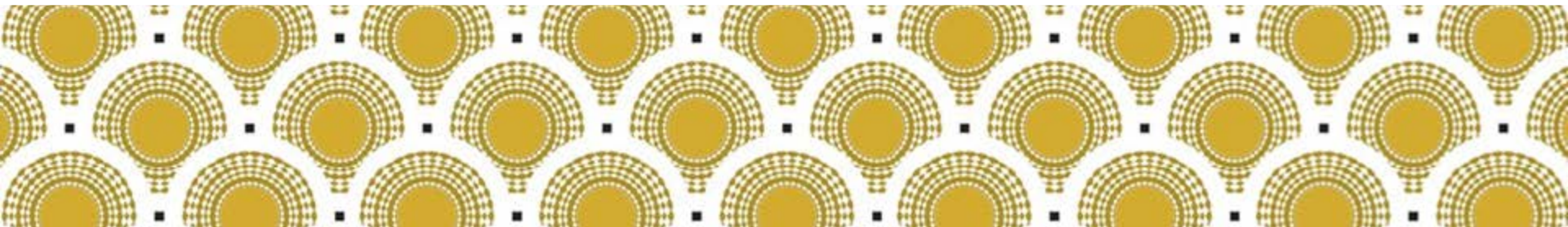




LINKING DOMESTIC FIRMS TO FOREIGN INVESTORS:

Recent evidence from the ASEAN

Tokyo, 28 May 2019



Outline

- Why study linkages with FDI?
- What is the state of FDI linkages in ASEAN?
- How do domestic firms (SMEs) benefit from FDI?
- How can policy enable SMEs to benefit from FDI?
- Key messages

1. WHY STUDY LINKAGES WITH FDI?

GVCs offer an opportunity for SME development

- **SMEs in ASEAN context:**
 - Most prevalent form of enterprise (98%)
 - High contribution to employment (>60%)
 - Low productivity and contribution to value added (<30%)
- **SME-specific constraints:** small size, limited knowledge and lack of experience prevent economies of scale and access to strategic assets
- **GVCs**, via FDI, can provide a channel to **relax SME constraints:**
 - new markets, technologies and know-how, capital, and high-quality inputs and services
- In turn, SMEs become more productive and generate more value added

GVC participation involves multiple channels

1

How can SMEs participate in GVCs?

	Backward linkages	Forward linkages
Trade linkages (direct & indirect)	Import inputs	Export outputs
Domestic linkages with foreign investors	Source inputs from foreign MNEs	Supply outputs to foreign MNEs

2

How can SMEs upgrade to higher value added activities?

Strengthen GVC integration through:

- **Deepening linkages (partnerships)** with foreign MNEs established domestically

3

How can SMEs grow and remain competitive?

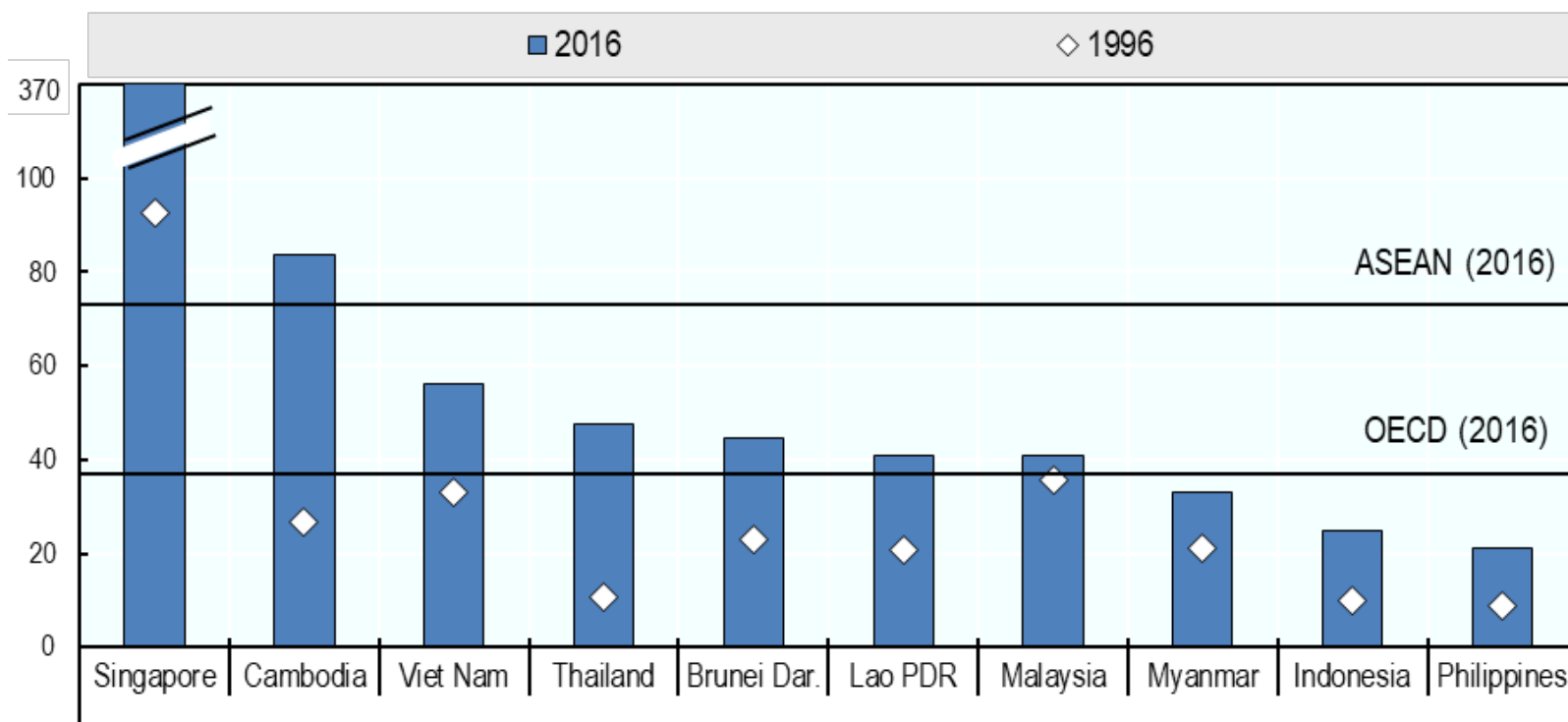
Ensure long-term competitiveness via:

