knowledge. They include backward linkages with suppliers, linkages with technology partners, forward linkages with customers and other spillovers effects.

6. The focus of this note is on how to develop *backward* linkages between SMEs and TNCs. Backward linkages occur when TNCs buy parts, components, materials and services from local suppliers, forming either arm's-length transactions or close inter-firm cooperation, depending on the types of advantages offered by local firms. The development of backward linkages benefits a country's industrial base by strengthening local suppliers and stimulating foreign investment. In particular, backward linkages have the potential to:

- generate additional economic activity through increased demand for locally supplied inputs, this translates into additional income and employment generation;

- stimulate improvements in the products and services of local suppliers through technology transfer and skills upgrading, thereby giving local suppliers a foothold in international markets with products meeting international production and quality standards;
- attract FDI by offering the advantage of a local supplier base capable of offering quicker delivery times and reduced transportation and inventory costs.

7. The concept of backward linkages is as old as the process of industrial development; it is frequently quoted as one of the main benefits of FDI in terms of the dynamic effects on the host country's economic base. However, empirical evidence suggests that backward linkages have not been strong in most developing countries, even in those countries that have succeeded in generating significant inflows of FDI. The main reasons cited by foreign investors for the low proportion of purchases from local suppliers include concerns that the goods and services offered by local suppliers do not meet their requirements in terms of quality, price and/or delivery. From a foreign investor perspective local suppliers are often considered unresponsive to their requests to improve the quality, delivery and prices of their goods and services.

1.1. Policy measures for promoting linkages

8. While the backward linkage concept is old, the mechanisms to give it effect are generally new and, in some cases, still being developed and refined. In the past, host governments relied on more coercive policies to create linkages such as local content requirements, restrictions on the number of expatriate managers, and even mandatory technology transfer provisions. The approach has since shifted to working with the private sector, where government policies consist of removing obstacles to greater interaction between foreign and domestic firms.

9. These obstacles include both the "information gap" on the part of both buyers and suppliers about linkage opportunities and the "capability gap" between the requirements of foreign affiliates and the supply capacity of local firms. Backward linkages can be developed under market conditions and in compliance with existing obligations under the WTO, particularly trade-related investment measures; they can also be developed using mechanisms that have proven effective, such as those supporting TNC suppliers development on a voluntary basis.

10. As developing countries try to upgrade the productive capabilities of SMEs and enhance the benefits from foreign direct investment (FDI), they have introduced policies conducive to business linkages development. Examples of successful policies promoting linkages can be found in Chile, Jordan, Malaysia, Thailand, Singapore and South Africa. According to Altenburg (2005), these policies are aimed at:

- **Creating an enabling environment for the private sector.** The regulatory and institutional environment in which firms operate impact on their ability to initiate productivity improvements, either through the optimal allocations of inputs, technology transfer and ability to generate spillovers. Most policy initiatives in this area place their emphasis on horizontal policies such as taxation, infrastructure, red tape reduction, intellectual property protection, competition policy, finance, and measures that impact the overall competitiveness of an economy.

- **Attracting FDI.** FDI promotion policies may facilitate the integration of developing country firms in global supply chains. Some policies can explicitly be designed to attract TNCs that promote technology and knowledge transfer to local suppliers and subcontractors, whereas others may be aimed at helping established foreign affiliates to enter and/or upgrade into higher-value activities. After-care services are also very important to influence investors' decision on linkages development.
- **Promoting skills development and innovation.** Strengthening the supply capacity of local SMEs is, in most cases, the key challenge for developing business linkages in developing countries. This requires the development of skills in different fields, ranging from technical skills in production processes to management competences. Education policies with a focus on technical and managerial skills are important. In addition, the provision of a range of good infrastructure facilities, e.g. technology parks, can promote innovation and R&D through public-private sector partnership.
- **Improving access to financial and non-financial business services.** Difficult access to finance is another major growth constraint for SMEs in developing countries. The cost and availability of capital to small enterprises is therefore a decisive determinant of linkage formation. In addition to finance, the modernization of SMEs also entails incorporating external know-how and the availability of providers of non-financial business with specialized competencies in different fields. Policies aimed at strengthening such service supply thus help to make SMEs partnership-ready and have an impact on linkage development.
- **Promoting the development of industrial clusters.** Cluster initiatives allow for economies of scale and agglomeration and also help to develop an experienced local pool of skilled labour and a network of firms cooperating in complementary areas of specialization. By doing so, they strengthen their comparative advantages in a sustainable manner and become attractive sites for quality FDI. In many cases, the presence of TNCs becomes crucial to integrate clusters companies into global value chains and to strengthen their export capacity, from both the production and distribution points of view.

