OECD OCDE

GLOBAL FORUM ON
INTERNATIONAL INVESTMENT

ATTRACTING FOREIGN DIRECT INVESTMENT FOR DEVELOPMENT

Shanghai, 5-6 December 2002

CREATING EFFICIENT NETWORKING AND EFFECTIVE LINKAGES IN INVESTMENT PROMOTION*

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At the outset, allow me to express my sincere thanks for the opportunity to share some thoughts with you from UNIDO's side with respect to ways and means for developing countries and their enterprises to attract FDI for development and benefit more competitively from investment, as the theme of this Global Forum indicates.

As we are all aware, the issues in attracting FDI are complex, and there is no such thing as a simple, single path to using FDI in development success. Action is required at many levels, needs to be well-calibrated in terms of policy instruments and to be well-articulated in strategic terms in order to turn the potential benefits of foreign investment flows into a particular host country in the developing world into tangible development outcomes over the long-term.

There is no doubt that the challenges in front of policy makers, development strategists and investment promotion practitioners are rising in line with dynamic changes that are taking place on one hand within the evolution of the integrated international sourcing, technology, production, distribution and marketing of goods and services[1], and on the other hand within the spatial distribution of the world's leading multi-national enterprises (MNEs) and their collaborative investment relations[2]

A look at the statistics on global FDI flows annually compiled from the International Finance Statistics for UNIDO's classification of countries confirms persistence of the asymmetric distribution of FDI between developing and industrialised countries on the one hand and within the developing countries on the other hand. The least developed countries (LDCs), and many countries in Africa are by-passed by FDI flows. This threatens to prolong and increase their marginalisation and prevent their economies intermediating meaningfully, with attendant advantages, in the present process of globalisation. This is in sharp contrast to the widely acknowledged range of socio-economic and managerial benefits that FDI can bring to a host country – in terms of capital and technology inflows, employment creation, income generation, as well as management skills and organizational know-how. The combination of attracting FDI and promoting investment is therefore not an end in itself. It must be seen strategically in the wider context of the contribution of FDI to a country's industrial development.

Issues

There is a growing consensus that an increasingly deregulated and liberal FDI regime hallmarked by modal neutrality, market contestability and policy coherence is a necessary, but not sufficient, condition to attract foreign investment into a country. Sound macro-economic fundamentals and micro-economic reforms to contribute an enabling environment for investment continue to be prerequisites for a country to maintain its place on the international investor's map. Additionally, creating and maintaining effective support institutions – that is, investment promotion agencies (IPAs) – is likely to remain a crucial factor for attracting investments. Furthermore, country image-building and investment destination marketing efforts will also remain important as part of a strategic long-term process.

From UNIDO's experience, the sufficient condition, on the part of the developing country IPAs for successful investment promotion efforts, is a far more pronounced emphasis on the pro-active and targeted promotion of specific investment opportunities and international investors. Let me explain what I mean by this before highlighting dimensions of creating efficient networking and effective linkages in investment promotion.

In present circumstances of globalisation, the factors that determine FDI location decisions have grown in complexity. Traditional motivations, such as a country's natural resource base, its market size, or the availability of low-cost labour while still valid, are losing importance in the decision-making of multinational enterprises (MNEs). Due to rapid technological advances, convergences in information communications technologies and new managerial techniques, profound changes are underway in the industrial organization of manufacturing and production processes. These changes, which are encapsulated by the economic geography of production and the spatial distribution of international stages of manufacturing, have an increasing impact on the investment location decisions

[1] Antonelli, Cristiano. 1999. The Evolution of the Industrial Organisation of the Production of Knowledge. *Cambridge Journal of Economics*, 23(2): 243-60.

[2] Cohendet, P., F. Kern, B. Mehmanpazir & F. Munier. 1999. Knowledge Co-ordination, Competence Creation and Integrated Networks in Globalised Firms. *Cambridge Journal of Economics*, 23(2): 225-41.

and operations of MNEs and the way in which MNEs interact with other enterprises particularly host local firms[3]. At the host country level, the availability of production factors of a kind and quality needed for linking up to, and integrating with, international value chains which in turn have multiple subcontracting and original equipment manufacturing (OEM) relationships assumes growing importance.