- Engaging in **outward FDI and partnering** with foreign MNEs abroad

2. WHAT IS THE STATE OF FDI LINKAGES IN ASEAN?

FDI has expanded faster than GDP over the last two decades

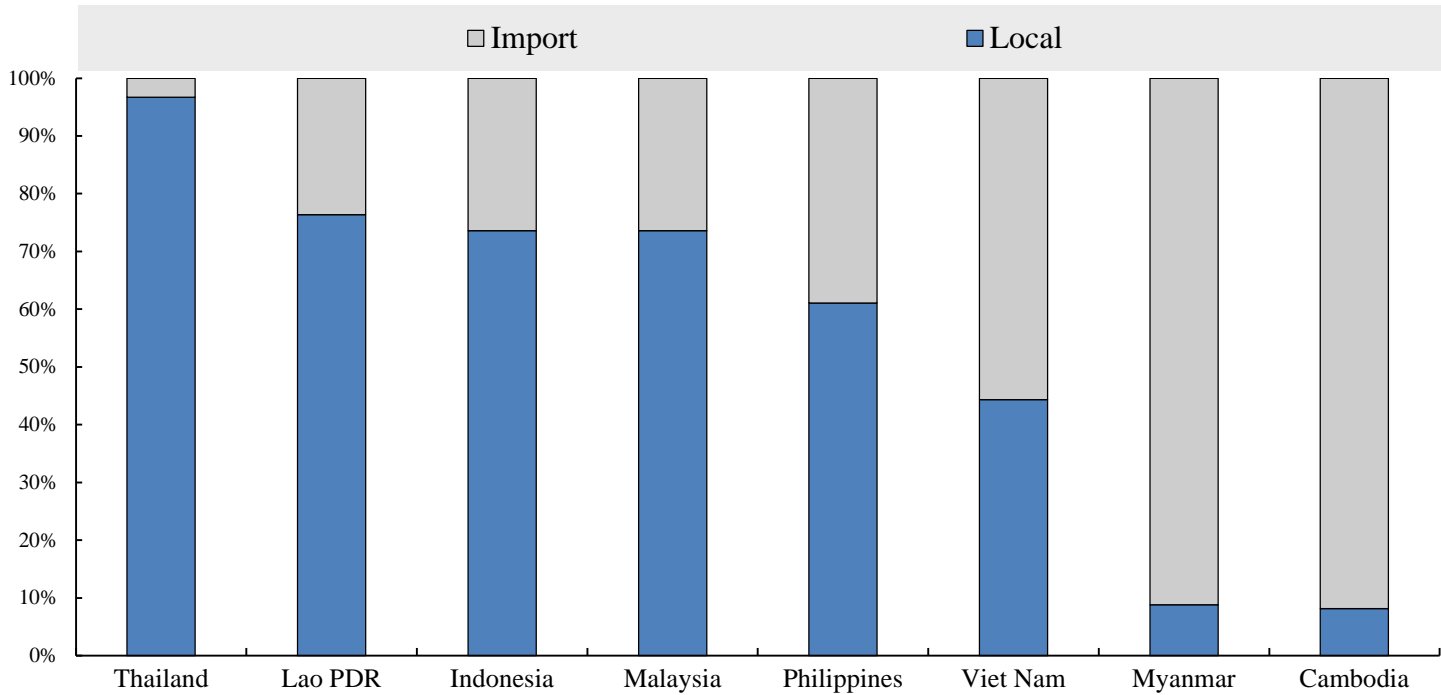
Inward FDI stocks relative to GDP (in %)



