

FDI-Local Firm Linkage Development

East Asian Experiences and Suggestions for Ethiopia



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Dual Economic Structure of a Typical Latecomer Country Receiving Manufacturing FDI

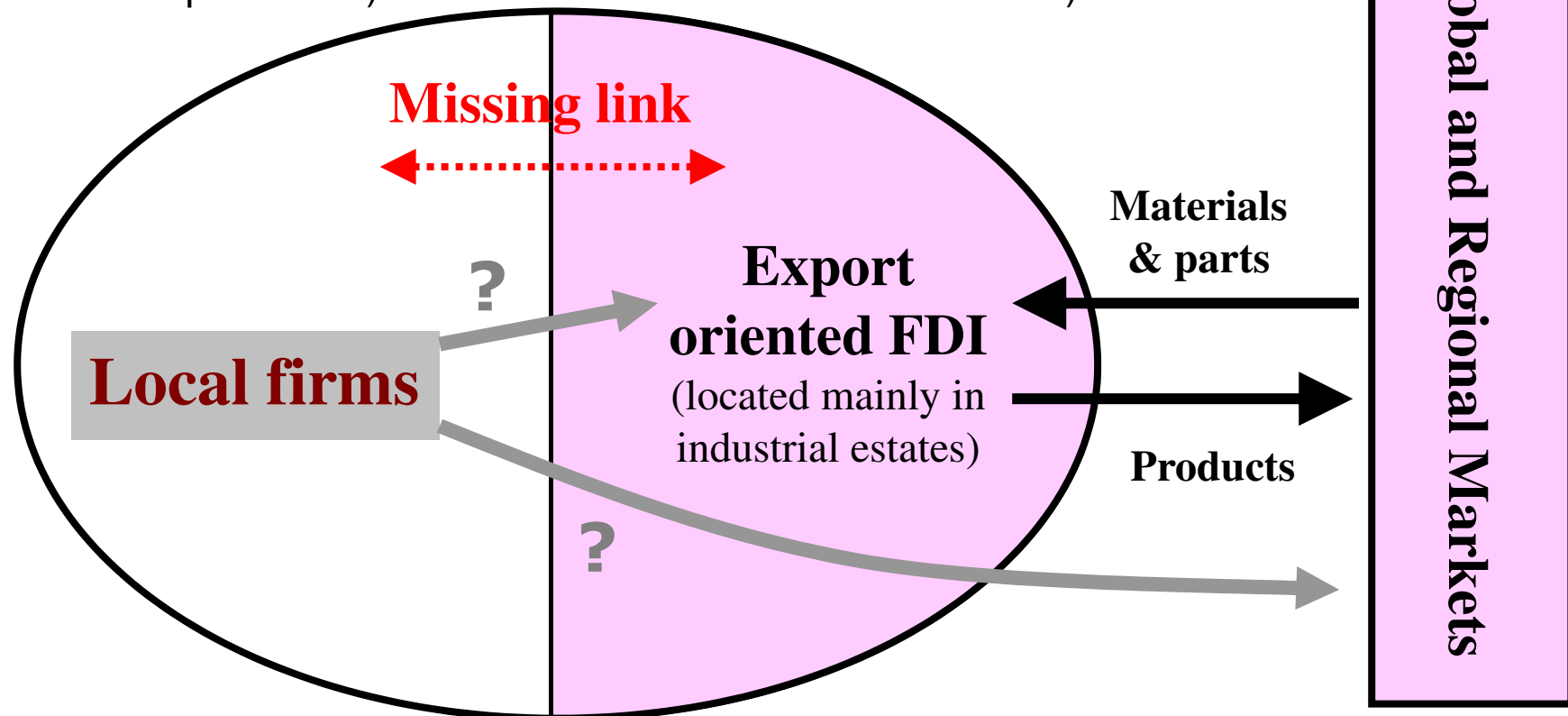
The Need to Link Domestic Sector with Globally Integrated Sector

Domestic Sector

(Under-developed,
often protected)

Export Sector

(Integrated & competitive
under free trade)



Statement of the Problem

- ❑ **FDI enclave:** FDI firms have limited production linkage with domestic firms beyond using local land and labor.
- ❑ **FDI reliance:** FDI dominates structural transformation and export. Domestic value creation and local participation in GVCs remain weak.

