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UNECA Report:

Building linkages between MSMEs and Southern-led Multi-National Companies: the case of Southern Africa

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Road map

(Southern) African economies and Global/Regional Value Chains

The role of linkages for connecting MSMEs to cross-border value chains

Results of case studies

Conclusions and policy suggestions

GVCs: an opportunity for development (also for MSMEs)

- Connecting to **Global Value Chains** (GVCs) can be an opportunity of development, despite of the risks and challenges they take along (Taglioni and Winkler, 2016; Kummritz et al., 2017; World Bank, 2020).
 - ✓ At the global level, an increase of GVC participation by 1% results to raise income per capita by more than 1% (World Bank, 2020).
- It can be of particular importance for small and medium-sized enterprises (**SMEs**), helping them to ***scale up***, improve their ***productivity*** and acquire ***new technology*** (OECD-UNIDO, 2019; OECD, 2021).
- Given that a **limited manufacturing base** prevents **African countries** from developing comparative advantages through the entire value chain (IMF, 2015), the access to GVCs represents a “***golden opportunity***” to take advantage of technological spillovers from global players.

Limited participation and benefits for African economy (so far)

- However, the participation of African producers in GVCs is currently very **limited and with scant benefits**, due to large scale and technological gaps with lead global players.
- Africa's participation mostly consists of **exporting raw natural resources and agricultural commodities** that are processed abroad.
- In 2019 the **export of intermediates** (i.e. **forward participation in GVCs**) represented **5.9% of Africa' GDP**, while the **imports of intermediates** (i.e. **backward participation in GVC**) accounted to **2.1% of the continental GDP** (AUC-OECD, 2022)

AfCTA: an opportunity to strengthen Regional Value Chains

- African Continental Free Trade Area (**AfCTA**) is going to support African regional value chain (**RVC**) and facilitate productive transformation, boosting diversification and upgrading (AUC and OECD, 2022).
- RVCs might increase the opportunity for African countries to **enhance cross-border trade of intermediates, especially in manufacturing sectors**, and generate more productive jobs in the downstream stages of the value chains
 - ✓ See Tschirley et al. (2015); Barrientos et al. (2016); Black et al. (2021)
- **In 2019 regional value chains represented only 2.7% of the total African participation in GVCs.**
 - ✓ In *Latin America* and *Asia* regional value chains represent, respectively, 26.4% and 42.9% of the total respective areas' participation in GVCs

A focus on Southern Africa

- As highlighted in UNCTAD (2021), **Southern Africa** is the most integrated area of the continent and is likely to take large benefits from regional value chain
- Southern African participation in GVCs is mainly limited to **exports of raw materials and agricultural products to the Global North, plus China and India.**
 - ✓ **Instead, manufacturing value chains are mostly limited to national and regional markets.**
- Southern African economies **lack necessary conditions** to access **global manufacturing value chains**, such as developed transport and electricity infrastructure, technology capacity and experience as suppliers of lead global players (Rodrick, 2018).
 - ✓ Exceptions are **auto assembly cluster and processed fruit sector in South Africa** and **clothing sector in Lesotho and Eswatini.**
 - ✓ Overall, most of the Southern African manufacturing output is concentrated in **South Africa**: in 2017, **90% of manufactured exports from the region was originated in that country**

Origin of value added exported

	Angola	Botswana	Eswatini	Lesotho	Malawi	Mauritius	Mozambique	Namibia	South Africa	Zambia
Foreign Value Added Exported (%)	8.63	8.67	29.2	48.34	13.2	31.6	10.08	24.51	21.13	9.02
Origin of foreign VA exported										
Developing countries (%)	41.8	70	73	55	71.82	66.4	72.9	75.08	32.73	65.9
Top 5 origin countries										
1	USA	South Africa	South Africa	China	Tanzania	China	South Africa	South Africa	Germany	India
2	China	China	USA	Taiwan	India	India	China	Germany	China	South Africa
3	Portugal	UK	China	South Korea	South Africa	USA	India	China	USA	China
4	Brazil	India	Germany	Japan	China	Germany	Portugal	USA	UK	DR Congo
5	India	Viet Nam	UK	Tanzania	UK	South Africa	Germany	UK	Japan	UK

Author's calculations on EORA-UNCTAD data. Values refer to year 2018.