Source: UNCTAD FDI statistics

Foreign manufacturers are embedded within host countries

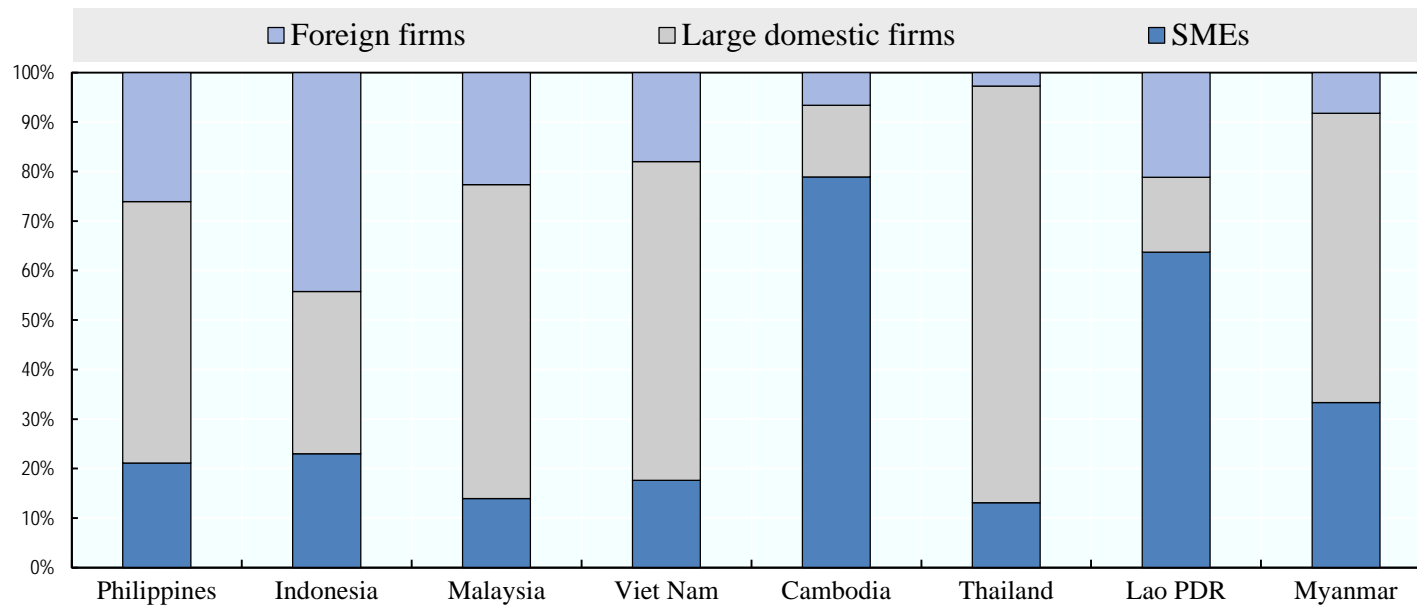
Output-weighted share of local sourcing by foreign manufacturers