Causes (mutually related):

- ✓ **Domestic capacity:** Local firms lack Quality, Cost and Delivery (QCD) requirements necessary to compete in the global market.
- ✓ **FDI's global strategy:** FDI comes for cheap labor and trade privileges (AGOA, EBA, etc.) They don't expect skilled managers or engineers from the host country.
- ✓ **Policy problem:** Host government does not have appropriate measures to encourage linkage.

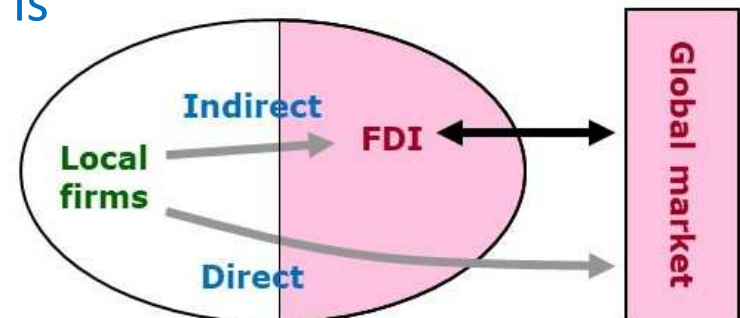
Two Ways to Overcome

- **Direct approach:** Domestic firms improve capacity and compete directly in the global market with their brand names and without assistance from foreign partners.

However, competing directly with EU, US, Japan, Korea, China, etc. is difficult. Very strong local firms may adopt this approach (Japan, Korea, Taiwan; Malaysian attempt).

- **Indirect approach:** Domestic firms strive to become reliable production partners of FDI, supplying globally competitive components and services.

If local firms are weak, this approach is appropriate though it also requires significant policy effort (Thailand, Vietnam, etc.)



Five-part Industrialization Strategy for Ethiopia during GTP II

This version: July 2016

Manufacturing vision	Becoming a leader in light manufacturing in Africa and one of the leaders in overall manufacturing globally
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Manufacturing targets for 2019/20	<ul style="list-style-type: none"> - GDP share of 8% - Export share of 25.6% - One or two industrial champion products with high VA 	<ul style="list-style-type: none"> - Employment of 758,000 - Quality industrial HR
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Policy areas (for FDI-linked technology transfer):

