Small Scale Enterprise Development and Foreign Direct Investment in Africa

CHALLENGES AND OPPORTUNITIES

United Nations
Office of the Special Adviser on Africa

Acknowledgments

The study has been prepared by Jeya Wilson. It has benefited from useful comments and suggestions of Katrin Toomel. The work was carried out under the overall direction and guidance of David Mehdi Hamam.

TABLE OF CONTENTS

TABLES

FIGURES

EXECUTIVE SUMMARY

The inflow of foreign direct investment (FDI) and the development of small scale enterprises (SMEs) are both essential driving forces for economic growth in Africa. This paper considers both elements and assesses the nature of the relationship between the two. In so doing, it seeks to establish the requirements that are necessary for FDI to have an impact on SME development, and in particular the role of governments and TNCs. Clusters, local content, capacity building and skills training are seen as effective strategies for SME development. TNC-SME linkages are the optimal strategy for ensuring transference of the benefits of FDI to SMEs, and they bring benefits to TNCs as well.

To be successful, these strategies require input from all stakeholders: from TNCs, the willingness to integrate local suppliers into their global value chains; from SMEs the commitment to attain and sustain global standards; from host governments, the willingness to provide the necessary infrastructure, invest in skills and technology training, and create an appropriate regulatory environment for TNC-SME linkages. Only through a combination of such inputs can small scale enterprises in Africa develop and become competitive in the global market.

LIST OF ABBREVIATIONS

AfDB	*African Development Bank*
DFID	*Department for International Development (UK)*
FDI	*Foreign Direct Investment*
GDP	*Gross Domestic Product*
GNI	*Gross National Income*
GTZ	*Deutsche Gesellschaft für technische Zusammenarbeit*
HDSA	*Historically Disadvantaged South African*
IFC	*International Finance Corporation*
IPR	*Intellectual Property Rights*
LDC	*Less Developed Countries*
M&As	*Mergers and Acquisitions*
NEPAD	*New Partnership for Africa's Development*
NGO	*Non-Governmental Organization*
NSD	*National Suppliers Development Program (Egypt)*
OECD	*Organization for Economic Cooperation and Development*
OSAA	*Office of the Special Adviser on Africa*
SMEs	*Small and Medium Enterprises*
TNC	*Transnational Corporation*
UNCTAD	*United Nations Conference on Trade and Development*
UNDP	*United Nations Development Programme*
UNIDO	*United Nations Industrial Development Organization*
USAID	*United States Agency for International Development*

INTRODUCTION

It is a generally accepted tenet of international development that small scale enterprises (also referred to as SMEs)[1] play an important role in alleviating poverty, especially in Africa. Programs addressing African development have identified private sector development, and in particular small scale enterprise development as a priority area for action[2]. There have been a number of small scale enterprise development programs over the years. Some have evolved from the relationships established with transnational companies (TNCs) and private sector initiatives, while others have been driven by governments, multilateral and donor agencies.

The global investment scene has witnessed a sea change in the past decade. The size, scope and methods of foreign direct investment (FDI) have changed dramatically in response to factors such as technological advances, privatization, changes in the capital markets, and the growing liberalization of the regulatory environment governing investment. FDI is a key factor in global economic integration and the internationalization of business. For the TNC making the investment, it can provide resources, new markets, greater efficiency and cheaper production facilities. For the host country that receives the investment, FDI provides a source of new technologies, processes, products, capital, and management skills. For small scale enterprises, FDI represents access to markets, access to expertise and most of all access to technology.

As SMEs in themselves cannot attract FDI, these inflows do not automatically result in small scale enterprise development. Neither do TNC-SME linkages develop simply because there is investment by a TNC. As a case in point, in East Africa only 10 per cent of major contracts are awarded to domestic firms even though 90 per cent of total registered engineering firms are local[3]. Rather, for SME development to take place requires the intervention and the input of all stakeholders: the supportive policies of the host government; the willingness of TNCs to open their global value chains to local firms; and the preparedness of SMEs to supply world class products.

This paper regards small enterprises or SMEs as relative terms that cover a wide range of formal and informal businesses. However, given the difficulty of obtaining data on the informal sector and the lack of any evidence to indicate that FDI impacts directly on the informal sector, this paper focuses only on the formal sector.

Although FDI in its classical definition occurs when a company from one country makes a physical investment in another country, the definition has now been broadened to include many forms, such as the direct acquisition of a foreign firm, construction of a facility, investment in a joint venture, or a strategic alliance with a domestic company. However, it is usually accepted that an investor has to acquire at least 10 per cent equity for it to be recognized as a direct investment enterprise[4]. FDI can take several forms: the purchase of an existing firm through a merger or acquisition (M&A); a start up project; a joint venture with local partners; or partial acquisition through licensing agreements.

Material for this paper is drawn from a range of secondary sources with the caveat that data relating to FDI and SMEs are not readily available and not always consistent[5]. As this paper's prism is on the impact of FDI on the African economy in general, and small scale enterprises in particular, the assessments are focused mainly on the economic aspect, and not on issues such as gender equity or the environmental consequences of FDI.

The paper is in three parts. The first part analyses the FDI flows into Africa in relation to FDI globally, and in terms of the main recipients of FDI on the continent, including a sectoral analysis. The second part looks at strategies for small scale enterprise development and focuses on the role of governments and TNCs in assisting SMEs to benefit from FDI. It shows with examples, the various approaches that can be taken to promote TNC-SME linkages and have demonstrable benefits. Specific programs that develop local enterprises to be globally competitive are discussed. The paper concludes with recommendations for action to develop the small scale enterprise sector in Africa.

1 The definition of a business as a small scale enterprise or SME differs according to the source. The AfDB, for example, defines a SME as having less than 50 employees. The IFC classifies SMEs as companies with total assets of less than $15 million.

2 For example, NEPAD, IFC, UNIDO, UNDP, DFID and TICAD.

3 OSAA (2007) The Private Sector's Institutional Response to NEPAD: Review of current practices and experiences in the East African sub-region, S. 44.

4 The IMF recommends using this percentage to differentiate between direct investment and portfolio investment in the form of shareholdings. IMF Balance of Payments Manual, Fifth edition.

5 The sources include UNCTAD's World Investment Reports, World Bank surveys, Economist Intelligence Unit, UNIDO, and academic research papers.