Source: OECD-UNIDO based on World Bank Enterprise Surveys

Foreign multinationals source from ASEAN SMEs

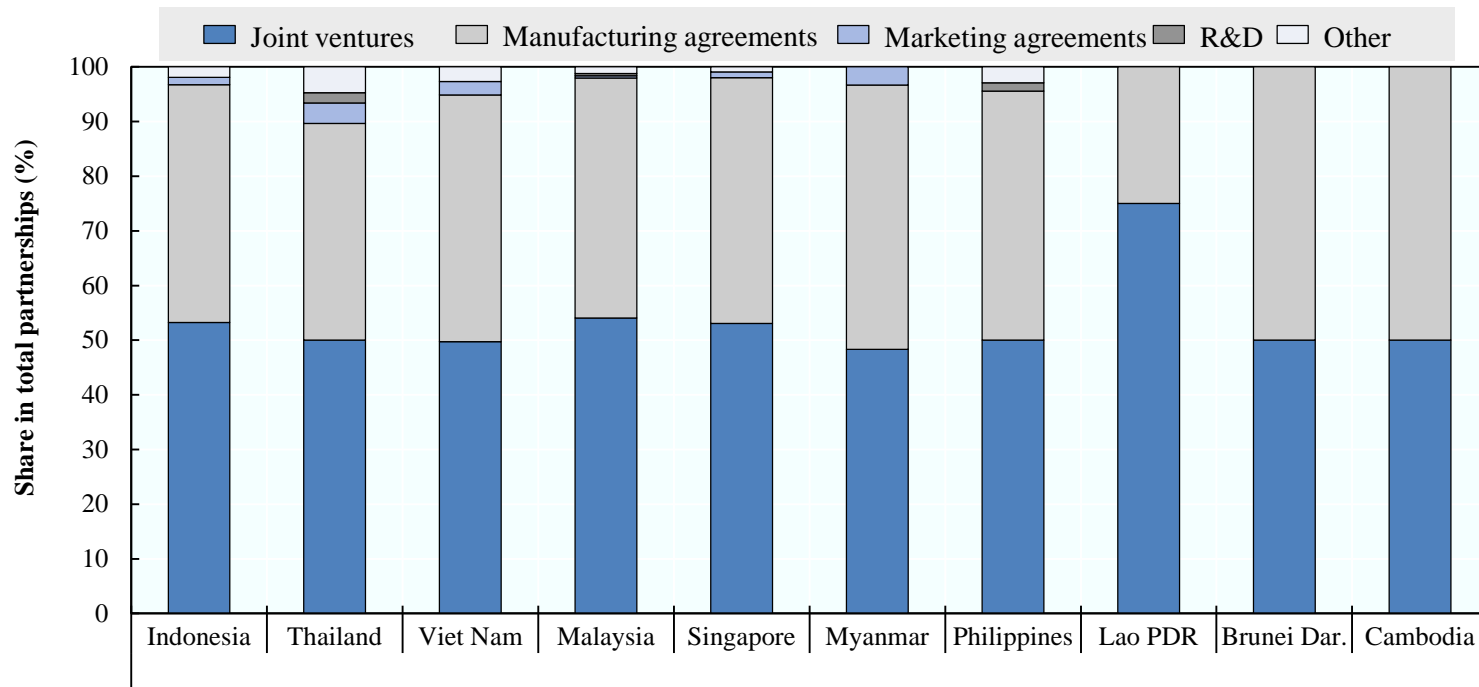
Foreign manufacturers purchases of locally-produced intermediates, by supplier