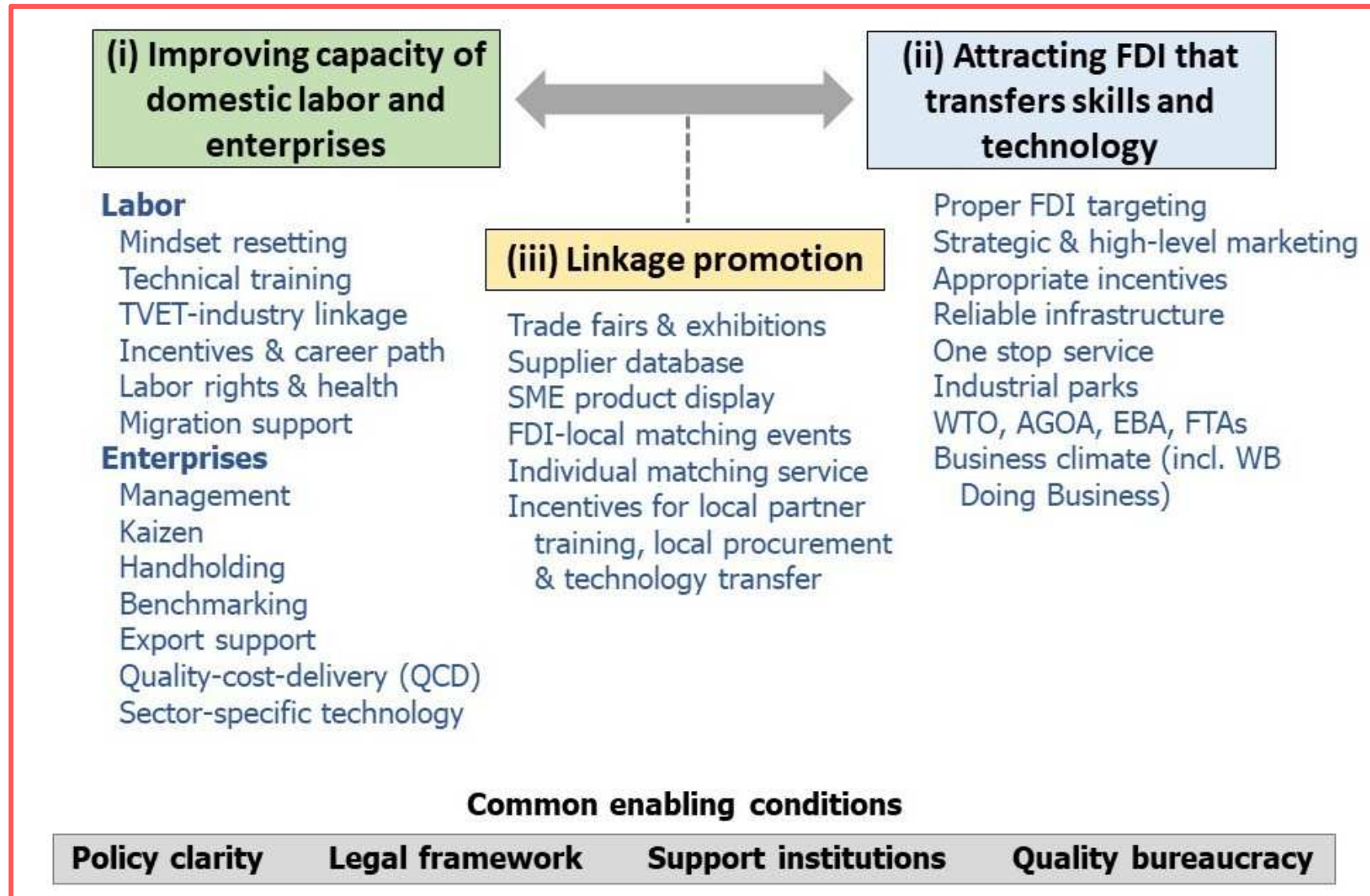


Policy areas (cross-cutting):