11. Best practices related to linkages enabling policies have developed over time. For example, according to recent UNCTAD's research (UNCTAD, forthcoming), the Malaysian government introduced special programmes to assist SMEs to overcome size and scale constraints; to minimize difficulties accessing key information for business and investment decisions; to reap benefits from R&D; and to promote inter-industry linkages and promotion of ancillary industries. Under its Second Industrial Master Plan (1996-2005) the government has committed itself to a "Manufacturing ++" Strategy with a clear focus on technological upgrading and broader integration of SMEs into competitive areas. The industrial linkage programme developed by Malaysia offers approved suppliers in selected industries full income tax exemption or an investment allowance of 60 per cent on qualifying capital expenses for five years. TNCs can also claim tax deductions for suppliers-related support programmes (Rasiah, 2005). Investment in R&D, however, has been far too low to achieve the envisaged transitions towards a knowledge-based society, and some elements of the strategy (e.g. venture capital financing and university spin-off programmes) have not been fully utilized.

12. Developing countries have also introduced policies to target individual industries, groups of industries or even individual firms, taking into account sector specificities. For example, South Africa has adopted a strategic approach to industrial development (Robbins,

2005). The most successful sector-specific policy has been the Motor Industry Development Programme that helped to establish competitive and relatively integrated clusters of automobile companies. South Africa has since 2004 carried out customized sector support programmes in selected priority sectors.

13. Another interesting case is the BUILD Programme developed by Thailand's Board of Investment (BOI). There is a unit for industrial linkage development within the BOI in charge of the programme. BUILD functions as a "middleman" to forge links between both Thai and foreign customers and local suppliers. The programme's objectives are to use technology transfer to reduce imports of parts and components, linking Thai suppliers with large companies and strengthening part makers in Thailand (UNCTAD, 2005a).

1.2. Main drivers of business linkages

14. It is important to identify the main linkages drivers and take them into account for the formulation of enabling policies. There are different drivers of business linkages. The classic backward linkages model, driven by the needs of FDI and the hosting country, refers to inter-firm relationships in which a company purchases intermediate goods and services as its production inputs on a regular basis from one or more local companies in the production chain. This model is the one most frequently adopted as it provides maximum benefits to both the host country and the companies (both domestic and FDI) located there. A good example of a classic linkage model is the one developed in Ireland (see Box 1).

Box 1. The Irish Model

Ireland's National Linkage Programme incorporates all the essential elements: State involvement, critical mass of purchasing and potential suppliers, technical audits, funding to assist developmental programmes, full participation by the private sector, a clear policy and framework for its development and startling results. It was established in 1985, as part of the Irish Government's planning for balanced industrial development. The "Irish Model" is generally regarded as being very successful and well structured. Its main features include:

Primary objective. To maximize the amount of raw material components and services sourced locally by manufacturing industries. It initially targeted the electronics sector but was expanded later to cover engineering, chemical, pharmaceuticals, food and consumer products.

Working with purchasers. The National Linkage Programme worked closely with over 250 TNCs and large Irish companies in all the major manufacturing sectors to identify new business opportunities for local suppliers. It also worked with TNCs to monitor technology and business trends and to establish criteria for successful supply relationships including quality, cost and service requirements. Seminars, sector review studies and other National Linkage Programme development activities were strongly supported by the multinational companies.

Developing the supplier base. The National Linkage Programme worked closely with supplier companies on specific development areas related to the multinational customer base. This included necessary developments in operational management and control, quality systems, finance and marketing.

The programme encouraged the formation of partnerships, strategic alliances and joint ventures. It also worked to eliminate barriers that might exist between local suppliers and the chosen customers, and it assisted more than 100 other suppliers based in Ireland. The programme's results were startling. A large number of local SMEs were upgraded and became suppliers to companies such as IBM, Apple, Dell, etc. These SMEs also became eligible to join international procurement panels and

gained new export markets. The Irish Linkage Programme has changed focus over time. When started in 1985, the principal objective was import substitution; increasing the returns from State interventions (investment grants, tax holidays and training grants, etc), improvement and upgrading the capability of domestic companies to attract FDI. Today, the linkage programme is focused on finding potential suppliers in low-cost countries for the medium and large companies (including TNCs) located in the country. The key focus now of the Programme is to source low-cost inputs for companies so that they can be competitive and remain in Ireland; the reason for this would be that purchasing inputs from local suppliers would be expensive and make them uncompetitive.