Source: OECD-UNIDO based on World Bank Enterprise Surveys

Inter-firm partnerships are common in ASEAN manufacturing

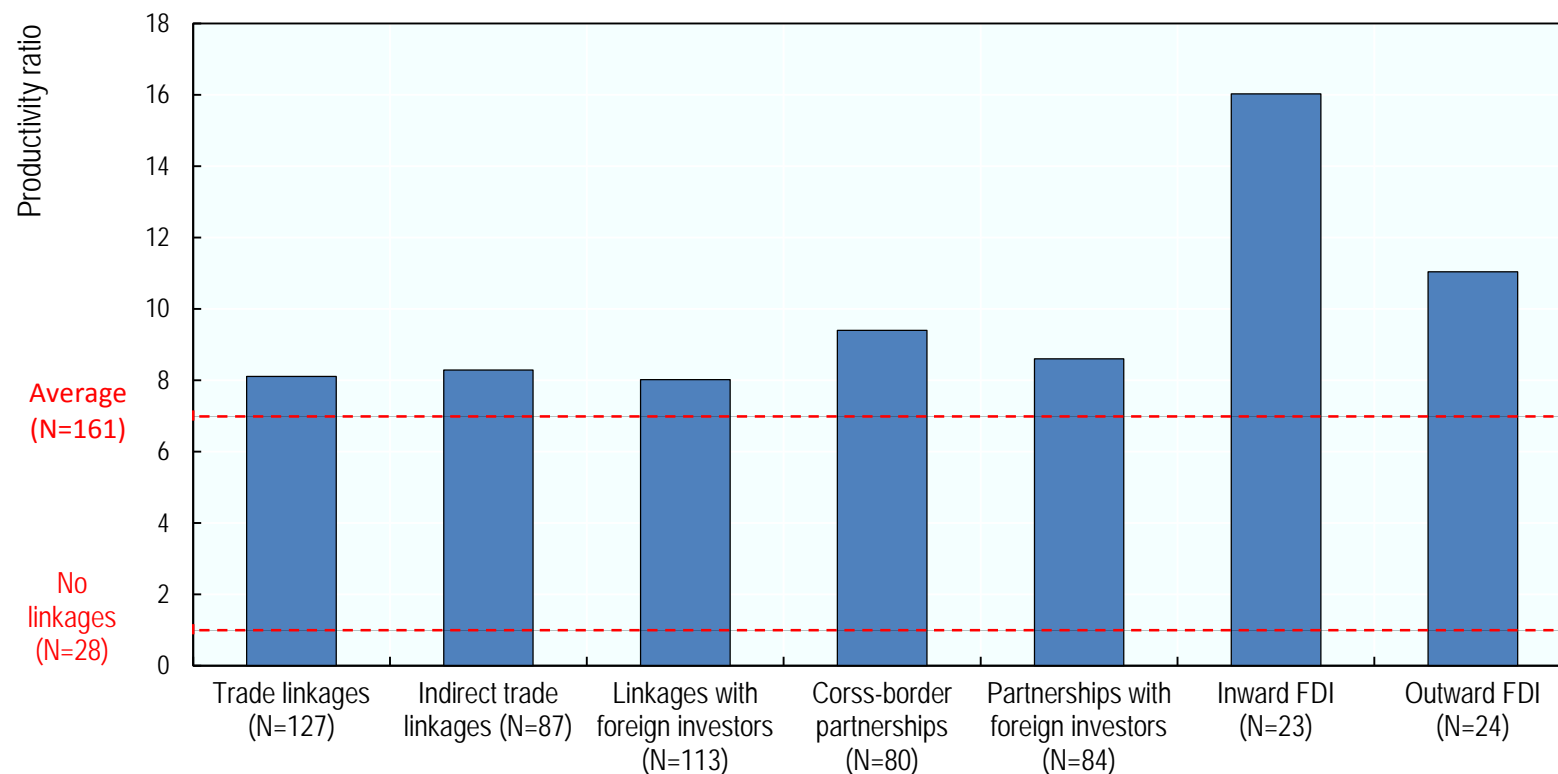
Type of partnerships



Source: OECD-UNIDO based on Thomson & Reuters

3. HOW DO SMES BENEFIT FROM FDI?

GVC linkages are associated with above average productivity



Source: OECD-UNIDO Thai Enterprise Survey (2018)

Firms perceive improvements in performance as a result of linkages

- Over 95% of firms that report linkages also report some kind of performance improvement as a result of linkages
- Top perceived improvements:

Sourcing from foreign investors	Selling to foreign investors	Inward/outward FDI
Reduced costs	Product upgrading	Product diversification
Improved product quality	Skills development	New export channels

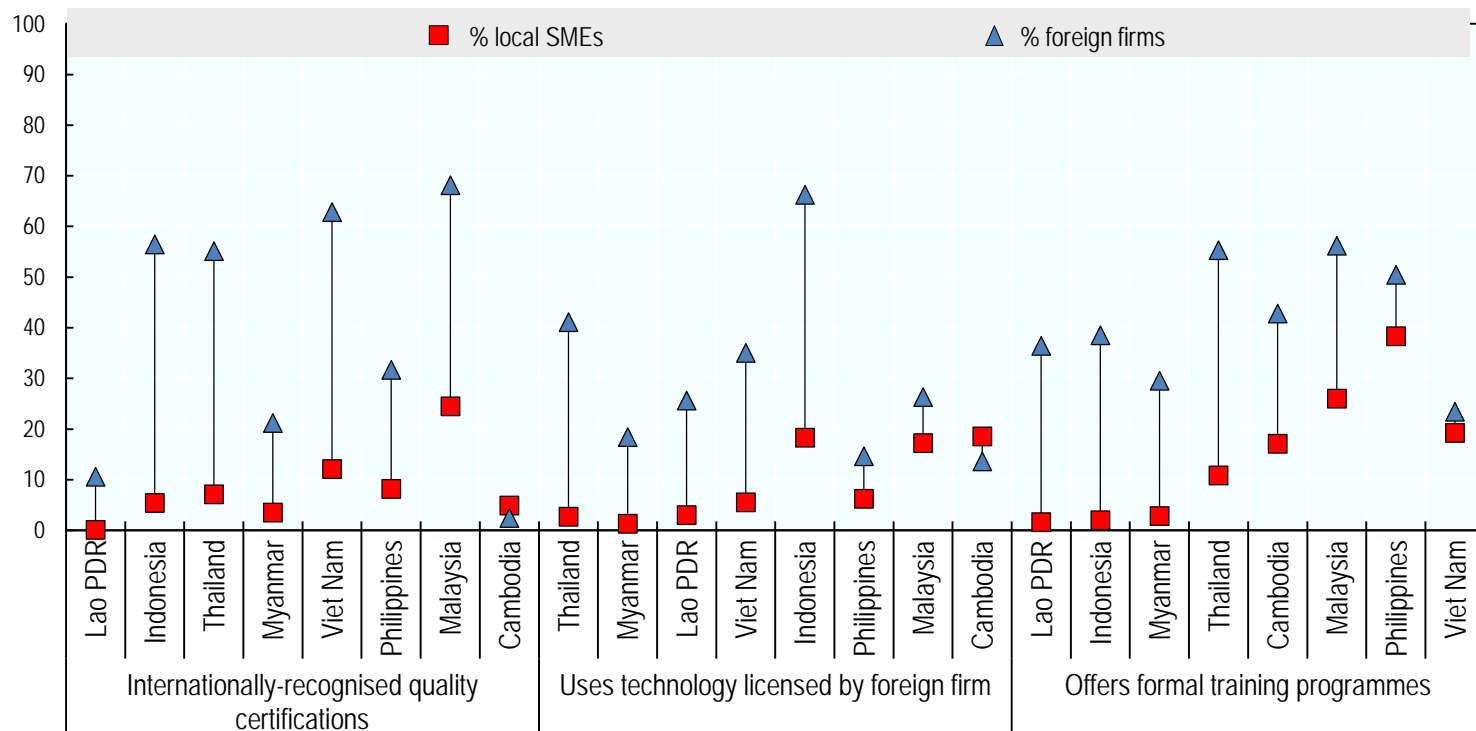
Source: OECD-UNIDO Thai Enterprise Survey (2018)