Three-part Strategy for FDI-local Firm Linkage

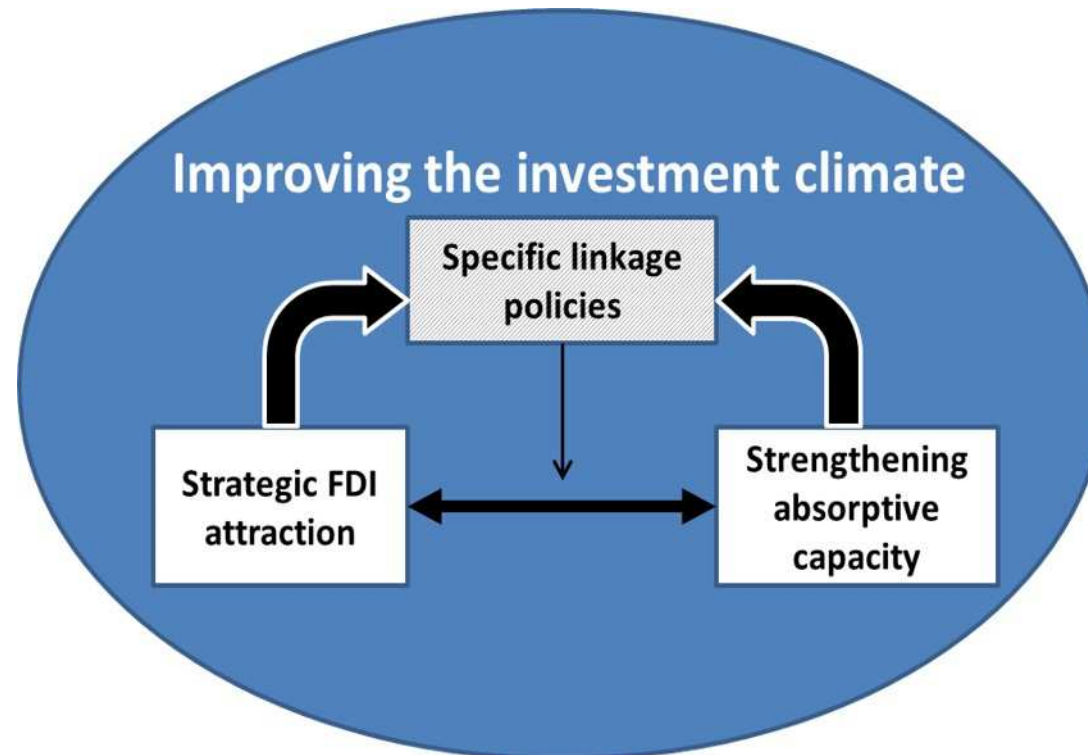
Ethiopia Productivity Report, 2020



Blue letter items are concrete policy actions recommended in the Ethiopian context.

UNCTAD Argues Similarly

UNCTAD (2010), *Creating Business Linkages: A Policy Perspective*, Figure 1, p.14. UNCTAD/DIAE/ED/2009/1



Four policy components: (i) Improving investment climate, (ii) Strategic FDI attraction, (iii) Strengthening absorptive capacity of local firms, and (iv) Linkage policies



Core Elements of Linkage Development

1. Local enterprise capacity building

- This is the heart of industrial development for which policy measures and instruments are many. Desirable not just for linkage but for all industrial purposes.
- For FDI linkage, a small number of potential firms, whether large or small, should be targeted rather than general promotion.

2. Strategic FDI attraction

- Foreign firms willing to stay long, create domestic value, improve workers and partner firms, and work with government should be invited.

3. Linkage formation

- Government may directly offer matching services or indirectly incentivize FDI and local firms to work together.

A Few Remarks

- Even if FDI arrives, technology transfer does not occur naturally or spontaneously; it must be generated by **private effort** (local firms) and **appropriate policy** (government) of the host country.
- In East Asia, linkage normally refers to the input-output relationship in **manufacturing** (not service or extractive sectors) on a **commercial, competitive basis** (not forced).
- This is often called the development of “**supporting industries**” – domestically operating firms (whether FDI or local) that supply high-quality components regularly to FDI final assemblers operating in the same country.
- This is a common policy issue in Southeast Asia (Thailand, Vietnam, Malaysia, Indonesia, etc.)

Case Studies from East Asia

Past and Present

1. Expansion of Kaizen (Ethiopia)

- JICA's ongoing Project for Establishing Comprehensive Support System for Enhancing Firm Competitiveness aims to expand the support scope beyond kaizen.

Kaizen + Management + Marketing + Inherent technology

- Selected companies are improved in 4 batches. In the process, KEC consultants acquire knowhow.
- For this, KEC must cooperate with many service providers.
 - MOI's technical centers (former institutes), commercial banks, EED (former FESMMIPA), Enterprise Development Institute (MoLS), City of Addis Ababa (consultants, counselors, master trainers), dispatched Japanese technical experts, etc.
- Network creation among enterprise support service providers is a great step forward in domestic capacity building.

2. QCD Requirement

- ❑ Quality, Cost and Delivery (QCD) are the common requirement for any firm to become a regular supplier of Japanese manufacturers.
- ❑ **Quality** means all delivered products meet the preset specification without exception (zero defects).
- ❑ **Cost** means continuous cost-cutting effort to stay globally competitive.
- ❑ **Delivery** means meeting all delivery deadlines without fail (one delay, the contract is cancelled).
- ❑ Other requirements may be added (Safety, Governance, etc.) but QCD remains the core requirement.