Source: www.enterprise-ireland.com.

15. Linkages programmes can also respond to needs of governments to facilitate small-scale suppliers. In certain circumstances it may be even necessary to also include micro enterprises in a linkage programme. This can normally be handled in two ways:

(a) by establishing a “business2business” facility whereby the linkage project team identifies certain low-level goods and services that could be provided by local small scale companies. In most cases these goods and services will be provided without any increase in the capacity or capability of the small scale company.

(b) by working with a limited number of the best small scale companies to move them up the capacity scale in order to become suppliers of lower level goods.

16. Jordan is a good example of a country that has incorporated a small-scale company component into its national linkage programme, and where the involvement of small-scale companies has proved to be a success as they add an extra dimension to the National Linkage Programme and are helping to promote local purchasing. This was done for the following reasons:

- There was no well-developed data networking system that could be used by small scale companies to identify business opportunities. This resulted in companies importing products when a small company located nearby was capable of producing them.
- There was a well-established Chamber of Industry that was willing to be the focal point for the programme.
- There were a large number of micro- and small-scale companies in the country.
- There was a lot of pressure to include smaller scale companies as they represent a large proportion of the total manufacturing base in the country.

17. The private sector also contributes to business linkages development whenever it is in the strategic interest of the TNC to develop a network of efficient local suppliers. In this case, the upgrading process takes place within the company operations through a stand-alone supplier development programme. As shown in recent UNCTAD's publications (UNCTAD 2001, 2003, 2005), there are no shortage of examples of such programmes, Case studies illustrate how large TNCs such as Toyota, Unilever, FIAT, AngloAmerican, DaimlerChrysler, Volkswagen and Tata, may decide to establish a close relationship with their suppliers in their own self interest. These programmes have often been very effective in achieving their specific objectives. However, particularly when there is a sole company generating the programme, there could be difficulties in setting fair terms to suppliers and in extending the programme's economic benefits more widely.

18. Business linkages are also established by companies, especially TNCs, in recognition that they have a social responsibility to the host country where they are located. Nowadays, it is not enough for TNCs to regard their investment and job creation activities, etc. as an adequate “pay-back” to the host country. With the increasing importance – also as a competition factor – of the so-called “moral” market, it is becoming more prevalent for TNCs to see how they contribute more tangibly to the local economy. One way of doing this is to work with potential local suppliers in helping them to establish businesses that can provide basic services and, in some cases, goods to the TNC.

19. A good example of linkages within corporate responsibility initiatives is a programme developed by the mining sector in Indonesia. In 2003 the World Bank carried out a study in Balikpapan, an area on the island of Kalimantan (Borneo) where there is a large concentration of mines; the study which received the full support of the major mining companies sought to identify areas where local people could supply basic goods and services to the mining companies. In many cases this involved the mining companies outsourcing services that they previously sourced internally. The collective purchasing of the mining companies in areas such as the provision of security, food preparation, land maintenance, basic servicing of machinery etc. allowed a large number of local entrepreneurs to set up small businesses to supply their requirements. Xstrata (Switzerland) developed a new scheme which entails generating business linkages at the start of mining exploration activities in an underdeveloped region of Peru. Local stakeholders have identified linkages and a development fund has been established in partnership with local communities (UNCTAD, 2006).

20. Another example in this regard is the Mozal Aluminium factory in Maputo, Mozambique. As soon as the decision was made to locate the plant in Maputo, the company appointed a senior executive with sole responsibility of sourcing as many goods and services as possible in the local market. The company established a fund to help local businesses and entrepreneurs to reach the required standards. The company’s commitment facilitated the establishment of a linkage programme within the local investment promotion agency (IPA).

1.3. The role of public-private partnerships

21. One important element of the enabling environment for business linkages is a close cooperation between public and private sector institutions. The extent to which decision-makers in companies and governments understand current patterns of industrial organization, recognize relevant trends and anticipate emerging technologies, markets and organizational structures has proven crucial for linkage development.

22. Designing a clear strategy for private sector development and securing the commitment of the different stakeholders to set up institutions representing the interests of main stakeholders is also important. In the absence of institutional settings and/or their coordination, including that of international donors, efforts are often wasted in duplication and unproductive inter-agency rivalry and strategic goals are rarely achieved (Altenburg, 2005).