PART I

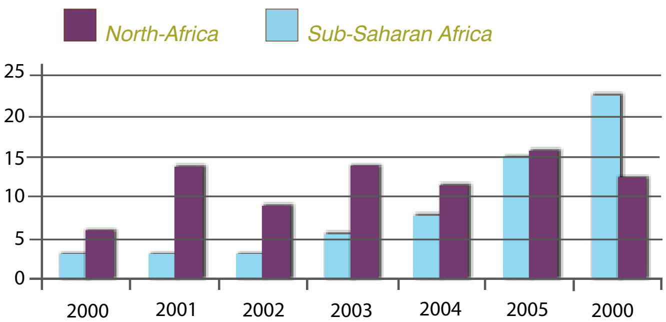
THE FDI SCENARIO IN AFRICA

In 2006, FDI inflow into Africa was at its highest at $36 billion (Table 1). Yet this was only 2.7 per cent of global FDI. As this table and Figure 1 show, although globally total FDI inflows varied considerably during the period 2000-2006, the small FDI inflows into Africa did not follow the global trend throughout this period but simply increased slowly in dollar terms. However, as Figure 2 shows, the contribution to this increase in FDI was largely as a result of investment in North Africa.

Figure 2

FDI inflows 2000-2006 Africa

(Billions of dollars)



Source: Generated from data in Economist Intelligence Unit (2006) World Investment Prospects to 2011

Table 1

FDI inflows 2000-2006

(Billions of dollars)

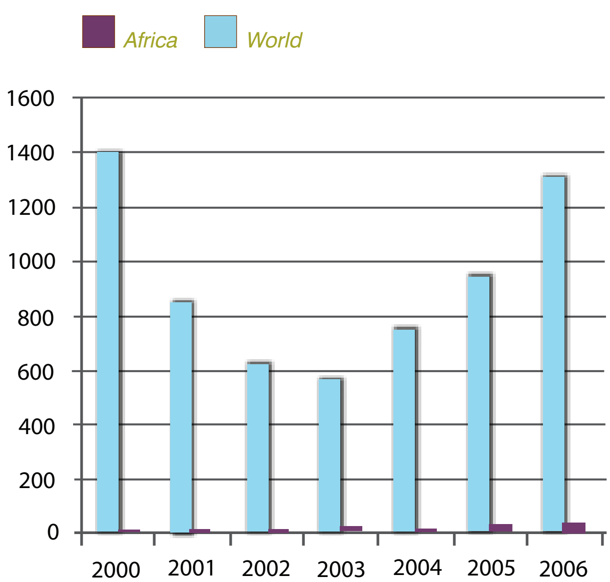
	2000	2001	2002	2003	2004	2005	2006
World ($bn)	1 408.3	851.1	618.1	557.9	742.1	945.7	1 305.9
Africa ($bn)	8.9	16.3	12.4	18.5	18.0	29.6	35.5
% world total	0.6	1.9	2.1	3.3	2.4	3.1	2.7

Source: UNCTAD World Investment Reports

Figure 1

FDI inflows 2000-2006

(Billions of dollars)



Source: Generated from Table 1

Sectoral distribution by primary, secondary and tertiary sectors[6] based on cross border M&As in the period 2003-2006 shows there are large fluctuations on a year-by-year basis in all sectors (Figure 3). Although the primary sector has traditionally been the dominant sector in Africa, the tertiary sector shows an appreciable increase during this period. This is mostly accounted for by increases in sales of financial institutions and in transport, storage and telecommunications in 2005 and 2006 as a result of sectoral liberalisation in several countries[7]. The impact of this liberalization on SME development has depended on the specific industry. For example in Egypt when, for the first time, a fully government owned bank was part-sold to a foreign entity, there was little, if any, impact on SME development[8]. By contrast, Ghana's liberalisation of allowing foreign ownership in the telecommunications industry had a direct impact on small scale enterprise development (see the example of MTN discussed in Part II.5)

A major reason for the low FDI in the secondary sector is the limited production facilities for manufacturing in many African countries. This factor has been a barrier to capitalizing on the opportunities offered by the preferential market access for textiles under the US Africa Growth and Opportunity Act, and the Everything But Arms Initiative and the Cotonou Agreement of the European Union. In Botswana, for example, where the textile sector comprises 12 per cent of the manufacturing sector and nearly 13 per cent of SMEs are textile companies; this failure has had a negative effect on small scale enterprise development[9].

6 The primary sector includes mining, quarrying and petroleum. The secondary sector covers manufacturing and includes food, beverages and tobacco, machinery, motor vehicles and stone, clay, glass and concrete products. The tertiary sector covers services and includes electricity, gas and water distribution, transport, storage and communications, finance and trade.

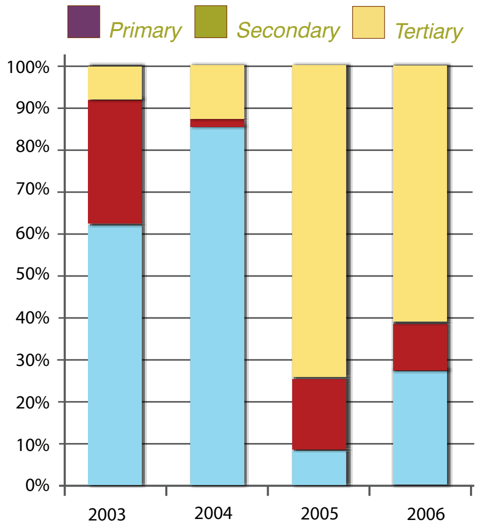
7 UNCTAD (2007) World Investment Report, p 38

8 80 per cent of the Bank of Alexandria to Sanpaolo, an Italian financial institution.

9 Mbambo B and Cronje J (2007) Learning with a Website for the Textile Industry in Botswana. Educational Technology & Society, 10 (1), pp 157-170.

Figure 3

Distribution by Sector of Cross Border M&As 2003-2006



Source: Compiled and generated from UNCTAD World Investment Reports

In the period 2003-2006, ninety per cent of FDI flows into Africa were concentrated in twelve countries (Table 2). In 2006, all six countries in North Africa received over $1 billion, making the sub-region unique in the continent. Among other factors, this is attributable to buoyant energy markets and relatively low extraction costs for hydrocarbon, large scale privatization of state owned assets, and access to EU markets[10].