In-company QCD poster in Vietnam

3. Handholding

(Hands-on or Yorisoï Support)



- Handholding is a program that provides necessary support to a small number of SMEs to attain a business goal.
 - ✓ Public service with no or little fee (subsidized program)
 - ✓ Screening mechanism to select eligible firms
 - ✓ A clear business goal is set in advance
 - ✓ Duration of 2-3 years (usually non-renewable)
 - Based on firm diagnosis and consultation, customized help is offered which may include:
 - Management, marketing, kaizen, technology, finance, ICT, labor management and recruitment, testing, certification, networking, etc.
- (The menu is broader than JICA's ongoing project with KEC)

Handholding (cont.)

- Typical business goals include (only one is chosen):
 - ✓ Product development (incl. commercialization of R&D)
 - ✓ Export
 - ✓ Linkage with FDI
 - ✓ Overseas investment
 - ✓ Creation of an industrial cluster (town or village level)
- Handholding is a common practice in East Asia but some Westerners criticize it as selective, not general.
- Handholding requires a large number of competent business consultants willing to work for small fees.
- In Japanese municipal or township governments, industrial officials routinely visit SMEs so they know which firms are eligible without any additional survey.

JETRO Support for SMEs Investing Abroad

Up to 1000 Japanese SMEs per year (subject to budget); one JETRO official and one external expert conduct HH; additional experts are called as needed.



Costs borne by firm

- Travel, accommodation, local transport, etc.
- Lawyer & accountant fees
- Translation & interpretation
- Costs incurred for establishing a company abroad
- All other costs not supported by JETRO



JETRO services (free)

- Expert support
- Consultation at JETRO HQ & domestic offices
- Country information by JETRO overseas offices
- Arrange meetings with potential overseas partners
- Introduce accounting, legal, tax consultants abroad
- Market, policy, tax, legal, etc. information

JETRO financial support

- Expert fees, expert travel & all other expert-related expenses
- One return air travel for one key person from the firm



Kobe Asian Business Support Center

Handholding Support by a Japanese Municipality

- Kobe is a port city in Japan with a population of 1.45 million. KABSC assists Kobe SMEs to invest in the rest of Asia.
- Each firm is supported by one official and a group of experts with no consultation fee (max. 10 times/year): information, legal issues, taxes, contracts, marketing, etc.
- Seminars, study meetings and overseas missions are also offered.

Malaysia: MATRADE's Handholding for SME Export



- 24 firms per year (12 Malay SMEs & 12 woman SMEs).
- Eligibility: Malay or woman ownership & CEO; in operation for at least 3 years with domestic market presence; office or factory located in Malaysia.
- Two MATRADE officials (one program officer & one trade expert) assist each firm. Support lasts 3 years, non-renewable.
- Screening process: (i) internal selection based on MATRADE database & SME Corp information; (ii) submission of firm profile to MATRADE; (iii) MATRADE Technical Committee evaluation & company visit → Approval
- Seminars on branding, laws/taxes/markets, standards, trade finance, etc.; business missions & trade fairs; free web listing.
- **All costs covered by MATRADE including foreign travel.**

4. Thailand:

Network-based Linkage Promotion System

Two leading official agencies of linkage promotion are:

BUILD (BOI Unit for Industrial Linkage Development) under the Board of Investment

BSID (Bureau of Supporting Industries Development), MOI

Other official agencies include:

- Department of Industrial Promotion, MOI
- Industrial Estate Authority of Thailand (IEAT)
- One Start One Stop Center
- Two Japan Desks (BOI & MOC)

Private organizations are:

- Technology Promotion Association (TPA)
- Thai-Nichi Institute of Technology (TNI)
- Alliance for Supporting Industry Associations (A.S.I.A.)

Thailand: Linkage Policy Network



Source: BOI presentation (May 2013)

Note: This network was created when the BOI was placed under the MOI at the time of former Prime Minister Yingluck Shinawatra.