Destination of value added exported

	Angola	Botswana	Eswatini	Lesotho	Malawi	Mauritius	Mozambique	Namibia	South Africa	Zambia
Destination of Value Added exported										
Developing (%)	37.85	17.06	25.30	27.99	20.05	12.27	33.81	23.65	21.85	41.02
TOP 5 DESTINATION COUNTRIES										
1	China	Israel	Netherlands	Belgium	Netherlands	UK	Germany	Germany	Germany	China
2	USA	UK	South Korea	Germany	Germany	France	South Africa	Angola	Japan	South Africa
3	Belgium	Germany	Germany	Russia	South Africa	Germany	Belgium	Netherlands	UK	Germany
4	France	Norway	France	UK	Belgium	Belgium	Netherlands	Belgium	Netherlands	Japan
5	Germany	Belgium	UK	Belarus	UK	Netherlands	China	France	China	Netherlands

Author's calculations on EORA-UNCTAD data. Values refer to 2018.

MSMEs & GVCs/RVCs

➤ If large companies, both national and foreign, can shape the value chains across international markets, MSMEs are very important to guarantee that participation in GVCs turns into a “**broad-base and sustainable development**” (Asian Development Bank, 2015).

➤ According to ILO (2019)’s estimates, small and medium enterprises (SMEs) represent more than *two-thirds of total employment* in developing and emerging economies.

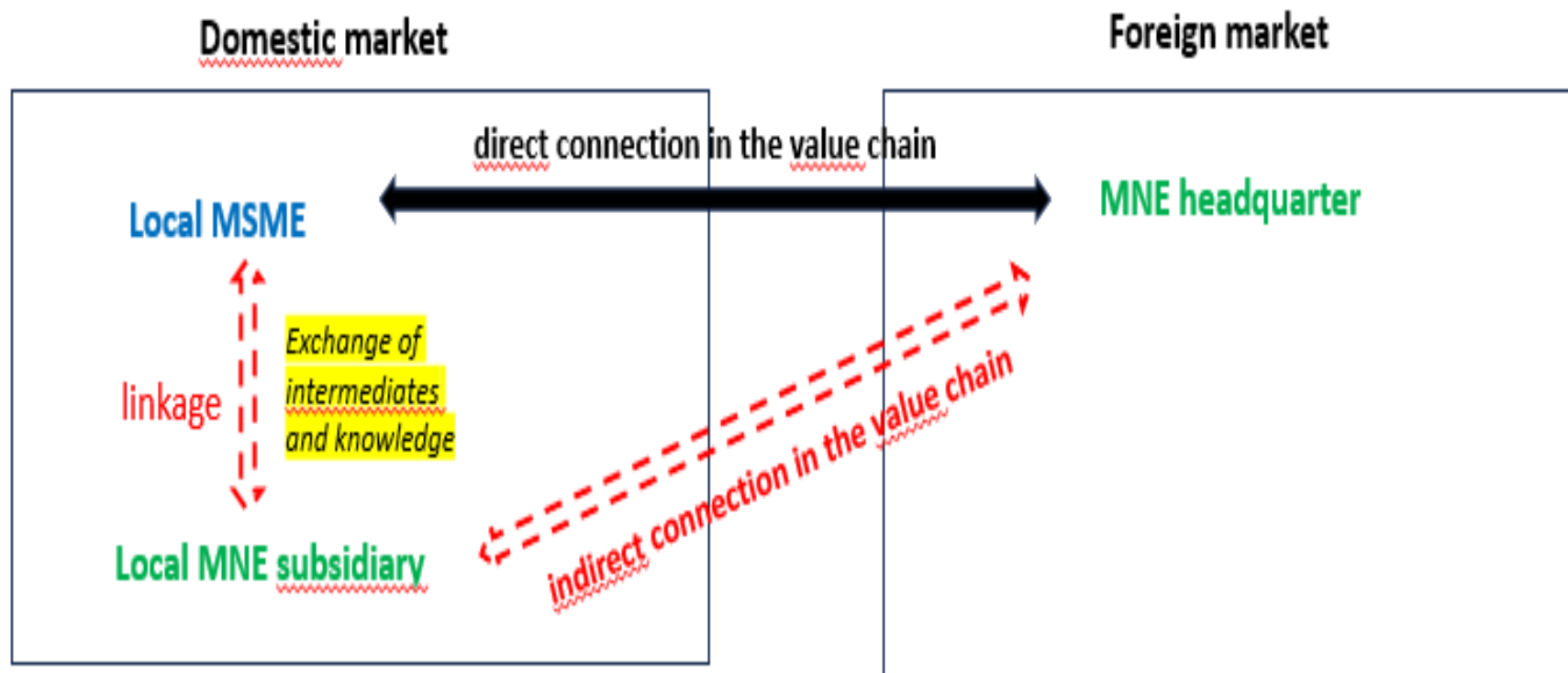
- ✓ In the *Middle East and North Africa area*, self-employment and micro enterprises (i.e. less than 10 employees) represent about **70%** of total employment

- ✓ in *South Asia and Sub-Saharan Africa* they account for **80%** of total employment (in some countries, like Mali, they almost reach 100%).