Investor motives affect the realisation of linkages

- **Key motives: Access to market, local production capabilities and opportunities for sourcing from local suppliers**
- **Investors report efficiency gains as a result of local sourcing**
- **However, they source from foreign firms for higher quality products**

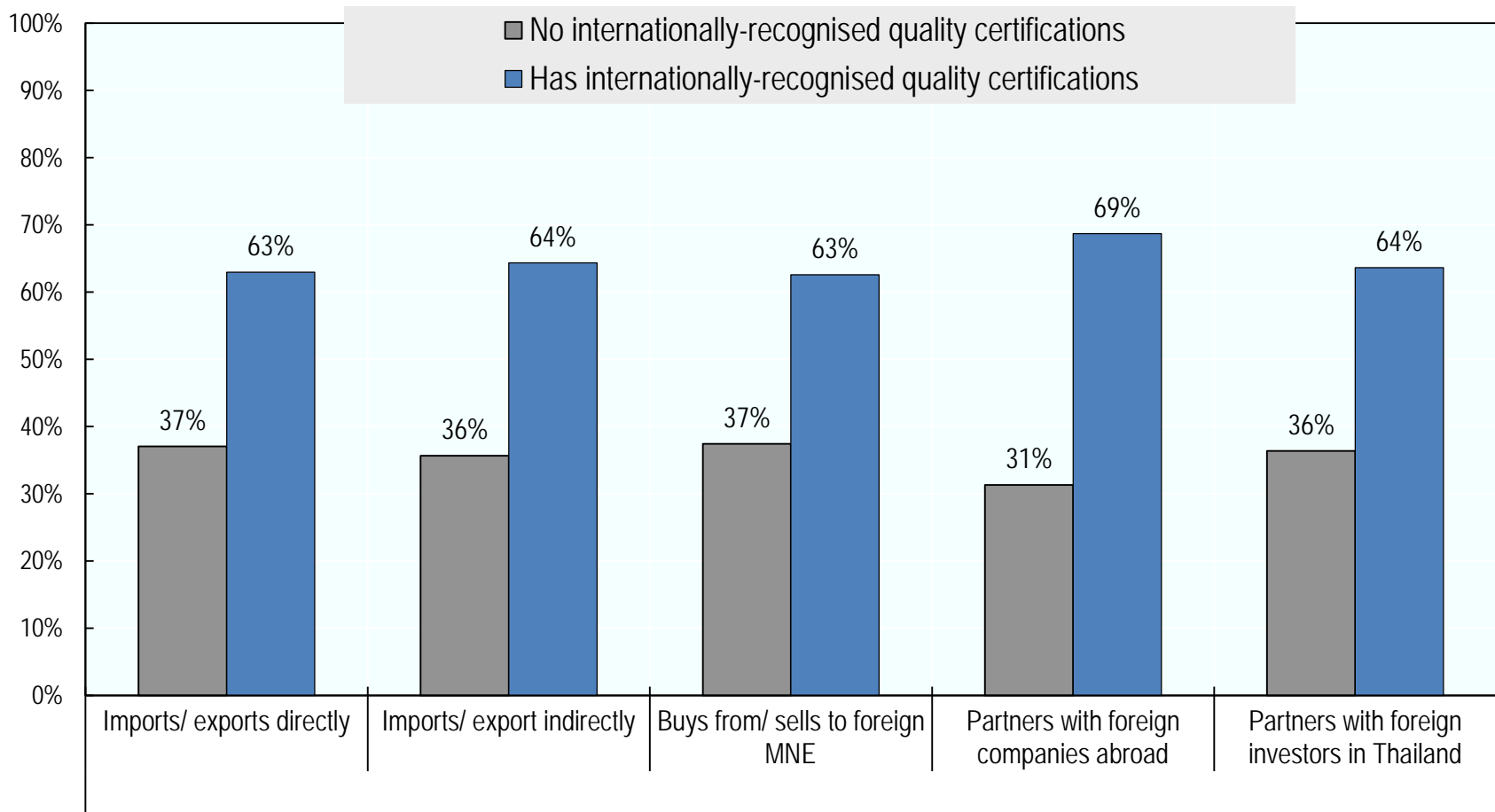
Absorptive capacity of domestic firms affects linkages

- Gaps in absorptive capacity between foreign firms and ASEAN SMEs are substantial