Thailand: FDI-Local Firm Linkage Promotion

Organization	Status	Functions
BUILD (BOI Unit for Industrial Linkage Development)	One unit of the Board of Investment (central FDI agency); estab.1992.	FDI-Thai firm matching (e.g., sourcing services, Vendors Meet Customers program, supplier database, annual subcontracting exhibitions)
DIP (Dept. of Industrial Promotion), MOI	Ministry of Industry	Design policies; monitor implementation and analyze performance
BSID (Bureau of Supporting Industries Development), DIP/MOI	Ministry of Industry; one technical bureau of DIP; estab.1996	Provide technical support & training to Thai supporting industries; develop prototype products; promote subcontracting, shindan, and industry associations
TAI (Thailand Automotive Institute)	NPO; estab.1998 by MOI; but now self-financing	Automotive policy research and master plan drafting; promote supporting industry clustering; export promotion; automotive testing center
A.S.I.A. (Alliance for Supporting Industries Association)	Private; a collection of 12 Thai industrial associations	Information exchange, technology learning, and receiving policy support for member associations and firms, coached by BSID/MOI
TPA (Technology Promotion Association)	Private NPO; estab.1973 by Thai alumni who studied engineering in Japan.	Offer technical & management courses; conduct business consultation; publish & translate books; tech Japanese language (all fee basis)
TNI (Thai-Nichi Institute of Technology)	Private university; estab. 2007 by TPA	Teach Japanese style manufacturing in both theory & practice; active cooperation with Japanese FDI
Japan Desks (two desks at BOI and DIP/MOI)	BOI and MOI; staffed by Japanese experts	Appointments, events, and logistic support for Japanese SMEs and local govts' visiting Thailand for business partnership

BUILD

https://build.boi.go.th/EN/home?lang_switch=switch_from_TH

- The BOI Unit for Industrial Linkage (BUILD) was established in 1992. It was recently upgraded to the Industrial Linkage Development Division (ILDD).
- BUILD assists FDI-local partner search via:
 - Free matching service for business partners (JV, OEM, patent use, production contract, etc.) and local input procurement
 - SUBCON Thailand (large annual component trade fair)
 - Managing the ASEAN Supporting Industry Database
 - Subsidizing Thai firms to attend overseas trade exhibitions





BUILD: Partner Search Process

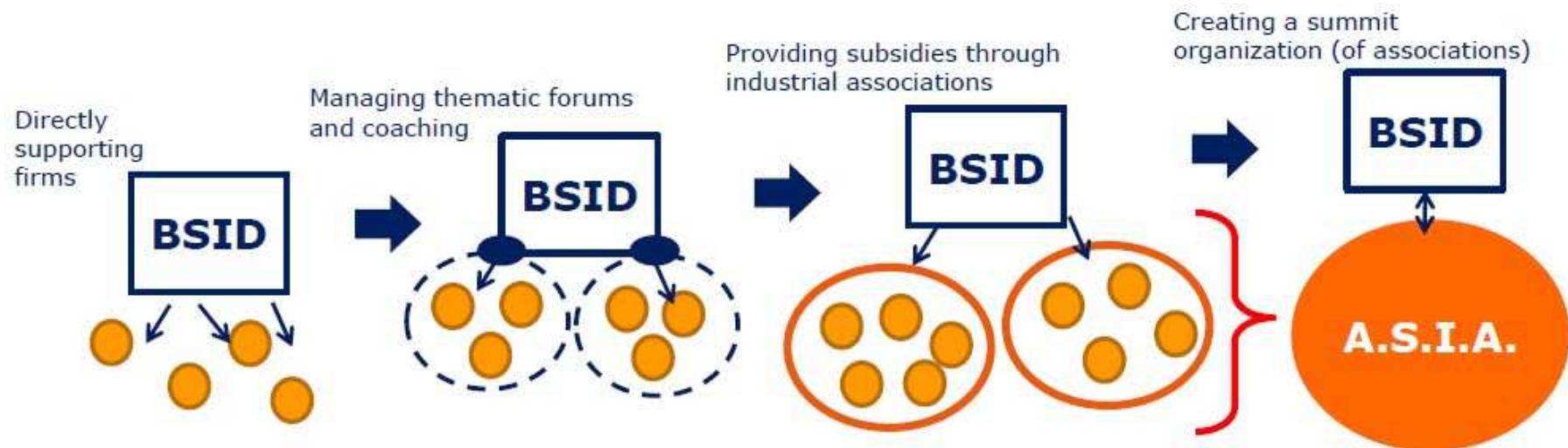
1. BUILD receives inquiries from foreign buyers through various channels: BUILD matching service website, email, One Start One Stop Center, overseas offices of BOI, etc.
2. BUILD announces the spec and volume requirements in the website and solicits expression of interest from Thai suppliers.
3. One official is assigned to each inquiry. Partner search may take a few month up to a year. It is not always successful.
4. Individual one-on-one meetings may be arranged between a buyer and each potential buyer.