Table 2

Top African FDI Recipient Countries, 2003-2006 by 2006 ranking

(Millions of dollars)

	2003	2004	2005	2006
Egypt	237	2 157	5 376	10 043
Nigeria	2 171	2 127	3 403	5 445
Sudan	713	1 511	2 305	3 541
Tunisia	821	639	782	3 312
Morocco	2 314	1 070	2 946	2 898
Algeria	634	882	1 081	1 795
Libya	143	357	1 038	1 734
Equatorial Guinea	1 431	1 651	1 873	1 656
Chad	713	495	613	700
Ghana	137	139	145	435
South Africa	720	799	6 251	- 323
Angola	3 505	1 449	- 1 303	- 1 140

Source: UNCTAD World Investment Reports data

Egypt, the largest recipient of FDI in Africa has more than 1.6 million registered SMEs, and their distribution by sector is given in Figure 4. It can be seen that the majority of SMEs are in the tertiary sector, and none in the mining sector. However, as more than 80 per cent of FDI inflows into Egypt in 2006 went into non-extractive activities, there is potential scope for small scale enterprise development in these sectors[11].

10 Economist Intelligence Unit (2007) World Investment Prospects to 2011, p 57

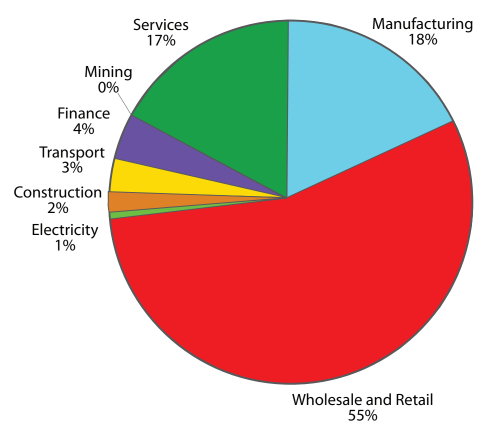
South Africa had the highest inflow of all African countries in 2005. A major contributing factor for this was the acquisition of 60 per cent of a South African bank[12]. By contrast, FDI was negative in 2006 because of the sale of foreign owned equity in gold mines to a local mining company[13]. Both these transactions have an impact on SME development because of South Africa's Mining Charter and Financial Sector Charter both of which stress the need for preferential procurement and enterprise development for small black and women-owned enterprises, referred to as "Historically Disadvantaged South African" (HDSA) companies.

Other African countries with substantial increases in FDI inflows are Burundi, Cape Verde, Djibouti, Ethiopia, Gambia, Guinea-Bissau, Madagascar and Somalia[14]. These inflows were mainly directed at new oil exploration and mining where there are limited opportunities for small scale enterprise development.

In the extractive industries, local input is minimal because of the high degree of specialization required in exploration and extraction. Downstream activities are mainly confined to refining, and local sourcing is generally limited to catering, cleaning and construction services. The opportunities for domestic SMEs to benefit from FDI are therefore very limited, and the conditions have to be proactively created for SME participation. Some of the programs that have successfully incorporated small scale enterprises into TNC value chains in the extractive sector form part of the discussion in the next section.

Figure 4

Egypt SME Distribution by Sector



Source: Compiled from Ministry of Finance, Egypt (2005) Profile of M/SMEs in Egypt. English translation. SME Development Unit.

11 UNCTAD (2007) World Investment Report, p 36.

12 ABSA, by Barclays Bank UK.

13 Sale by Canadian firm Barrick in South Deep mine and Russian firm Polyus in Goldfields

14 UNCTAD (2007) World Investment Report, pp 251-2.

PART II
STRATEGIES FOR SMALL SCALE ENTERPRISE DEVELOPMENT IN AFRICA

The biggest challenge facing small scale enterprises in Africa is the globalization of value chains with the production of goods and services increasingly fragmented across enterprises and countries. The majority of SMEs interviewed by the OECD in seven in-depth country/enterprise case studies which included two African countries - Egypt and South Africa - were not able to identify their competitive strengths within the value chain, and some explicitly pointed to the lack of time and resources to understand the evolving global context. The SMEs stated that government support was critical to facilitate their participation in global value chains[15].

Intervention by government and the cooperation of TNCs are necessary for small scale enterprises to benefit from FDI. This part looks at ways in which SMEs can be integrated into global value chains, the obstacles facing such integration, and the action that can be taken by TNCs and governments to facilitate the process.

II. 1
Providing Accurate and Accessible Data

One of the first steps to facilitate small enterprise development is for governments to take the initiative to ensure that there is reliable and detailed data on SMEs. The OECD takes the view that, given the diverse, incomplete and deficient state of SME statistics, careful analysis of the raw data is important before attempting to draw any policy conclusions. In addition, it underlines that SME statistics are a sub-set of business statistics for the economy as whole and should not be seen in isolation[16].

A research team analyzing the role of SMEs in the Egyptian economy cites the lack of available data on SMEs in Egypt as a pressing limitation. In many instances even when the data is available, it is outdated. In addition, despite a number of wide ranging SME surveys conducted by donor-funded projects, data remains inaccessible to both specialized research institutions and the public[17]. This lack of accessible and accurate data is confirmed in an UNCTAD study on South Africa that also found very little information on the nature of the contribution of the small business sector to the economy, and no statistical information on TNC-SME linkages[18].

15 OECD (2007b) Enhancing the Role of SMEs in Global Value Chains. OECD background report for OECD conference, Tokyo, 2007, p 5.

16 OECD (2004c) SME Statistics: Towards a More Systematic Statistical Measurement of SME Behaviour, p 6.

17 Ministry of Finance, Egypt (2005) Profile of M/SMEs in Egypt. English translation. SME Development Unit, p 5

18 Robbins, G (2006) Strategies and Policies on TNC: SME Linkages Country Case Studies: South Africa. A study for UNCTAD.

II. 2
Clusters and Small Scale Enterprise Development

Clusters provide small scale enterprises the opportunity to take advantage of FDI and global value chains by being able to position themselves to access capital, technology and markets. By doing so, they strengthen their comparative advantages in a sustainable manner and become attractive sites for FDI. The presence of TNCs and appropriate intervention by government become crucial in integrating clusters into global value chains[19].