MSMEs & GVCs/RVCs (cont.)

- GVC **opportunities** for MSMEs are related to the access to *large demand* from foreign buyers, *technological learning* from large global players and *higher productivity* driven by tougher competition in international markets (Nichter and Goldmark, 2009; Asian Development Bank, 2015).
- Several **limits** can prevent MSMEs from accessing GVCs or benefitting from them (Mutalemwa, 2015; WTO, 2022), such as:
 - ✓ Concentration in non-tradable sectors (such as retail, construction and services)
 - ✓ Deficits in economies of scale, financial resources and managerial and language skills,
 - ✓ Lack of information about market opportunities and quality certification;
 - ✓ Also external barriers: burdensome domestic and foreign regulatory rules; weak infrastructures and institutional quality
- Such limits might turn lower in case of RVCs (OECD, 2021):
 - ✓ Demand characteristics are more homogeneous at regional level
 - ✓ RVCs often develop on already existing cross-border relationships between buyers and suppliers and, further, on family and ethnic ties.

The (potential) role of linkages



Linkages as «mutually beneficial arrangements»

- According to **World Bank (2018)** they can yield “mutually beneficial arrangements”.
- **MNEs** set up linkages to save production costs, increase the access to local - tangible and intangible - assets, enhance specialization and flexibility of foreign affiliates and adapt technologies and products to local economies.
- **MSMEs** can benefit from such linkages:
 - ✓ they can increase their sales and profits by accessing new markets;
 - ✓ they can start producing new and more and more complex products required by MNEs;
 - ✓ they can set in more stable commercial relationships with buyers and suppliers of foreign origin.

Different types of linkages

➤ Smallbone (2006) and Ndemo & Smallbone (2015) distinguish between five types of linkages between MNCs and small and medium enterprises:

1. **Backward linkages**, by which MNEs source components, materials and services from local suppliers
 - ✓ Very important for spillovers (Rodríguez-Clare, 1996; Alfaro and Rodríguez-Clare, 2004; Alfaro et al., 2004; Ndemo and Smallbone, 2015; Alfaro-Urena et al. 2023)
2. **Forward linkages** with domestic customers (such as outsourced marketing outlets and after-sales services);
3. Linkages with local competitors (i.e. **horizontal linkages**), by which MNEs can set new and more challenging standards to local competitors.
4. Linkages to **technological partners** (by joint ventures, licencing agreements or strategic alliances)
5. **Other spillover effects** (such as when trained workers move from MNEs to local enterprises).

Empirical investigation: objects

- Which are the **factors** that are more likely to shape:
 - ✓ the chances of linkages between foreign MNE subsidiaries and local MSMEs?
 - ✓ the chances to benefit from such linkages?
- Looking at **different dimensions**:
 - ✓ Firm-level characteristics
 - ✓ Type of linkage
 - ✓ Industry
 - ✓ MNE origin

Empirical investigation: methods

- The empirical analysis relies on data collected through two surveys at company level:
 - ✓ the *MSME Survey*, which was addressed to local MSMEs
 - ✓ the *MNE Survey*, which was addressed to local affiliates of foreign MNEs.
- Main references:
 - ✓ The African Investor Survey 2010 (UNIDO, 2012)
 - ✓ Alfaro-Urena, Manelici, Vasquez (QJE, 2022)
- Interviews to *institutional stakeholders in Namibia*

MSME Survey: The sample

Country	Primary sectors		Manufacturing sectors		Services		Total	
	#	%	#	%	#	%	#	%
Botswana	0	0.0	1	100.0	0	0.0	1	100.0
Lesotho	0	0.0	2	66.7	1	33.3	3	100.0
Mauritius	0	0.0	3	100.0	0	0.0	3	100.0
Mozambique	1	4.7	6	28.6	14	66.7	21	100.0
Namibia	1	12.5	4	50.0	3	37.5	8	100.0
Zambia	4	15.4	11	42.3	11	42.3	26	100.0
Total	6	9.7	27	43.6	29	46.7	62	100.0

MNE subsidiaries interviewed in Namibia

	<i>MNE 1</i>	<i>MNE 2</i>	<i>MNE 3</i>	<i>MNE 4</i>	<i>MNE 5</i>
Sector	Retail (food)	Retail (food)	Manufacturing (office furniture)	Manufacturing (packaging)	Fishery
Location	Windhoek	Windhoek	Windhoek	Walvis Bay	Walvis Bay
Establishment year	1990	2020	2004	1990	1989
Entry mode	Greenfield	Acquisition	Acquisition	Greenfield	Greenfield
Foreign ownership	South Africa	South Africa	South Africa	South Africa	Japan