BSID

Mr. Panuwat Triyangkulsri
Former Director of BSID



- The Bureau of Supporting Industry Development (BSID) was established in 1996 under MOI by upgrading the Metalworking and Machinery Industries Development Institute (MIDI) supported by JICA.
- BSID took the step-by-step approach to develop component industries for automobiles, electronics, etc.



BSID
mascot



BSID: Step by Step

- ❑ Initially, when Thai component firms were few, BSID directly extended technical and managerial support to individual firms.
- ❑ JICA assisted with the training of private consultants (Kaizen, Shindan, etc.)
- ❑ When Thai component firms grew to approximately 1,000, BSID established and managed **thematic forums** (subsector groups) in design, metallurgy, machinery, foundry, etc. BSID served as their coach and secretariat.
- ❑ Gradually, these forums gained experience and became truly privately-run **industrial associations**.



Step by Step (cont.)

- ❑ BSID then created the **Alliance for supporting Industry Associations (A.S.I.A.)** as a summit organization for 12 industrial associations.
- ❑ As Thai industry developed, BSID's role receded from direct support to indirect guidance and partial subsidization of seminars, training, consultancy, projects, etc.
- ❑ Shindan (SME diagnosis & advice) is required before applying for BSID's technical support.

Private Sector: TPA & TNI

- ❑ **Technology Promotion Association (TPA)** is a Thai NPO established in 1973 by former Thai students who studied engineering in Japan. It offers business, technical and language courses, business consultation, calibration service, and business matching between Thai and Japanese SMEs.
- ❑ In 2007, TPA created **Thai-Nichi Institute of Technology (TNI)**, a private university dedicated to Japanese-style manufacturing. TNI works closely with Japanese FDI for worker recruitment, internship, scholarship, training, instructor dispatch, etc.



5. Malaysia (1990s): FDI-Local SME Linkage Development

- Malaysia implemented two major linkage programs from the late 1980s to the early 2000s.
- They aimed at SME capacity building and business matching (FDI attraction was handled by another agency, MIDA).

Vender Development Program (VDP), 1988-97 by the Ministry of International Trade and Industry (MITI)

Industrial Linkage Program (ILP), 1997-early 2000s by the Small and Medium Industry Development Corporation (SMIDEC) under MITI

Note: Today, Malaysia no longer gives policy attention to FDI-local firm linkage development. It is more interested in the creation of innovative and globally competitive SMEs (the “direct approach”).

Vendor Development Program (VDP)

- In 1988, VDP aimed to strengthen linkage between Proton, the national car company (**the anchor firm**), and local Malay component suppliers (**vendors**).
- The anchor firm was required to do the following:
 - Purchase as many parts as possible from eligible vendors
 - Provide technical assistance to vendors
 - Intermediate government loans to vendors
- In 1992, VDP was expanded to include two electrical and electronics (E&E) firms as anchors. More sectors were added later.
- Some vendors grew for Proton. However, many FDI firms were reluctant due to the low technical capacity of local firms.