Clusters are defined by the combination of two characteristics: sectoral specialization and geographical location. They allow for economies of scale and the leveraging of local comparative advantage. They develop an experienced local pool of skilled labour and a network of firms cooperating in complementary areas of specialization along cluster-based value chains. Clusters improve competitiveness by increasing the productivity of the enterprises in the cluster through product specialization and collective efficiency, and they foster teamwork and cooperation as enterprises in a cluster see themselves as being interdependent as allies with a shared vision and goal.

The potential as well as the challenges of clusters are seen in the overview of 11 enterprise clusters in the Annexe. The automotive cluster at Nnewi in Nigeria is one of these clusters[20]. It is made up of four villages, with each village hosting a number of automotive spare parts manufacturing firms of varying sizes. There is a total 85 firms with an average of 12 employees. Over the years, Nnewi entrepreneurs developed close links with automotive spare part producers and wholesalers in Asian countries. These links proved invaluable when Nnewi traders began to develop their own production activities and were able to obtain detailed advice and other technical assistance from their Asian suppliers on the type of machinery and other technologies they should acquire and the specific skills needed to operate these efficiently[21].

The Nigerian government has not, however, given the level of government support that the cluster requires. In a survey among the firms in the cluster where various government policies were examined, less than seven percent of the firms indicated that there was sufficient support from government for the needs of the cluster such as water, electricity, transport, IT and the protection of intellectual property rights (IPR)[22]. The role of trade and manufacturing associations has been crucial in the absence of effective government support, particularly the Nnewi Chamber of Commerce and the Nigerian Association of Small Scale Industries.

19 Zeng, DZ (2006) Knowledge, Technology and Cluster-based growth in Africa," World Bank Institute, April 2006

20 Abiola, B (2006) "The case study of Nnewi auto parts cluster in "Nigeria," World Bank Institute, and Zeng, D Z (no year given) African Experience in Cluster Development. World Bank Institute, ppt.

21 Abiola, op. cit, p 21.

22 ibid, p 17.

In Kenya, the government has deliberately chosen to limit its role in the cut flower cluster which has 5 000 to 6 000 small scale growers and 85 large growers. This cluster has six per cent share of the world market in cut flowers[23]. The government's role here stands in contrast to its historical role in the coffee industry where marketing boards and centralized cooperatives run by the government limited the competitiveness of the coffee industry[24]. In the case of the cut flower cluster, the government set up a specialized agency[25] to promote and facilitate the industry, and made floriculture a priority sector. It created an enabling business environment, enacting laws to protect IPR with regard to new plant varieties, promoting quality standards and providing incentives for exports. Direct involvement, however, has been minimal and this "hands-off" approach has encouraged private sector growth and development[26]. Small scale floriculturists have, however, requested government intervention in diversifying export destinations and becoming part of an integrated supply chain in preference to an ad hoc value chain supplying the Dutch auction system in which they currently operate. They also need assistance in incorporating technology and tougher environmental standards into production practices.

II. 3

Local Content and its Impact on Small Scale Enterprise Development

The efforts and initiatives by African countries to develop industry clusters around TNC-based mineral extraction have met with only limited success. To remedy the situation, the level of local content is often specified in contracts, with TNCs being asked to specify how they plan to increase such content, with the percentage of local products or services, such as automotive components for TNC assembly plants, being measured either in terms of volume or value[27]. From the 1960s, the Nigerian government attempted to increase local content, but the level remained around five per cent from the 1960's to 2006. In a further attempt to foster linkages between TNCs and local firms, a target of 45 per cent local content was set for oil-related projects by 2006 and 70 per cent by 2010. However, Nigeria has not yet reached 20 per cent local content according to one source, although the official figure is currently given as between 33 and 35 per cent[28]. The reason given for not reaching the target is the lack of Nigerian companies with the required capabilities and technical skills[29]. Hence it is evident that to attain high levels of local content requires the development of local suppliers who can add value, and that this cannot happen by decree alone.

23 Hornberger, K et al (2007) Kenya's Cut Flower Cluster. Harvard Business School, p 15.

24 ibid, p 23.

25 The Horticultural Crops Development Authority.

26 Zeng, D.Z (2007) African Experience in Cluster Development. World Bank Institute.

27 Discussed in detail in Black, A and Bhanisi, S (2006) "Globalisation, Imports and Local Content in the South African Automotive Industry, Accelerated and Shared Growth Conference 2006.

28 Reported in Nigeria's business paper "This Day" 12 November 2007.

29 ibid.

The South African government has had greater success with the Petroleum and Liquid Fuels Charter which sets a target for HDSA companies to own 25 per cent of the total equity in the operating assets of the oil sector by 2011[30]. To achieve this target, the government has put several interventions in place. These include: compiling and updating a list of HDSA suppliers; requiring all licensees to contribute funds toward an "Upstream Training Trust" to fund skills development strategies for HDSAs; promoting HDSA companies as joint venture partners in expansion or upgrades by TNCs in the oil sector; and encouraging the involvement of small scale HDSA companies in marketing and distribution because entry costs are lower than in exploration or refining and there is an immediate, regular cash flow.

II. 4

Skills Development and Capacity Building for Global Competitiveness

To survive international competition, SMEs require the management skills and production expertise to be able to match product quality requirements of TNCs and to scale up quickly. The availability and quality of domestic suppliers is a key determinant to participation in TNC global value chains[31].

The Egyptian government, in partnership with the private sector, set up the National Suppliers Development Program aimed at making hundreds of small suppliers globally competitive. Through this initiative, the Government provides active support in turning enterprises currently supplying the domestic market into outward-oriented suppliers with a firm foothold in an existing global supply chain. The programme assists firms to improve quality and lower production costs in order to be competitive in the globalized market. Both UNCTAD and the American Chamber of Commerce Egypt note that the Government's initiative is an example of how a country can attract FDI without risking the demise of local producers, and that without this type of programme, Egyptian producers, like many other African producers, risk becoming marginalized even in their own markets[32]. Among the TNCs that have helped pioneer projects under the program are General Motors, which owns Egypt's largest vehicle assembly plant, DaimlerChrysler, Americana, Cadbury and Hero.

The Egyptian government is also playing an active role in supporting the country's ICT sector. The initiatives include: "smart villages" which are high tech business parks that provide enterprises with world class infrastructure at a reasonable cost; subsidies for training, marketing and technological development; and partnerships with TNCs such as Siemens, Alcatel and Cisco to training ICT graduates[33].