23. One good example of public-private sector cooperation is the Ugandan business linkage programme which is supported by UNCTAD through its local EMPRETEC centre¹

¹ EMPRETEC is an integrated capacity-building programme run by UNCTAD since 1988 that helps to foster entrepreneurship capabilities and the growth of internationally competitive SMEs in developing countries and

(Box 2). Besides the programme in Uganda, UNCTAD has also built linkages programmes based on public-private sectors partnership in Brazil and preliminary work has been carried out in Argentina, Ethiopia, Ghana, Kenya and Vietnam. In developing the programmes, EMPRETEC centres and its programmes have proved to be very useful, acting as focal points for promoting the business linkage concept and for its implementation.

24. UNCTAD experience gleaned from research and first-hand experience in assisting countries has been consolidated in a business linkages programme guidelines that also contains a roster of good practices (UNCTAD, 2005b).

Box 2. UNCTAD's Business Linkages Programme in Uganda

The Business Linkage Promotion Programme in Uganda is being implemented by a Business Development Services Centre as lead facilitator, namely Enterprise Uganda (hosting the EMPRETEC centre), in collaboration with Uganda Investment Authority (UIA) and supported by UNDP, UNCTAD, and the Government of Sweden. The main objective of the project is to promote the creation of durable and mutually beneficial partnerships between TNC affiliates and large local companies on the one hand, and SMEs on the other, so as to enhance the productive capacity, efficiency, competitiveness and sustainability of their relationships. The key role of each partner is as follows:

Enterprise Uganda/EMPRETEC identifies SMEs, brokers and facilitates implementation of business linkage deals and defines SMEs' capacity gaps. It also ensures the transfer of technology and know-how including coaching and mentoring of SMEs by TNCs and facilitates access to markets and finance. Ultimately, Enterprise Uganda acts as the "third party" chaperoning the linkage between the TNC and the local SMEs, making sure that the upgrading process of the latter is not too strenuous on any party. In addition the EMPRETEC programme follows-up on the day-to-day operations of SMEs and facilitates continuous learning and innovation, as well as access to business development services. It holds specialized seminars and training courses, and focuses on those skills important for partnering with large enterprises.

UNCTAD, in addition to its role of coordinator of the EMPRETEC programme and network, provides advisory services on the business linkages methodology and technical expertise, promotes awareness of global best practices and helps to disseminate achievements and lessons learned to other programmes.

The Uganda Investment Authority contributes to the improvement of the business policy environment and facilitates the initial brokering of the linkages with the TNCs. Experience of the programme has so far demonstrated that in spite of the productive capacities constraints of SMEs, TNCs were ready to upgrade the business relationships with SMEs into long-term relationships, provided SMEs committed themselves to remedy shortcomings in their business systems and upgrade their skills. Since its inception in 2005, the project achieved the following results:

- Uganda Breweries will assist in upgrading of the members of the barley growers' association in eastern Uganda, to benefit over 2,000 farmers.
- In western Uganda, Kinyara Sugar Works Ltd under Booker Tate signed an agreement to strengthen its link with Kinyara Sugarcane Growers Ltd, thereby benefiting about 2,500 local farmers.

countries with economies in transition. EMPRETEC is present in 26 countries and coordinated by UNCTAD headquarters in Geneva. The programme is based on public-private partnership and it aims at developing sustainable mechanisms to unleash entrepreneurial potential and provide business development services (BDS) for local SMEs.

- Two telephone companies have signed up to upgrade their distributor network.
- The country's biggest real estate developer has signed an agreement to support 15 local suppliers.

Source: Enterprise Uganda, 2006.

25. Other good examples of private-public sector partnerships are technical assistance programmes such as the Business Linkages Challenge Fund (BLCF) financed by the British Government's Department for International Development (DFID). It supported private sector partnerships that bring commercial benefits to the businesses that participate and help to reduce poverty in target developing countries. Companies have access to grants of between GBP 50,000 and GBP 1 million to increase access to markets, transfer technology, improve competitiveness, or address the policy and regulatory environment for business. The BLCF Projects ended in 2005. There are plans for further funding as the BLCF model has generated considerable interest from both the private sector and donor organizations seeking to work in this area.

26. Since 1999, the **Business Linkages Group** in South Africa has facilitated more than US\$350 million in transactions between small and medium-sized manufacturing firms mainly in agribusiness, tourism enterprises and large corporations. ECIAfrica is one of the leaders in the linkage arena. Services offered by the Business Linkages Group include: design of linkage and outsourcing systems; training and mentoring; identification, evaluation and accreditation of small business linkage partners; procurement; and aftercare to a wide range of buyer/supplier relationships. Current major projects are Promoting Agribusiness Linkages (PAL), South African International Business Linkages (SAIBL), Southern Africa Regional Trade (TRADE) and the Tourism Enterprise Programme (TEP).