Source: World Bank Enterprise Surveys

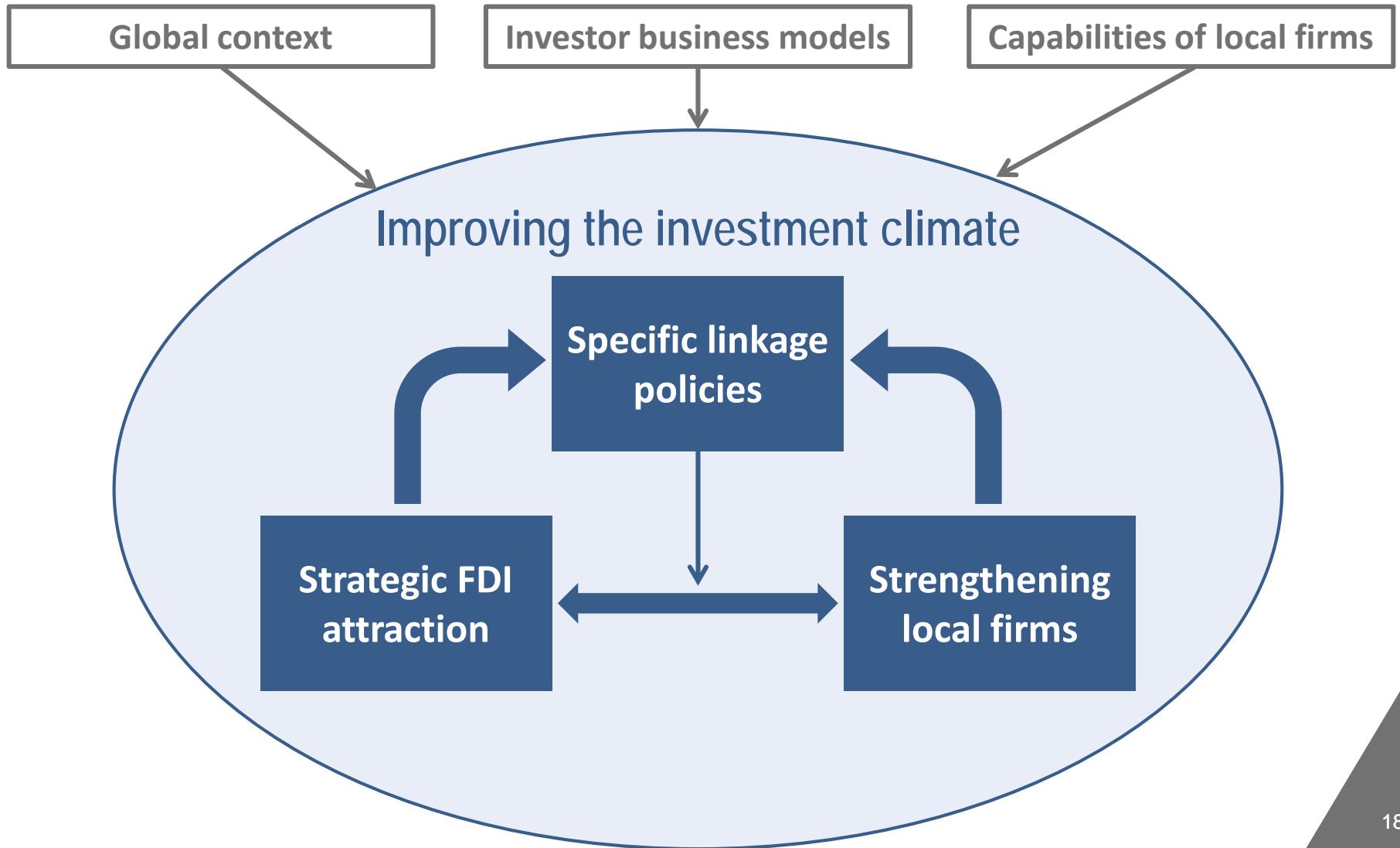
International certification increases the likelihood of SME integration in GVCs



Source: OECD-UNIDO Thai Enterprise Survey (2018)