Institutional stakeholders interviewed in Windhoek

Many thanks to:

- Bokamoso Entrepreneurial Center
 - ✓ SME incubator in Namibia
- Namibia Investment Promotion and Development Board
- Ministry of Higher Education, Training and Innovation
- Namibian Chamber of Commerce and Industry
- Namibia University of Science and Technology
- SMEs Competitiveness Consultancy Ltd
 - ✓ a social entrepreneurship entity that helps small and medium enterprises

Results: MSME size

- Larger local companies turn out to be more likely to be chosen as suppliers of foreign MNE affiliates and receive support from them.
 - ✓ Some of the MNEs *interviewed* in Namibia indicated size and sufficient inventories as one of the most relevant factors to choose local suppliers
- Larger size also seems to increase the chances of **forward type linkages**.
- Nevertheless, smaller local companies seem, on average, to be more reactive to **foreign competition** on local market by enhancing investments and innovation (see Kaplinsky and Morris, 2019).
 - ✓ Some of the MNE subsidiaries interviewed in Namibia revealed to be in competition with very small local competitors, that are introducing new products because of foreign competition.

Results: MSME innovation

- Innovative MSMEs have more chances to be involved in **vertical linkages (of both backward and forward type)** with foreign-owned companies and, on average, take larger benefits from being suppliers of MNE affiliates
 - ✓ Some of the MNEs interviewed pointed out that the willingness of local MSMEs to transform their production process to meet their needs is one of the crucial factors for the choice of local suppliers.
- They are also more likely to benefit from **direct competition** with foreign companies on the local market and to be involved in **technological partnerships** with MNE subsidiaries.
- Thus, innovation is confirmed to be a **key competitive factor** for companies in developing countries (Verhoogen, 2023) and, particularly, for small African companies (Makanyeza and Dzvuke, 2015)

Results: MSME quality certification

- Having product quality certification results to help MSMEs to be involved in **vertical linkages** (of both backward and forward type) and **technological partnerships** with foreign MNC affiliates.
 - ✓ Most of the MNE affiliates interviewed in Namibia pointed to product certification as a very important factor when choosing a local supplier
- MSMEs with product certifications are also more likely to receive **support** from both foreign buyers – in case of backward linkages – and foreign sellers – in case of forward linkages
- They also seem to react to **foreign competition** on local market through investments and innovation.
- **Certifications are confirmed to be key to access international value chains (Asian Development Bank, 2015).**

Results:

MSMEs external funding

- Access to external funding does not seem to be supportive in terms of chances to set up **forward linkages** nor **technological partnerships** with MNE subsidiaries.
- However, it results to give an advantage to local MSMEs in terms of chances to get support from foreign buyers through **backward linkages**.
- Furthermore, it seems to help MSMEs to react to **market competition** from foreign players through investments and innovation.
- Thus, it is confirmed to be a key **competitiveness factor** for small companies in developing countries (Nichter and Goldmark, 2009; Dupas and Robinson, 2013) and, particularly, African economies (Derbyshire and Fouché, 2018)
 - ✓ This was also revealed by the institutional stakeholders *interviewed* in Namibia.

Results:

Formal education of workers in MSMEs

- Education of workers resulted one of the **main location factors** for the MNE affiliates interviewed in Namibia
- However, looking at the results from MSME Survey it does not come up that larger share of employees with high formal education enhances the chances to **vertically integrate** with foreign companies or to become their **technological partner**.
- Lack of **vocational training** was indicated as one of the major weaknesses of local MSMEs from Namibian institutional stakeholders
 - ✓ Most of the MNE affiliates interviewed claimed to support their local suppliers through training by standardized programs, visits to supplier company or visits from the employees of the latter to the foreign buyer.
 - ✓ This finding is supported by Kottaridi et al. (2019), showing that for foreign investors in more developing areas vocational training of local labour force can be more relevant than general education.