27. GTZ has also gained considerable expertise with regard to public-private partnerships for business linkages development. For example, Germany's Federal Ministry of Economic Cooperation and Development set up a cost-sharing grant scheme ("PPP facility") to co-finance (up to 50 per cent of project costs) development-oriented private sector initiatives and delegated its administration to different implementing agencies. To date, a network of more than 1,000 corporate partners has been created and some 1,700 projects implemented. These include, *inter alia*, vocational training which international investors provide for their local suppliers; introduction of new crops; agricultural extension services; introduction of social and environmental standards in the supply chain, etc.

28. In addition to business linkage programmes, USAID has recently developed initiatives in countries that help clusters of firms in specific industries improve their opportunities to compete in global markets. This is being done by working collaboratively with enterprises and host-country policymakers to strengthen the business environment, raise production standards, create buyer-seller market linkages and reduce or remove impediments to productive investments. Often, linkage projects are an important feature of large investment projects in impoverished regions by the International Finance Corporation (IFC). These projects can have a profoundly positive development impact in frontier markets. IFC designs funding mechanisms for financial intermediaries and provide technical assistance to all parties involved.

2. Developing a business linkage programme

2.1. Core elements for setting a backward linkage programme

29. The basic concept behind a backward linkage programme is to *encourage* companies to maximize the purchase of their inputs locally rather than importing them. The strategy underlying the development of backward linkages is to improve the capacity of local companies to enable them to supply components that are currently being imported and to increase their potential for suppliers to move into export markets. Any party seeking to establish such a programme would need to take into account elements that are specific to the country/market, and/or other factors, such as the economic, cultural and social context to ensure successful results. However, in executing the programme there are a number of specific factors that should be considered and some core elements that should be in place for the programme to work effectively. They include:

30. *A critical mass of purchasing companies* that constitute a real opportunity for domestic supply – these constitute the demand-side of the linkage equation. It is uncommon that purchasing requirements of one company constitute sufficient demand for suppliers. It is normally an aggregate of the inputs or purchasing requirements of a number of companies that constitutes the critical mass necessary for backward linkages to occur. Apart from the pure economics of requiring a critical mass of inputs, it is also desirable, from the suppliers' perspective, to have a number of companies making up their market rather than rely on one or two companies that may dictate terms and conditions in an unfair manner.

31. *A pool of domestic suppliers*, i.e. companies capable of supplying the goods and services as required by the demand companies to their standards and specifications – these constitute the supply-side of the linkage equation. In most developing countries that attract FDI, it is the quality and competence of the domestic suppliers that limits the potential of any linkage programme. The domestic companies that participate in a linkage programme should be selected based on their ability to supply the goods and services required by the purchasing companies only when they demonstrate the qualities necessary to satisfy the stringent demands of these companies. It must be stressed that purchasing companies have demands of quality and performance placed on them by their customers. Purchasing companies in turn must ensure that suppliers meet the same requirements. In effect, domestic companies supplying to larger TNCs and foreign affiliates will have to meet international standards for quality, performance, delivery and standards compliance.

32. *An effective selection mechanism(s)* to bring about the effective “linking” together of the demand- and supply-sides of the equation. In particular, experience has shown that purchasing companies are reluctant to participate in linkage programmes unless they have some control over the selection of the suppliers. Therefore, it is necessary to put in place a series of mechanisms that will allow the purchasing company to have confidence in the selection process of potential suppliers. It is normal practice for the linkage team to work closely with the purchasing companies.

33. *Support mechanisms* to assist the potential domestic companies to achieve the standards required to become suppliers to multinational and/or other large companies and ultimately to move into export markets. Reviews of linkage programmes that have not been successful usually identify the lack of support mechanisms to assist potential suppliers to achieve the necessary standards of the purchasing companies as the prime reason for failure. Required support to bring domestic supply companies up to international standards usually includes technology upgrading to improve production processes and product standards; manpower development and managerial training to work with new technologies and to develop the skills necessary to move into international markets; and access to financing to enable these companies to acquire new capital equipment and training, or as required expand, as well.