In other words, whether or not developing countries can engage with these production networks very much depends on the level of development of specific parts of their industries. In order to link into these international value chains developing country companies have to be increasingly internationally competitive within particular niches. Clearly, this fact requires that we direct our attention beyond the confines of "traditional" investment promotion policies towards an improved design and articulation of quality, standards and metrology-related policies; policies on the promotion of (and internationalisation of) small and medium-sized enterprises (SMEs); and technology and innovation policies. Several key publications including UNIDO's Industrial Development Report 2002/2003 emphasize that promoting linkages takes us to the nexus of investment and SME policies.

UNIDO's publication – the Industrial Development Report 2002/2003[4] – addresses the critical importance of innovation and learning to improve the competitive performance of a country's industrial sector. The report identifies points of engagement with the international system of production for the increase of industrial competitiveness through the upgrading of national learning and innovation systems. The report introduces the Competitive Industrial Performance (CIP) Index as a benchmark for comparing industrial performance and ranks 87 countries.

FDI is one of five key drivers of industrial performance - in addition to local technological effort, skill development, licensing and quality of infrastructure - analysed in the report and is found to play a central role in developing competitiveness, particularly for dynamic industries. The UNIDO report's findings raise issues concerning the usefulness of promoting relatively low technology industries, such as labour intensive textiles over the longer term.

What does the UNIDO Report imply for the future work of attracting increasingly higher level manufacturing value-added FDI by developing country Investment Promotion Agencies (IPAs)? One general conclusion that may be drawn is that, in order to better support their country's FDI policy regime and regulatory framework, IPAs need to develop acute institutional awareness of the underlying structural changes in world production systems as articulated by international investment and technology flows. Capacities have to be built up, or strengthened, for researching, monitoring and informed assessment of evolving technological and organizational patterns in manufacturing in general and within priority sectors in particular. The objective is to identify points at which links between local industry and foreign companies can be created. IPAs should do this in concert with other institutions in the country to jointly define needs and take action in coordinated strategic and practical steps to meet this objective. The need for IPAs to network more intensely with other players in the business support system, such as business associations, Chambers of Commerce and Industry, SMEs development agencies, export promotion bodies, R&D and technology institutes cannot be overemphasized in the overall strategy to attract FDI.

More specifically, one increasingly effective way for IPAs to support the creation of linkages between domestic and foreign enterprises is to get involved – directly – in the process of matchmaking of complementary enterprises through subcontracting, OEM and supply relations. It is accepted that the

[3] Dunning, John H. 1997. *Alliance Capitalism and Global Business.* Routledge.

[4] UNIDO. 2002/2003, *UNIDO Industrial Development Report 2002/2003.*

availability of a local network of reliable and capable suppliers and subcontractors is a strong motivation for FDI especially that which is export oriented.

UNIDO has gained considerable practical experience in this field from its enabling services for managing Industrial Subcontracting and Supply Chain Development. I would like to share with you the main features of this programme of activity as well as the lessons of experience.

Industrial subcontracting between firms of different capabilities, types and sizes, especially between large and small enterprises, is a defining characteristic of modern intermediation in industrial economy. In industrialized countries, and in agglomerated markets, an intricate and spatially extensive network of complementary inter- and intra-firm relations exists. Large corporations rely on smaller enterprises for the manufacture of parts, components and sub-assemblies, or for certain processing, transforming and finishing operations. Due to dynamics in production costs, subcontracting is recognized as an efficient tool to increase the rate of utilization of installed industrial capacities, to increase both production and employment in the SME sector, to produce better quality products at reduced cost, and thus to contribute to integration and national growth.

The objectives of the UNIDO Programme, therefore, include reinforcing the capacity of local SMEs to engage with international production by increasing production (and thereby employment), upgrading technological processes and products, improving their international competitiveness, attracting foreign investment and promoting exports of manufactured products through linkages with the marketing networks of MNEs.