30 Charter for the South African Petroleum and Liquid Fuels Industry on Empowering Historically Disadvantaged South Africans in the Petroleum and Liquid Fuels Industry

31 UNCTAD (2001) World Investment Report, p xxiii

32 UNCTAD (2006) World Investment Report, p 47; AmCham Egypt Bulletin, November 2006.

33 UNCTAD (2007c) Enhancing the Participation of Small and Medium Sized Enterprises in Global Value Chains, Note by the UNCTAD Secretariat, p 12.

The government initiatives are paying dividends with SMEs in the ICT sector. Small scale enterprises supplying Microsoft Egypt have been able to leverage the reputation of their lead partner through the "lighthouse effect" of having credibility bestowed by a global player. SME suppliers that are certified Microsoft Gold Partners have used the Microsoft network for other projects both in Egypt and in the region[34]. At the same time the supplier network assists Microsoft with new market entry and local credibility.

Part of the South African government's intervention in the oil sector is through the Sector Education and Training Authority, which is a statutory body that operates in 23 sectors and was relaunched in 2004 to respond to evolving skills needs. In addition, the Small and Medium Enterprises Development Program (SMEDP) was complemented by the Skills Support Program in 2005 as a shortage of skilled labor was a serious constraint on attaining competitiveness through FDI. The program gives training and promotes the development of advanced skills for SMEs to engage with TNCs and benefit from FDI. Over 12,000 enterprises have benefited from the SMEDP. Another programme, the Workplace Challenge Programme, focuses on adopting world class manufacturing practices and assists enterprises to improve their productivity and competitiveness. Eleven clusters incorporating nearly 100 enterprises have been assisted under the program[35].

II. 5

TNC –SME Linkages and their Impact on Small Scale Enterprise Development

Linkages are a tried and tested method by which small scale enterprises can benefit from TNCs and is the predominant form of interface between the two. When a TNC invests in a country, it has three options for obtaining inputs in that country: import, produce locally in-house, or procure from a local supplier. Linkages are an optimal way for an SME to benefit as a local supplier and to meet the criteria set by the TNC. They are the strongest channel for the transference of skills, knowledge and technology from TNCs.

Anglo Zimele in South Africa is an example of a mining TNC's linkage programme. Started in 1989 as a small business initiative by Anglo American, the programme is based on the three pillars of procurement, business development and finance. Anglo American's procurement department identifies HDSA suppliers who can participate in their supply chains, and a transfer of skills transfer and strategic guidance are given to these companies. A mining fund assists small black-owned junior mining companies with funding and technical support during the typically high risk exploration and pre-feasibility phases of mining projects, bringing them to commercially bankable positions. The programme has invested in over 54 SMEs and supports over 2 000 direct jobs. An evaluation carried out in 2005, showed a survival rate of 72 per cent over eight years[36].

The significant benefits that linkages afford for both the SMEs and the TNCs are summarized in Table 3.

Table 3

Benefits Of Linkages

BENEFITS TO SMALL SCALE ENTERPRISES	BENEFITS TO TNCS
Knowledge transfer and technology upgrading	Reduction in procurement, production and distribution costs.
Skills, capacity and standards enhancement	Opportunity for corporate social responsibility combined with profitability.
Access to new markets, domestic and foreign	Local credibility and reputation.
Prospects for further FDI especially into cluster	Greater integration in domestic markets.
Diversification of customer and market structures	Increase in knowledge of and access to local consumers.
Risk-sharing through joint funding and operations	Access to new innovation
Access to finance	Import substitution and foreign exchange savings.
Opportunities to upgrade, innovate and increase competitiveness.	Greater flexibility in changes to design and production because supply is local.
More stable buyer or producer relationships	
Growth in size and turnover	

Source: Adapted from IFC (2007a) Business Linkages: Lesson, Opportunities and Challenges.

Six main types of mechanisms have been identified[37] through which TNCs partner with each other or with other stakeholders to support business linkages and SME development, often with the explicit goal of overcoming some of the obstacles faced by SMEs:

- *linkages along individual company value chains*
- *groups of companies in the same industry sector or location working collectively together*
- *traditional trade and industry associations enhancing their capacity to better serve SMEs*
- *joint public-private financing mechanisms*
- *dedicated small enterprise support centers*
- *multi-stakeholder public policy structures*

An example of an individual company's linkages contributing to SME development is MTN, a telecommunications TNC which operates in 15 African countries. MTN has extensive backward

34 OECD (2007b) Enhancing the Role of SMEs in Global Value Chains. OECD background report for OECD conference, Tokyo, 2007, p 50.

35 South Africa Yearbook 2007, Chapter 7.

36 Bickham, E (2006) Local Business Development- Anglo American's experience in South Africa, ppt.

37 Nelson J (2007) "Building Linkages for Competitive and Responsible Entrepreneurship" UNIDO and Harvard University.

and forward linkages[38] with small support companies that provide a wide platform of services to it. MTN Ghana, for instance, reaches the market through a distribution infrastructure that has 35 distributor offices, 575 sub-distributors, over 91 000 retailers and some 40 000 electronic voucher resale points. MTN Nigeria has extensive wholesale and retail distribution channels, with 161 appointed distributors and 19 451 second and third tier points[39].

TNCs can, and do, take SME development and linkage programs beyond their own value chains. Often they do this for reasons of public relations or corporate social responsibility as it demonstrates their commitment to the community, strengthens their license to operate, and gives recognition to the central role that a dynamic SME sector plays in local economic development.

Recognising that access to finance is a perennial problem for SMEs, Shell launched a fund of nearly $100.00 million in 2006, with 70% of capital leveraged from African partners, open to SMEs in all sectors in Tanzania, Kenya Uganda, Nigeria, Rwanda and South Africa[40]. As of October 2007, 59 SMEs have been financed with 33% going to start-ups. A further 492 SMEs have received business development assistance[41].

BP Tanzania chairs what is known as the Private Sector Initiative, which brings together TNCs to seek out better ways to integrate local SMEs into their supply chains. An SME supplier database of 506 Tanzanian suppliers is shared between the procurement departments of the TNCs, resulting in an expanded market and increased opportunities for the SMEs while at the same time reducing the risks associated with such transactions[42].