2.2. Main stages of a business linkage programme development

34. This section describes the main phases of a backward linkage programme establishment. As a first step, it is important to establish the programme oversight committee. It is recommended that this committee would be private sector-driven, but it should also include the main stakeholders. For example, it could be comprised of representatives of the private sector, representatives from Business Associations/Chambers of Commerce and Industry, representatives from relevant government institutions and the Director of the linkage programme. Its function is to guide the overall direction and scope of the programme, provide advice and ensure the maximum benefits from linkages. The UNCTAD-GTZ Projeto Vinculos in Brazil illustrates how to initiate the linkage programme with public-private partnership and international cooperation. This is a best practice for reconciling donors and recipients' objectives (Box 3).

35. As a second step, it is important to recruit a project linkage team to implement the programme. The project team could consist of a project director and a team of linkages promoters in charge of promoting the individual linkages from a technical point of view. The staff should be experienced in production processes and be fully up to date in best practice manufacturing processes. From a logistical point of view, in order to operate a linkage programme it is important to establish a project office/business linkages centre equipped with the following hardware: office accommodation, transport, data storage systems and other office requirements. These facilities can be provided by either the government, possibly by locating the programme within an existing institution, or by donor agencies.

36. Other steps of the programme's execution are illustrated in Table 1 included in the Annex. The description of activities that need to be undertaken is not exhaustive and they could differ depending on the specificities of each programme. However, it is important to consider the following aspects in the programme design.

37. In designing the programme, it should be understood that it has the greatest potential in sectors with the largest capacity to source components and services within the domestic market. From the start it is important to involve relevant trade and/or industry associations representing the sector(s) suitable for inclusion in the programme. The sectors should be selected among those that require a wide diversity of components and other intermediate inputs, many of which can be supplied by domestic companies. For example, the automobile industry (requiring parts and components constituting 70 per cent or more of final sale value); the machinery and precision instruments involving primarily assembly activities (50 per cent or more); consumer engineering electrical and electronics industry (40 to 50 per cent); the construction industry; hotel services; the consumables of large capital-intensive projects (both

during construction and when in operation); and government procurement. Other typical target industries include metal working, production of plastic parts and components, mold and die manufacturing, printing and packaging, and business services (accounting, legal and IT services).

Box 3. The experience of UNCTAD-GTZ Projeto Vinculos in Brazil

Projeto Vinculos was a direct outcome of the UNCTAD XI Conference in Sao Paulo in 2004. At that time, the Government of Brazil and high-level corporate representatives identified business linkages as a crucial instrument for strengthening enterprise competitiveness and domestic production capacities.

UNCTAD joined forces with GTZ, Instituto Ethos and Fundacao Dom Cabral (FDC) to develop a new concept for promoting business linkages with financial and operational support by the Government of Germany. After less than two years of activity, strategic partnerships have been launched with Philips Amazonia, BASF and FIEB/IEL (Bosch, Lyondell, Veracel). The project is upgrading local current and potential suppliers, promoting about 55 linkages through these partnerships. It is also forging strategic partnerships with complementary SME promotion and financing institutions. A key component of the project is the engagement of the private sector through cooperation agreements, thereby allowing for an open exchange of competence and dissemination of international best practice. TNCs have been involved since the project's inception and have contributed to the project's methodology development. Meetings with TNCs are regularly convened to ensure a continuous public-private sector dialogue. The project acts as a facilitator in the linkage brokering.

It also offers TNCs the opportunity to exchange best practices on supplier development activities. The project is an illustration of partnership for development as it engages multilateral, bilateral and local institutions, as well as the private sector. In particular, it is the first UNCTAD project bringing together the following stakeholders in an innovative manner, namely: (a) TNCs in the conceptualization stage, in order to complement their own efforts in linkages promotion; (b) governments through public-private sector dialogue and policy advocacy; (c) local institutions engaged in corporate social responsibility activities; (d) establishing a dialogue with TNCs at the senior management level, as well as multilateral and bilateral institutions; and as well as a research/management organization that complements the programme design and management with local expertise and experiences. Based on the project's experiences, UNCTAD will formulate policy advice for the federal and regional governments in Brazil on promoting sustainable business linkages.

Source: UNCTAD, 2006.