The key role in this matchmaking support is played by the UNIDO Subcontracting and Partnership Exchanges (SPXs). To date, more than 60 SPXs have been set up with UNIDO's assistance in more than 30 countries. SPXs act as technical information, promotion and matchmaking centres for industrial subcontracting, OEM and partnerships between main contractors, suppliers and subcontractors. Together, they form the UNIDO SPX Network with links to more than 100 associated members. This SPX Network provides detailed standardized, updated and certified data on approximately 20,000 manufacturing companies worldwide.

UNIDO provides technical assistance for the set-up and operation of the SPXs, based on a standard approach and methodology. UNIDO recommends legal statutes and standard terms of reference for the establishment of autonomous SPXs, ideally as non-for-profit industrial associations run by qualified engineers under Management Boards. For the operation of an SPX, UNIDO has developed a comprehensive methodology and tools, known as the UNIDOSS (UNIDO Subcontracting System). These include a database management software, called "Outsourcing 2002", which is provided under a licence agreement.

The scope of enabling services provided by SPXs has been expanding to better their role as supply chain management and development centres. In addition, SPXs organize "Supply Development and Upgrading Programmes" for clusters of small-scale suppliers and subcontractors to assist them in meeting the increasing higher resolution quality requirements of major international contractors and buyers.

The available performance surveys conducted in 1993 and 1997 showed substantial traffic between SPXs and their respective registered companies. In 1997, two thirds of the companies concluded at least one contract because of SPX intervention. UNIDO can make available details of SPX successes which illustrates the range of achievements. It needs to be recalled that some SPXs focus more on high-tech activities while others concentrate on high volume contracts with foreign companies, and still others facilitate smaller subcontracts.

The reason for dwelling at some length on UNIDO's Industrial Subcontracting and Supply Chain Management Programme is to inform the discussion on IPAs and maximising benefits from FDI with respect to networking and linkages.

UNIDO responses

In relation to developing networking and building linkages for increasing effectiveness in investment promotion and attracting FDI, UNIDO has taken three new major initiatives.

The *first* is the launch this year of the UNIDO-Africa Investment Promotion Agency Network (AFRIPANET)[5] in November last year and its associated survey of investor perceptions in Africa. This Network functions as a resource group for agencies with whom UNIDO has worked extensively in country-level programme activities. It also provides a permanent platform for training as well as continuous linkage between member IPAs and UNIDO Investment and Technology Promotion Offices (ITPOs)[6]. And finally, it provides a feedback mechanism to guide UNIDO in adapting its enabling services to the changing needs of developing countries.

The overall objective of the Network is to bring permanence to the partnerships between the IPAs and UNIDO. The substantive focus is placed on the development of tools, methodologies and strategies for investment promotion which are more in line with the resources available to African IPAs. These are limited and typically below the levels of the "IPA success stories" in the developed and advanced developing countries often exemplified as best practice. The AFRIPANET Inaugural Meeting started network discussions to explore practical, low-cost schemes that could be more readily applied in member IPAs. The Investor Perceptions Survey conducted in four member countries (Ethiopia, Nigeria, Tanzania, Uganda) prior to the launch formed the basis for discussion. The surveys yielded valuable insights, in particular, the utility of IPAs and, encouragingly, the high degree of reinvestment intentions of existing investors. Catering more to existing investors was found to be a worthwhile, low-cost approach for the respective agencies. It is intended to increase the country coverage of the surveys starting this year and to make the results available as a regular UNIDO publication.

The *second* initiative UNIDO has taken recently in pursuance of improved networking for investment promotion is "UNIDO Exchange". This is a new electronic platform, designed to link the Organization's various promotional networks together and help increase their reach to the community of industrial development agents. The UNIDO network of Investment and Technology Promotion Offices (ITPOs) is a core group of the Exchange. UNIDO ITPOs are presently located in 13 capital-exporting countries. Their primary objective is to promote investment opportunities from developing countries within the business community of their respective host countries. "UNIDO Exchange" offers on-line access to a virtual marketplace for screened investment project and partnership proposals, technology offers and requests. It allows liaison between industrial institutions and operators for concluding partnership agreements, and it provides an interactive access to UNIDO services, tools and methodologies. IPAs are invited to register with "UNIDO Exchange" – it is a free service – and to add "UNIDO Exchange" to their marketing outlets.