In Chad, ExxonMobil developed a National Content Strategy when faced with the challenge of local enterprises that were not well enough equipped to win contracts and, when they did, had difficulty sustaining acceptable performance levels. ExxonMobil collaborated with the IFC and the local chamber of commerce in overcoming the challenge, and this benefited other TNCs in Chad as well (Table 4).

A very successful public-private partnership strategy for linkage creation has been South Africa's approach to industrial development through the Motor Industry Development Program introduced in 1995. It helped establish competitive and relatively integrated linkages between motor vehicle assembly plants and local firms supplying a range of components[43]. There are now more than 220 automotive component manufacturers in South Africa, and another 150 that supply the industry on a non-exclusive basis[44].

38 Backward linkage is the use by one firm or industry of produced inputs from another firm or industry. Forward linkage is the distribution chain connecting the producer or supplier with customers.

39 and about 30 000 informal distributors, MTN Website.

40 Aspire Funds in partnership with GroFin. Shell Foundation website and 2007 Report.

41 ibid.

42 PSI-Tanzania website.

43 BMW, Daimler Chrysler, VW, Toyota and most recently Renault have assembly plants in South Africa.

44 Flatters, F (2005) The Economics of MDIP and the South African Motor Industry, Queen's University; South Africa investment website.

Table 4

ExxonMobil's National Content Strategy

LINKAGE ACTIVITY	ACTIONS	OUTCOME
Procurement	*Break up contracts into sizes more manageable for SMEs* *Introduce shorter payment cycles* *Award contracts for longer terms*	*Using local SME suppliers helps institutionalize Exxon Mobil's commitment to the community and brings a high return on reputation.*
Supplier base	*Work with external partners to develop supplier database* *Collate information on contact details, goods and services, as well as needs for over 60 potential suppliers assessed by ExxonMobil.* *Additional 1,000 SMEs surveyed by IFC and local chamber of commerce.*	*ExxonMobil has access to reliable and actionable information on local supplier base.*
Supplier development	*IFC establishes Enterprise Centre providing SME capacity building so that suppliers can qualify for participation in ExxonMobil and other TNC's value chains.* *SMEs may only bid in areas in which they have demonstrated adequate competence.*	*300 SMEs are trained, and contracts signed to the value of $22.5 million.*

Source: IFC (2007a) Business Linkages: Lesson, Opportunities and Challenges.

II.6

Meeting Global Standards: Preparedness of African SMEs for Participation in Global Value Chains

The globalization of value chains constitutes a major challenge for small scale enterprises accustomed to serving local and national markets. Meeting the strict product standards and quality required for participation in global value chains is difficult and costly.

An UNCTAD study conducted in five countries, including Uganda and South Africa, indicates that TNCs, with a few exceptions, are reluctant to cooperate with the SME sector because of shortcomings such as lack of quality, high production costs, poor reliability and a preference for cash transactions because of limited access to credit. As a result, many TNCs prefer either to import, purchase from other TNC subsidiaries, or produce in-house rather than investing in local SME linkages[45].

45 UNCTAD (2006) Promoting TNC–SME linkages to enhance the productive capacity of developing countries' firms: A policy perspective.

South African SMEs in the Toyota supply chain, however, express concern about their ability to upgrade and respond in time to deliver products that are in line with the expectations of Toyota in terms of quality, supply standards and delivery times. Their proximity to the local Toyota plant, the ability to produce a component according to specification and a history of relationship does not necessarily guarantee an ongoing relationship with Toyota.

The suppliers feel that many of the requirements are onerous and complex, and absorb administrative time but do not provide a basis to obtain a premium in prices in the automotive value chain[46]. They list among their requirements assistance from government on skills development, investment in technology development, increase in safety and security, and improved infrastructure[47].

Even when SMEs do not enter into the global value chain of TNCs with which they have linkages, they still feel compelled to conform to those international standards for technology, quality, delivery and after sales service in their particular industry. SMEs also have to adapt routines and practices developed at the cluster level to administrative and managerial practices set by international buyers. To mitigate this pressure on SMEs, governments should provide assistance by ensuring, for example, that national certification systems do not impose an excessive burden on small firms and encourage SME participation in the standard-setting process.

Business organizations such as chambers of commerce and professional associations can also help as most members of chambers are SMEs. The Zululand Chamber of Commerce in South Africa, for example, has not only worked with TNCs to develop linkages with small suppliers, but also has a system of accreditation that gives potential business partners confidence in the capabilities of accredited suppliers[48]. This is a model that could well be replicated elsewhere as it is important to map and identify the extent to which local capabilities match the input requirements of TNCs, and the scope for local enterprises to move up the value chain. Part of the exercise is technology benchmarking, providing support for global standards such as ISO certification and skills audits. Such an analysis is essential for a linkage strategy as it assists the government in the allocation of resources.

PART III

CONCLUSIONS AND RECOMMENDATIONS

There is a symbiotic relationship between the TNCs that invest in a host country and the SMEs in that country. This paper has considered the nature of this relationship from four aspects: the pattern and flow of FDI to Africa; the opportunities and challenges faced by small scale enterprises in benefiting from FDI; the response of TNCs to creating linkages with SMEs; and the role of government in assisting small scale enterprises to benefit from FDI.

FDI inflows to Africa, despite record levels, remain but a small part of global FDI. Virtually all the inflow goes to a handful of countries, the majority of which are in North Africa, and the FDI inflow to sub-Saharan Africa is abysmally low. SMEs in Africa face constraints due to a lack of skills, technology and finance, as well as a lack of economies of scale. Although this paints a gloomy picture, FDI can, and does bring an array of benefits in terms of capital, skills, technologies, processes, products, and markets. As examples in this paper have shown, SMEs have gained such benefits through linkages with the TNCs that make the investment.

The further enhancement of TNC-SME linkages, however, is contingent upon:

- The willingness of the SMEs to reach and sustain global standards.
- The willingness of the TNCs to integrate local small suppliers into their global value chains.
- The willingness of governments to create a regulatory environment that encourages small scale enterprise development, to invest in upgrading the skills and technological capabilities, and to implement policy promoting sector-specific FDI and TNC-SME link ages.

The reluctance of TNCs to engage with local suppliers is a salutary lesson for SMEs. There is an onus on SMEs that want the "Triple A" of: access to expertise; access to markets, especially international markets; and access to technology. They have to take responsibility for themselves to take advantage of the benefits of FDI, and aim at achieving global standards.