38. While *selecting companies*, there is a need to evaluate both sides of the equation, namely the suppliers, as well as the purchasing companies. A linkage programme needs to be highly focused, and company-specific, involving a lot of "hands on" time allocated to each company. It is important that only selected companies – i.e. those meeting the defined criteria – can participate in the programme. It is essential that companies without such potential be excluded from the programme. Apart from wasting valuable staff resources, a wrong selection would jeopardize the overall programme's success. However, this is a difficult issue to handle because the excluded companies may feel aggrieved and may obstruct the selection process. In *attracting TNCs* it is important to recognize that factors affecting corporate decisions on internal production and outsourcing and on purchasing domestically or abroad are both complex and dynamic. Therefore it is crucial to target TNCs that have, or are willing to have, a well developed strategy to upgrade their suppliers (supplier development programme).

39. In dealing with TNCs the following issues should also be addressed:

- A purchase/operational manager should act as the project's contact person; this person should also be responsible for implementation is assigned. Linkages projects often involve the Corporate Social Responsibility departments that have different operational targets. Thus, it is advisable to involve directly the supply chain/operational departments.
- The CEO of the purchasing company should be briefed on the programme and agree to his/her company's participation. This will allow the purchasing manager to participate in the programme without fear of reprisals.
- The management's commitment to the concept of business development is secured and a member of the senior management team (or owner) is selected to oversee the implementation.

40. *In selecting suppliers*, participation in the linkage programme should be limited to supplier companies that are either identified by the purchase company or selected by the linkage team. Generally, purchasing managers are reluctant to take a decision to bring a completely new and untried supplier on board as the responsibility, in the case of failure, will be theirs. The programme is not suitable for start-up entrepreneurs. It requires already established manufacturing facilities and funding should be available to finance part of the development plan. As will be explained below selecting suppliers also requires a rigorous technical audit. Before commencing a full-fledged linkage programme, it is recommended that *a pilot programme be undertaken*. This allows the sector selection, mechanisms and overall concept of the programme to be tested without fully committing large resources. Some evidence suggests that a pilot programme typically lasts about 18 months and cost about \$300,000. It would identify clear targets of purchasing companies and potential suppliers, carry out technical audits, establish support mechanisms and set up development plans. The pilot programme would also help in defining realistic targets for new business development generated by the linkage programme.

2.3. Support mechanisms

41. A number of support mechanisms are necessary for business linkages programmes. These generally cover the following aspects:

42. **Business diagnostic and auditing.** In order to assist domestic companies to become qualified suppliers it is necessary to: (a) undertake an audit of the potential supply company's to identify deficiencies, reviewing existing machinery, the technical ability of management and staff, technology applied and ability to meet international standards; production processes; the production process in terms of quality and quality control; finance available for investment; general administrative practices; (b) prepare a plan on what needs to be done to address identified deficiencies, including funding; and (c) develop an agreed schedule of activities to overcome deficiencies. Auditors that carry out business diagnostics and the company audits should be comprised of technically competent professionals from purchaser companies working in conjunction with experts from private sector associations, industry federations, etc. It is essential that they are sufficiently experienced in production engineering so as to enable them to quantify deficiencies in supplier companies and to put in place an integrated programme to remedy them.

43. **Technology transfer.** In the case of technology acquisition, an existing technology is identified and a technology transfer arrangement is put in place. In the case of technical assistance, support is delivered through advice from companies and/or persons familiar with the technology being developed in the company. There are mainly two ways in which this can be carried out: technical staff from the supplier company can spend time in the purchasing company in order to understand exactly what standards and specifications are required and why, and technical staff from the purchasing company can work with the staff in the supplier company.

44. **Training.** The enhancement of skills, both for management and operatives, is an important programme's element and can be ensured either through formal training by BDS institutions, or through the temporary placement of supplier company staff in a purchasing company. In particular, it is through global supplier programmes that the managerial attitudes and the behavioural skills of SMEs owners can be trained in order to meet the requirements of a large corporate culture. Once established, the deepening and consolidation of existing linkages can be facilitated through the provision of special support services. Such support services may include advice on how they can best target the activities they wish to enter and the functions they wish to upgrade; the information, consultancy and training on available technology and adaptation; (c) training and specialized education in more advanced, high-value added activities such as design, etc.

45. **Finance.** The ability to provide some form of preferential access to finance will be a requirement of the linkage programme. Experience has shown that supplier companies involved in a linkages programme need funding to meet several objectives, namely to purchase new technology; pay staff wages while on training; pay for skills training visits to sectoral trade fairs in other countries; purchase new equipment; extend premises, and/or increase their working capital. In many cases, linkages programmes provide financial support to assist supplier companies undertake these expenses. Funding can be made available through a number of mechanisms, such as loans at preferential rates, loans at normal market rates, funding through a revolving fund, grants or other subsidies. For example, in Ireland, the State agency charged with the task of promoting indigenous industry – Enterprise Ireland – provides grants (non-interest bearing and non-refundable finance) to help companies acquire the fixed assets deemed necessary. In addition grants are also given to offset the costs of training both management and operatives.