Other MSME characteristics considered in the analysis

- MSME age
- MSME internationalization
- Share of female workers

Results :

Geography & First-Tier relationships

- MSMEs that are **closer to MNE affiliates** are:
 - ✓ more likely to be engaged in **backward linkages** and **technological partnerships**;
 - ✓ more likely to benefit from supplying foreign affiliates and from **horizontal linkages** with foreign competitors on the local market.
 - This confirms that geographical closeness can enhance benefits and spillovers from the presence of MNEs (Mendola et al., 2022),
 - From the interviews to foreign companies in Namibia, physical distance and/or closeness to transport infrastructures often resulted one of the most important factors for the choice of local suppliers.
- Nevertheless, foreign companies seem to prefer **more distant MSMEs** when setting **forward type linkages**
 - ✓ Probably, because of the role of MSMEs as distributors/retailers
- Local MSMEs that supply only indirectly – i.e. **through higher-tie suppliers** – MNE affiliates are less likely to receive support from foreign buyers (Villena & Gioia, 2020).

Results: Industry

- MSMEs in **manufacturing sectors** are those that have more chances to supply foreign companies and, along with MSME in primary sectors, to be supported by foreign buyers.
 - ✓ Manufacturing local suppliers – along with suppliers in services sectors – are also more likely to benefit from **backward linkages** in terms of innovation.
 - ✓ This result matches one finding in Alfaro-Urena et al. (2022).
- Local MSMEs operating in **service sectors** seem to be preferred by MNEs for **forward type linkages**.
 - ✓ As it comes out from the interviews to MNE affiliates in Namibia, MSMEs can be engaged as retailers or distributors (particularly by manufacturing MNEs) to reach local market.
- MSMEs in both **manufacturing and service sectors** also result to be more likely to take advantage of **horizontal linkages**, which boost investments and innovation.
- Finally, local small companies in **primary and service sectors** are more likely to be chosen as **technological partners** by MNEs.

Results: MNE origin

- Suppliers of **African MNE affiliates** are more likely to be supported by foreign buyers and benefit from **backward linkages** along several dimensions
 - ✓ In line with Gold et al. 2017; Morris et al. 2016; Morris and Staritz, 2017.
 - ✓ Most of the South African MNE subsidiaries interviewed in Namibia support their local suppliers in different ways (e.g. instruction manuals and standardized training and visiting supplier companies)
- Benefits are focused on employment and wages in case of **Asian buyers** and on innovation in case of **Northern buyers**.
- No clear difference across MNE origins in terms of attitude to generate **forward linkages** with local MSMEs.
- MSMEs in **direct competition** with **African MNC affiliates** on the local market seem to react to such competition by more investment and innovation ;
 - ✓ Those competing with Northern affiliates, instead, result to lose market shares, such as competitors of Asian affiliates (as in Wegenast et al., 2019).

Policy suggestions

1) Developing capabilities of local producers

- Enhancing MSMEs' innovation
 - ✓ improving public education system
 - ✓ enhancing vocational training
- Extending access to external financial sources
 - ✓ Taking MSMEs out of informality

2) Promoting (international) quality product certification

- Explaining the importance of product certification
- Funding the purchase of quality product certification (when too expensive!)
- Harmonizing product certifications (at least at regional level...)

Policy suggestions (cont.)

3) Getting MNE affiliates and MSMEs closer

- Developing industrial areas where MNE subsidiaries and MSMEs could more easily co-locate
- Lowering transport and communication costs by reinforcing related infrastructures

4) Making first-tier linkages prevalent

- MNE subsidiaries might be unaware of lower-tier suppliers, making knowledge-transfer more difficult to occur
- It might reduce social and environmental issues (Villena and Gioia, 2020)

5) Boosting regional FDI, with some local content policy

- Leveraging AfCTA to boost FDI across the South African area
- Setting some (even temporary) minimum local content requirements for foreign investors

Summing up

- GVCs can be an opportunity of development, despite of the risks and challenges they take along
- Currently, the participation of African producers in GVCs is very limited and with scant benefits, due to large scale and technological gaps with lead global players
 - ✓ AfCTA opens a window of opportunity for developing **Regional Value Chains**
- MSMEs are very important to guarantee that participation in GVCs turns into a “**broad-base and sustainable development**” (Asian Development Bank, 2015).
- MSMEs suffer from **several limits** when trying to access GVCs/RVS (limited scale, lack of financial and technological resources)
- MSMEs can more easily access GVCs/RVCs and benefits from them by establishing **linkages** with local subsidiaries of foreign MNEs.
- The **likelihood and benefits of linkages** can depend different dimensions:
 - MSME capabilities
 - Industry sector
 - Origin of foreign MNEs
- Specific **policy actions** are needed

Future work

- Spreading both the **MSME Survey** and the **MNE Survey**.
- Covering Southern African countries so far not included in the empirical analysis.
- Reaching sufficient number of observations to carry out *econometric analysis*.

A shorter version on the LSE-GILD blog



Thanks for your attention!

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