TNCs need to venture beyond their "comfort zone" supplier base, and not consider their investment exclusively in terms of low wages and low labour standards. Outsourcing non-core business to local suppliers has its own "Triple A": access to local consumers; access to local knowledge; access to loyalty. In the African context, brand loyalty often lasts a lifetime, and the return on reputation has an incalculable value. TNCs that have opened their linkage programs to SMEs in other sectors in addition to their own, as examples in this paper show, help create an environment that is ultimately in their own long term interests. In short, integration of local SMEs into TNC global value chains ought to become a business imperative.

Government intervention can take the form of different inputs. Investing in sound infrastructure such as water, electricity, roads and IT services not only attracts TNCs but also ensures that local enterprises are not at a competitive disadvantage. When a government invests in clusters and supplier development programs, and establishes training centers and programmes that provide technical assistance, skills training and capacity development, as the examples in this paper show, it assists small suppliers to upgrade skills and technology to take advantage of the benefits of FDI. Creating specialized agencies to promote

46 OECD (2007b) Enhancing the Role of SMEs in Global Value Chains. OECD background report for OECD conference, Tokyo, 2007, p 56.

47 UNCTAD (2007c) Enhancing the Participation of Small and Medium Sized Enterprises in Global Value Chains, Note by the UNCTAD Secretariat, p 9.

48 ibid

and coordinate industry development, as in the case of the cut flower industry in Kenya, establishes close communication with enterprises and clusters in growth sectors that have TNC connections.

When governments are sector-specific in attracting FDI there are benefits to be gained, as the ICT sector in Egypt and the automotive sector in South Africa demonstrate. Even in the extractive sector, which is arguably the most difficult sector for SME linkages, the South African industry charter shows the positive impact when there is local content reservation for SMEs belonging to a designated group, as long as there is sufficient capacity and skills to meet the requirements of global value chains. Tax and other incentives such as a quid pro quo agreement, whereby TNCs are encouraged to work with local firms in return for certain concessions, also help in encouraging and supporting TNCs to establish linkages with SMEs within their own value chain and beyond.

African governments need to capitalise on the opportunities for continental and regional integration. One of the disincentives for investment is the small size of many African markets and the lack of integration between them. UNCTAD notes that, apart from a few countries such as Egypt and South Africa, African countries generally lack linkages between TNCs and local enterprises, and efforts to promote regional integration have been too limited to allow economies of scale. As a result, SMEs are unable to participate competitively in the international production networks of TNCs[49]. Assisting enterprises to meet global standards through defining sectoral standards, policies and regulations would ensure better integration with the global economy. It would also facilitate greater FDI which, if correctly targeted, act as a catalyst for small scale enterprise development

With global integration, the protection of IPR is an increasingly important area in TNC-SME linkages, as technology transfer is not only from TNC to SME but can flow in the other direction as well. The OECD Guidelines at present refer only to the transfer of technology and the need for protection of IPR from TNCs to other partners, as it is assumed that TNCs are the main conduit of technology transfer across borders[50]. Governments should, as a matter of priority, include protection for technology transfer from SMEs to TNCs, as inadequate protection of IPR can inhibit the incentive to innovate and have negative consequences for small scale enterprise development.

Business organizations play a critical role, as do multilateral and donor agencies, in small scale enterprise development. The inclusion of business organizations as a key stakeholder improves the advocacy and representation of the interests of SMEs. As an intermediary, business organizations give SMEs a stronger voice and promote the requirements of small businesses with policy makers, especially with regard to legal and regulatory reforms. From the perspective of multilateral agencies and donor countries, the international agenda on FDI and small scale enterprise development is a complex one with a plethora of programs[51]. The challenge lies in the monitoring and evaluation of business linkage activities, as the metrics are not always congruent in terms of the business impact on the one hand, and the development impact on the other. The agencies also need to expand, refine and reconcile their existing databases on FDI and SMEs, especially where there are discrepancies within the same study or between different studies, as ensuring the reliability and accuracy of data enables policy decisions to be made on a more informed basis.

FDI measurement needs to be based not only on quantitative values but also on quality. This concept of quality ought to incorporate not only job creation and technology transfer but importantly the long term commitment of a TNC and the extent to which it establishes mutually beneficial linkages with local suppliers. In such a qualitative approach, value should be imputed to the extent of the interaction, and networking with domestic enterprises, and the opportunities that are created through the partnership for innovation and value added functions as demonstrated in the case of Microsoft Egypt.

The task of ensuring that the increase in FDI in Africa translates into tangible small scale enterprise development does not rest with TNCs, governments, SMEs or multilateral agencies alone. It is only when collective responsibility is taken that the developmental goals of African governments and the business goals of TNCs can become congruent and small scale enterprises truly benefit.

49 UNCTAD (2006) World Investment Report, p 45.

50 Section VIII Science and Technology, OECD Guidelines for MNEs, Revision 2000, cited in ibid, p 7.

51 Including, the IFC's Business Linkages Program and its Private Enterprise Partnership for Africa, UNDP's Growing Sustainable Business initiative, and UNCTAD's Business Linkage Initiative. GTZ, DFID, USAID and most donor agencies have small business development initiatives in one form or another. NEPAD has private sector development at the core of the implementation of its projects, and both the-Africa-Asia Business Forum and the Tokyo International Conference for Africa's Development have sought to boost the expansion of investments by Asian firms.