3. Conclusions

46. The analysis of successful cases in countries such as Ireland, Malaysia or South Africa, demonstrates that it is important to embed business linkage programmes into a comprehensive strategy for industrial development (UNCTAD, forthcoming). Evidence shows that not all developing countries have been as successful at embedding foreign TNCs into the local economy through linkages. Several countries have prospered on the back of proactive linkage programmes, but for many others the evidence of linkages from inward investment has often been scarce.

47. The creation of TNC-SME linkages is, in fact, neither easy nor automatic. According to UNCTAD, the single most important host country factor influencing linkage formation is the availability of local suppliers with competitive costs and quality (UNCTAD, 2001). Local suppliers development can be supported by special programmes, but it is important to recall that their competitiveness is also dependent on a favourable enabling environment comprising broader policy, economic, social and cultural aspects. Therefore, the

role of government and of donor agencies is critical in facilitating the establishment of business linkage programmes. The areas where their involvement is particularly required include awareness-building, ensuring the commitment from other key partners, liaising with other stakeholders, and coordinating all the aspects of the programme.

48. It is also important to understand that no two linkage programmes are ever the same. Local conditions are always different and it is always necessary to undertake a detailed review of both the supply and demand sides of the equation, as well as the support systems available through NGOs, the government, donor agencies and the private sector. Only when an exhaustive study has been carried out of the local situation can a linkage programme be designed to meet a specific country needs.

49. It is also important to be aware that, once the programme is installed, it is necessary to keep reviewing the rationale and mechanisms of a linkage programme to ensure that they are still relevant and effective. Most linkage programmes evolve over time in order to meet changing market conditions. In some cases this will involve a complete rethinking of the basis for the programme, as was the case in Ireland, where the focus changed from a classic backward linkage programme to identifying potential suppliers in low-cost countries.

50. It is expected that during the discussions, experts will share their views on existing practices in the area of TNCs-SMEs business linkages to identify key success factors and risks to be considered by developing countries for the establishment of sustainable business linkage programmes as an effective tool to strengthen their productive capacity, particularly in the SME sector. The following issues have been identified for the experts to discuss:

- What policies can support the development of sustainable business linkages?
- How can governments assure consistency between business linkage promotion and other private sector development initiatives?
- What are the key success factors of successful business linkages programmes?

ANNEX TABLE. Possible programme execution schedule

No.	Activities
1	Improve the business environment for linkages
1.1	Review existing policies and strategies
1.2	Formulate recommendations on policy improvements and incentives
1.3	Discuss with principal stakeholders to secure commitment on implementation of recommendations
1.4	Publish recommendations and use results in attracting FDI
1.5	Pursue adoption of policy framework through advocacy
2	Motivate, through linkage promoters, foreign affiliates to establish new/ deeper business linkages
2.1	Motivate foreign affiliates
2.2	Conduct linkage scoping surveys in different regions serving as a basis for linkage plan
2.3	Build understanding of TNCs supply chains, fine-tune methodology on brokering business linkages
2.4	Meeting with TNCs and SMEs to identify needs and obstacles
2.5	Establish business linkages
2.6	Assign managers as linkage promoters to assist SMEs
2.7	Give production servicing opportunities to SMEs
2.8	Provide feedback to SME partners
2.9	Assess progress together with SMEs
2.10	Involve SMEs in a process of continuous improvement
2.11	TNC share market information and strategy with SMEs
2.12	Provide SMEs with additional business opportunities
2.13	Encourage SME partners to diversify their customer base
3	Strengthen the capacity of local BDS providers to upgrade SMEs
3.1	Provide training to staff from BDS providers on business linkages
3.2	Adapt develop core competency courses for SME partners
3.3	Assist TNCs in indemnification of suitable SMEs
3.4	Assist SMEs in the formulation of their linkage plans
3.5	Assist SMEs in the implementation of linkage plans
3.6	Provide basic individual consultancy
3.7	Remedy production and process related deficiencies
4	Share best practices in business linkages
4.1	Identify most effective means in establishing business linkages
4.2	Disseminate information on best practices nationally and internationally
4.3	Secure foreign affiliates' commitment to the business linkage project
4.4	Include business linkage information in investor targeting material
4.5	Document key lessons and experiences for dissemination

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