Industry Linkage Program (ILP)

- ❑ ILP was introduced in 1997, replacing VDP, under Industrial Master Plan 2 (1996-2005). It adopted the cluster-based approach (encompassing enabling conditions and services) and encouraged FDI-local firm linkage.
- ❑ ILP extended support to non-Malay SMEs as well.
- ❑ Targeted SMEs: E&E, automotive machinery and engineering, and resource-based manufacturing.
- ❑ SMEs must produce items included in the Promoted List.
- ❑ Lead companies must assist SMEs with training, factory auditing, and technical assistance for high quality. Incurred costs can be reimbursed.



ILP Support Measures

- (For lead companies) Pioneer Status with 100% tax exemption for 5 years, or Investment Tax Allowance of 60% on qualifying capital expenditures incurred within 5 years.
- (For local SMEs) Support packages for technology, skills, export, marketing, industrial sites, etc.
- Specifically, SMIDEC offered to SMEs: (i) Global Supplier Program (training, linkage and certification), (ii) Factory Audit Scheme, (iii) Annual Showcase, (iv) The Enterprise 50 Program, (v) SME Expert Advisory Panel, etc.
- Business matching.

6. Reverse Trade Fairs

- ❑ In normal trade fairs, firms display what they want to sell. In reverse trade fairs, assembler firms display what they want to buy from other firms (components, materials, technology).
- ❑ This is practiced widely in Japan, China and Southeast Asia to find reliable suppliers quickly from potential candidates.



Reverse trade fair in Osaka, Japan



Reverse trade fair in Ho Chi Minh City, Vietnam



7. Linkage Support by Private Industrial Parks

- In Southeast Asia where private industrial parks compete fiercely for customer firms, many parks offer business-support services (for free or fee-based).
- **Linkage creation** (finding buyers or suppliers) is one of the services rendered.
- Other services include business consultation, investment procedure, taxes, accounting, environmental documents, ICT, worker recruitment and management, and rental of space, equipment and cars.



Kizuna Rental Factory Industrial Park (Southern Vietnam)

This is a Vietnamese-owned private industrial park targeting Japanese high-tech SMEs. It offers full-service rental factories supported by Japanese or Japanese-speaking staff. Most services, including linkage, are fee-based but support for initial investment procedure is free.

<https://www.kizuna.vn/en#>



Lessons for Ethiopia

Summary of Findings

- Linkage development consists of (i) domestic capacity building, (ii) strategic FDI attraction, and (iii) linkage support.
- Policy measures for linkage formation are many. An appropriate model must be constructed for each country.
- Malaysia and Thailand have (had) relatively advanced models of linkage promotion.
- Private firms and NPOs can also play an important role (e.g., TPA/TNI, Kizuna).
- Donors' technical and financial support is also useful, but it must be owned and institutionalized by the host country.
- Unrealistic demand for technology transfer without local capacity building is ineffective and drives FDI away.



Suggestions for Ethiopia: Mechanism

- **Handholding** should be introduced—comprehensive time-bound support for selected local firms to attain effective FDI linkage
- Establish a **policy network** among existing linkage supporting ministries and agencies (MOI and its centers, EED/Creative Hub, EIC, EDI, City of Addis Ababa, etc.
- Fully utilize **donor support** (incl. JICA's industrial projects) to create a nationally owned linkage promotion mechanism.

Suggestions for Ethiopia: Procedure

- ❑ Select a few **target sectors** for linkage formation (agro-processing, cotton-textile-garment link, leather, etc.)
- ❑ Create a **list of potential Ethiopian firms**—as a database or more informal EXCEL files.
- ❑ Create a **list of FDI firms** willing to cooperate and build linkage with Ethiopian partners (or already working with local firms).
- ❑ Devise “**win-win**” incentives for FDI and local firms.
 - Ethiopian firms receiving designated technology or training from FDI may enjoy subsidies or matching grants (for both parties).
- ❑ Government may also directly offer matching services, events and reverse trade fairs for finding business partners or input suppliers.