The *third* initiative is a pilot activity that UNIDO is undertaking in Nigeria to improve access of local SMEs to equity finance through a Nigeria-based equity fund, set up by African Capital Alliance. The fund will operate on a fully commercial basis and as such will prefer a small number of large projects

[5] http://www.unido.org/afripanet

[6] http://www.unido.org/itpo

to many small ones. UNIDO is establishing a complementary SME Support Fund which will finance technical and business advisory services – both pre-investment and post-investment – to SMEs benefiting from the equity fund. Joint Ventures with foreign investors that provide technical know-how or market access are of priority interest to the equity fund. It is this aspect which may motivate IPAs towards a stronger involvement in the attraction of institutional investors and venture capital into their countries, given convergences in FDI and Foreign Portfolio Investment.

Conclusion and Policy Recommendations

The challenges which all countries, especially some developing ones, face in the attraction of more FDI flows are enormous. There is no easy way to progress for many developing countries, which face the threat of remaining marginalized from these flows.

From a strategic perspective, the solution is to increase the "absorptive and intermediation capacity" of the industrial sector in the host country for investment and production partnerships with foreign firms. While this includes technological upgrading and improved competitiveness as continuing tasks, in UNIDO's view, one important way ahead is for developing country IPAs to start addressing the issue of linking domestic industries with international production systems.

Three interrelated factors influence a country's ability to win FDI and reinforce linkages:

- Its overall investment policy framework, public governance and market competitiveness environment.
- Its investment promotion and institutional capacity building strategies.
- Its institutional capacity for implementing these strategies.

The relative importance of each factor varies by country and in time in relation to the country's developmental strategy and institutional structures for supporting the efficient working of markets. The policy environment is of paramount importance in a country with a sizeable local market and substantial natural resources. For countries with smaller markets and fewer natural resources, an active and focused investment promotion strategy is important, as is having an effective IPA to implement the strategy.

An investment promotion strategy involves the organised use of a range of promotional activities to enhance the capacity of a country to absorb FDI and thereby to increase the level of investment and intensify linkages in a country. Most strategies use four different but interrelated sets of activities with varied emphasis depending on changing conditions. They are: activities to service existing, prospective and new investors (investor servicing); procedures aimed at identifying and removing administrative obstacles and managerial impediments to FDI; campaigns to enhance the image of a country (image building); and actions to generate an increased flow of investor's projects (investment generation).

The importance attached to each of these activities varies by country and over time, but at any given time most strategies include elements of all four activities.

Investor servicing involves pre-approval services, approval services and post-approval services to existing, prospective and new investors. The key issue in investor servicing is policy effectiveness in reducing uncertainty for the investor.

Identifying and removing administrative obstacles and managerial impediments require analytical techniques and subsequent management and legislative policy responses. Using FDI 'road-mapping' to identify the administrative obstacles and managerial impediments is effective. There are two basic ways to deal with administrative obstacles and managerial impediments to FDI; legislation to remove or moderate, and human resource management to change behaviour.

Image-building activities comprise effective communication about the location. Image-building techniques must be accompanied by removing administrative obstacles and managerial impediments, investment-generation and investor-servicing activities, as on their own they are invariably wasteful.

Investment generation involves broad- or narrow-cast targeting as well as direct marketing to individual investors. The overall socio-economic development strategy of the country should not be overlooked in policy consideration during the investment generation process.

An investment promotion strategy should combine these techniques in innovative ways that suit the economic and industrial development requirements and the resources of an individual country. As such prospects for sustainable efficient networking and effective linkages are possible. Without the combination of techniques in innovative ways prospects are dim.

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