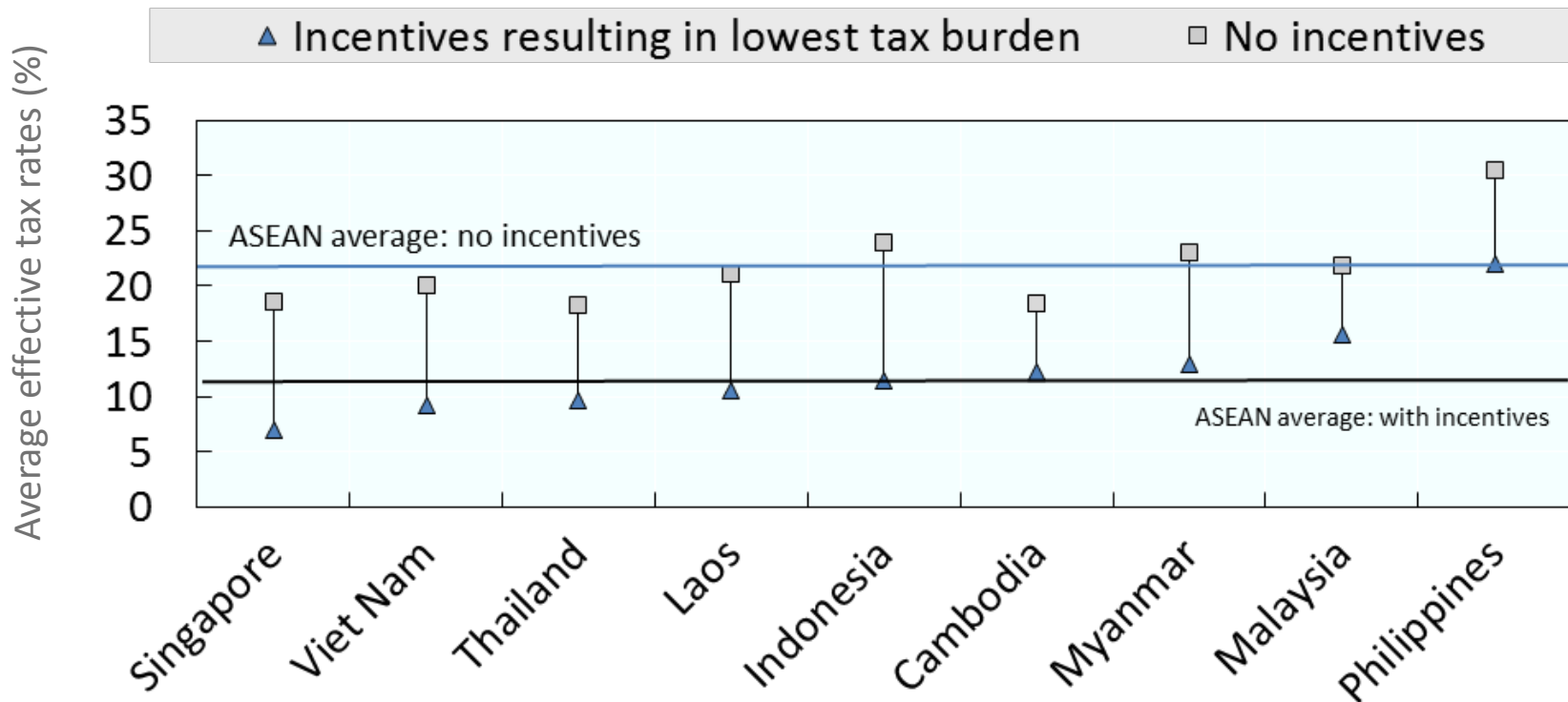
4. HOW CAN POLICY ENABLE SMES TO BENEFIT FROM FDI?

Policies for enabling MNE-SME linkages



Tax incentives can be used to support local sourcing and strengthen SMEs

- Incentives are not always a priority for investors
- Incentives can erode the tax base



Linkage programmes are widespread in ASEAN

- Successful linkage programmes require adequate resourcing
- Successful linkage programmes are driven by “feedback loops” and make extensive use of enterprise data

	Incubator/ SME centre	Matching services/ assistance	Matching/ networking events	Portal/ platform	Supplier database	Training/ supplier development	Solutions for SMEs	MNE specialist secondment
Brunei Dar.	X		X			X		
Cambodia								
Indonesia		X						
Lao PDR		X				X		
Malaysia						X		X
Myanmar								
Philippines		X	X	X	X			X
Singapore	X	X		X		X	X	X
Thailand		X	X		X			
Viet Nam		X		X		X		

Enhanced SEZ strategies can support creation of inter-firm linkages

- Case study: Electronics cluster in Penang, Malaysia
- Among the world's more successful records in generating backward linkages with local suppliers, from complex packaging to contract engineering services.
- Penang development strategy integrates investment promotion, skill-development, and infrastructure upgrades:
 - Penang Development Corporation: setting up SEZ and developing investment promotion strategy focused on attracting “anchor investors”
 - Penang Skills Development Centre: development of curriculum around specific needs and gaps identified by foreign multinationals

KEY MESSAGES

Focus areas for action by public agencies and development partners

Main findings

- Linkage promotion programmes vary in funding and effectiveness
- Incentives are not always important to investors and may erode the tax base
- Integrating SEZs with skills building has proven successful for creation of backward linkages
- Technical assistance is useful for SMEs to overcome barriers to linkage creation

Possible policy actions

- With limited resources, compiling information on local enterprises should be prioritised
- Consider targeted incentives but also administrative cost of verifying compliance
- Enhance existing SEZs with relevant skills building programmes
- Foster absorptive capacity through capacity building programmes, exchange of best practices and multi-stakeholder collaboration



THANK YOU

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