ANNEX

Overview of sample enterprise clusters

CLUSTER	COUNTRY	NO. OF FIRMS	FIRM SIZE (NO. OF EMPLOYEES	PRODUCTS	MAJOR CHALLENGES
LAKE VICTORIA	Uganda	17 fish plants	not available	Fish production and processing	Falling fish stock and EU quality standards
MWENGE	Tanzania	2 200	15 – 20	Handicrafts	Lack of finance, weak firm capacity, weak public institutions and infrastructure
KEKO	Tanzania	2 – 130	not available	Furniture	Weak infrastructure, lack of technological support and access to finance
NNEWI	Nigeria	85	<12 average	Auto parts	Asian competition and poor public goods
OTIGBA	Nigeria	+5 000	8 average	Computer hardware	Lack of capital, especially long-term financing, vulnerability to foreign exchange and import duties
KAMUKUNJI	Kenya	+2 000	1 - 2	Metalwork	Over-congestion of micro enterprises and low entry barrier; Weak linkages to knowledge institutions and weak infrastructure support
LAKE NAIVASHA	Kenya	24	250 – 6 000	Cut flowers	Resource depletion Environmental pollution
SUAME MAGAZINE	Ghana	+9000	5 – 10	Manufacture and vehicle repair	Lack of effective dissemination of R&D to firms and inadequate physical infrastructure
MAURITIAN TEXTILE AND CLOTHING	Mauritius	260	170 average	Textile and clothing	Increasing labour costs; low productivity and international competition
SOUTH AFRICA WINE	South Africa	+340 wineries	not available	Wine	Lack of effective marketing and branding strategy and expertise, financial constraints for small producers
WESTERN CAPE	South Africa	327	103 average	Textile and clothing	Increasing labour costs; lack of innovation in both product and process; international competition

Source: "Knowledge, Technology and Cluster-based growth in Africa," Douglas Zhihua Zeng, World Bank Institute, April 2006

REFERENCES

Abiola, B (2006) "Knowledge, Technology and Growth: The Case Study of Nnewi Auto Parts Cluster in Nigeria, WBI Africa Cluster Case Study.

AmCham Egypt (2005) Bulletin, 1 November 2005.

Banco de Espana (2003) "Definitions of foreign direct investment: a methodological note."

Bhaumik, S K and Gelb, S (2004) "Determinants of MNC's Mode of Entry to Emerging Markets: Some evidence from South Africa and Egypt." Queen's University and Edge Institute.

Bickham, E (2006) Local Business Development- Anglo American's experience in South Africa, ppt.

Black, A and Bhanisi, S (2006) "Globalisation, Imports and Local Content in the South African Automotive Industry, Accelerated and Shared Growth Conference 2006.

Broadman, H (2007) "Africa's Silk Road: China and India's New Economic Frontier, World Bank.

Deloitte (2004) "Partnerships for Enterprise Development" prepared for UNIDO, UNDP and the Global Compact

Economist Intelligence Unit (2007) World Investment Prospects to 2011.

Flatters, F (2005) The Economics of MDIP and the South African Motor Industry, Queen's University.

Hilmi, N et al (2007) Multinational firms' foreign direct investment. Hedge Fund Research Institute Working Paper, March 2007.

Hornberger, K et al (2007) Kenya's Cut Flower Cluster. Harvard Business School.

IFC (2005) The Private Enterprise Partnership for Africa. IFC's technical assistance strategy for private sector development in Africa.

IFC (2006) Micro, Small and Medium Enterprises: A collection of published data.

IFC (2007a) Business Linkages: Lesson, Opportunities and Challenges.

IFC (2007b) Creating Opportunities for Small Business.

Kauffmann, C (2005) Financing SMEs in Africa. OECD Development Centre Policy Insights No 7.

Klein, M et al (2001) Foreign Direct Investment and Poverty Reduction, Policy Research Working Paper, World Bank.

Kozak, R (2007) "Small and Medium Forest Enterprises: Instruments for Change in the Developing World," University of British Columbia.

Mbambo B and Cronje J (2007) Learning with a Website for the Textile Industry in Botswana. Educational Technology & Society, 10 (1).

Ministry of Finance, Egypt (2005) Profile of M/SMEs in Egypt. English translation. SME Development Unit.

Nelson, J (2007) "Building Linkages for Competitive and Responsible Entrepreneurship" UNIDO and Harvard University.

OECD (2004a) Proceedings of Conference of Ministers responsible for Small and Medium size enterprises, Istanbul.

OECD (2004b) Strengths and Weaknesses of SME statistics: The Users' Perspective.

OECD (2004c) SME Statistics: Towards a More Systematic Statistical Measurement of SME Behaviour.

OECD (2005) Encouraging Links between Small and Medium sized companies and Multinational Enterprises.

OECD (2007a) Compendium II on SME and Entrepreneurship.

OECD (2007b) Enhancing the Role of SMEs in Global Value Chains. OECD background report for OECD conference, Tokyo, 2007.

OSAA (2006) The Contribution of the Private Sector to the Implementation of NEPAD.

OSAA (2007) The Private Sector's Institutional Response to NEPAD: Review of current practices and experiences in the East African sub-region.

Page S and Te Velde, D W (2004) Foreign Direct Investment by African Countries, prepared for InWent/UNCTAD.

Robbins, G (2006) Strategies and Policies on TNC=SME Linkages Country Case Studies: South Africa

Shell Foundation Report 2007.

South Africa Yearbook 2007

This Day, Nigeria, 6 December 2006 and 12 November 2007

UNCTAD (2001, 2006, 2006, 2007) World Investment Reports.

UNCTAD (2005), "Economic Development in Africa: Rethinking the role of Foreign Direct Investment."

UNCTAD (2006a) Promoting TNC–SME linkages to enhance the productive capacity of developing countries' firms: A policy perspective.

UNCTAD (2006b) FDI in Least Developed Countries at a Glance: 2005/2006.

UNCTAD (2006c) "Developing Business Linkages." Note by the UNCTAD Secretariat.

UNCTAD (2007a) "Enhancing the participation of small and medium sized enterprises in global value chains." Note by the UNCTAD Secretariat.

UNCTAD (2007b),"Report of the expert meeting on increasing the participation of developing countries' SMEs in global value chains", Expert meeting on increasing the participation of developing countries' SMEs , Geneva, 18–19 October 2007.

UNCTAD (2007c) Enhancing the Participation of Small and Medium Sized Enterprises in Global Value Chains, Note by the UNCTAD Secretariat.

UNDP (2004) Unleashing Entrepreneurship: Making Business Work for the Poor.

Verick, S (2006) The Impact of Globalisation on the Informal Sector in Africa, Economic Commission for Africa.

Warner, M (2007) Enhancing Economic Performance in the Extractive Industries Sector. Briefing Note 9, Overseas Development Institute.

Zeng, D Z (2006) "Knowledge, Technology and Cluster-based growth in Africa, World Bank Institute Development Study.

Zeng, D Z (year not given) African Experience in Cluster Development. World Bank Institute, ppt.

Office of the Special Adviser on Africa
Tel.: 212 963 3461 | Fax: 212 963 3892
www.un.org/africa/osaa

09-25693 — May 2009 — 300