

ECONOMIC AND PRIVATE SECTOR  
PROFESSIONAL EVIDENCE AND APPLIED KNOWLEDGE SERVICES

## Topic Guide

# Making Market Linkages

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## Executive Summary

Weak linkages between businesses within an economy result in inefficiencies, missed opportunities and often, over reliance upon imported goods and services. This topic guide looks at initiatives to improve these linkages and create sustainable economic ties with and between local businesses, particularly SMEs and with international enterprises. The guide reviews the experience from past and current initiatives in this area whether undertaken by donor funded programmes, the private sector or national governments. It aims to serve as a resource to help practitioners to incorporate market linkage development into any type of development project, regardless of its focus (market development or otherwise).

There are three main types of linkage facilitators: private sector entities (business-to-business partnerships), donor agencies, and the public sector (local governments). Though this report primarily focuses on how linkage-building strategies should be adopted by donor programmes, much of the learning comes from business as many large firms operating in developing countries have implemented vendor support programmes.

From the donor perspective, market linkage initiatives have primarily either been programmes aimed specifically at linkage development or have been built into market development programmes. In fact, their use can, and should, be considered for any type of programme. Donors and implementers of donor programmes should recognise that working with local markets and businesses in any sector will improve sustainability, increase efficiency and deliver multiplier and spillover benefits:

- an increase in the efficiency of delivering goods and services (ranging from medicines to school supplies to solar panels)
- local procurement and inclusion of population in economic activity
- lower input costs for the implementing agency
- transfer of skills, knowledge and technology, both upstream and downstream
- creation of multiplier effects in the economy

The review undertaken for this topic guide has discovered a wide range of interventions that have been used to support the development of market linkages. This topic guide classifies these interventions into three categories:

1. **Building supplier and distributor capacity:** This includes interventions to build local capacity ranging from training schemes to vendor development and support through contract supervision or, for example support for access to finance.
2. **Developing Information and communications systems:** Interventions that reduce information asymmetries and failures, such as tender distribution services and business database and market information systems.
3. **Strengthening the policy and business environment:** Interventions that support the development of appropriate policies and regulation to foster linkages within the economy for example, Export processing zones and business park promotion and local content requirements.

One clear lesson is that effective market linkage support will incorporate a combination of these types of interventions, as each often yields positive spill-over effects to support and enhance the impact of the others.

Donors and practitioners alike must consider all of the above throughout the project cycle. The concept stage must assess the feasibility of building in linkage development,

how it can be tailored to help achieve project milestones and how to budget for the approach. The design phase must determine the best way to ensure the sustainability of the project, including performing market assessments and identifying strategic sectors to work in. The implementation phase must build on the considerations made in the previous stages and adopt an iterative methodology, monitoring carefully the progress in building local supply capacity and performance and the impact it is having both on programme delivery and on the wider business environment.

Finally, the M&E phase must allow a realistic time frame for the achievement of outputs and especially must evaluate longer term results that will flow from the improved local business performance. Though donors face pressure to ensure VfM and, results-based measurements must not only focus on short-term targets, but consider the impacts a programme will leave behind. With a dual emphasis on results and sustainability, these two ambitions are often in conflict, with the former prevailing as donors look for immediate impacts. This report posits that a market linkage approach can help strike a better balance between the two.

# 1 Introduction

Markets Linkages connect the organisations involved in producing the products and delivering the services for any and every market. As such when linkages are absent or weak, markets become inefficient<sup>1</sup>. Businesses and donor programmes operating in developing countries with poor linkages are often forced to source goods and services from outside the local economy. The benefits of investing in linkage development are significant. Whilst linkage creation does take time and effort, linkages enable long term market development and deepening, drive cost and efficiency savings and support inclusion of the poor in the market economy. Thus, through supporting the development of market linkages, businesses and programmes alike can ensure that their short term investment has a long term impact that will ultimately lead to improved local capacity, create jobs and accelerate growth.

Whilst many large firms have long recognised the need to build linkages along their supply and distribution chains, the aid sector as a whole has been slow both to recognise the importance of this and to make progress. Building linkages improves the efficiency of programme implementation and, by not seeking ways in which to build the capacity of local organisations so that they can undertake to provide donors (or large firms) with goods and services, all stakeholders are missing an important opportunity.

In developing countries, complex environments, market failures, information asymmetries and low business capacity represent significant challenges that require time and commitment to overcome. In light of this, creating linkages as an integral part of the implementation of projects has more often than not been perceived by practitioners to be at odds with the donor focus on results and VfM. Those implementing projects have also cited the increased risk of using untested SME suppliers as a reason for not contracting them to deliver goods and services to donor programmes. The literature, however, highlights the fact that, if implemented correctly, there is no increased risk associated with engaging local SMEs. Furthermore, as donors increasingly recognise the commercial and developmental benefits of creating linkages, there is increasing expectation that all project managers and practitioners have a strategy in place to support linkage development.

Large firms, with their commercial focus, face many of the same challenges. In the past, the benefits of building the capacity of local suppliers and distributors was seen to be outweighed by the time and effort it takes to promote local market development. Given the overriding objectives of a corporate entity are increasing output and profit, exchanging trusted, reliable international suppliers for potentially poor local suppliers was viewed with some suspicion. However, increasingly the cost savings, improved efficiency and flexibility achieved through working with local suppliers, combined with the importance of obtaining a 'license to operate' and a commitment to corporate social responsibility has resulted in many larger firms undertaking local linkage schemes as part of their overall business strategy.

There is extensive literature that demonstrates the positive impact linkages can have on the local community, on SMEs, for those larger firms that successfully implement such schemes, and the wider economy (e.g. see Box 1, below).

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<sup>1</sup> Knopp, D. (2003)

The social license to operate generated through such market and business linkage schemes is also a key consideration for both donor and private sector led interventions. From the perspective of businesses, creating local links can help to overcome the negative social and political attitudes that are often harboured towards the private sector. In the past, the need for donors to have a license to operate has largely been ignored as donors assumed the license came from the fact that they were funding programmes with grants. This is no longer a safe assumption and increasingly donors must address their own 'license to operate' issues to avoid the accusation that aid spend is a mechanism to employ international consultants and provide business to their own goods and service providers.

Through reviewing the literature on what has already been done in this area and by undertaking interviews with those practitioners that have experience in implementing successful business linkage strategies, either through specific linkage programmes (both business and donor led) or as a part of donor programmes, this topic guide aims to consolidate and select those interventions that are most effective. Specifically, the paper will address the following:

- The conceptual basis for market linkage development.
- The challenges hampering the formation of market linkages.
- Approaches used in relation to 1) supplier and distributor development; 2) enabling linkages through establishing/improving information and communication services; and 3) strengthening linkages through policy and business environment initiatives.
- What this mean for practitioners.

## 1.1 Research methods

This review was undertaken as a desk review by Nathan Associates London Ltd.

The paper largely depends on secondary data sourced from donor and programme websites. In addition, the team gathered data through email exchanges and telephone interviews with programme managers, practitioners and other specialists.

It should be noted that when collating evidence, it became evident that very few of the programmes and documents reviewed utilised rigorous monitoring techniques. Where possible, results and lessons learnt have been drawn from those programmes that have implemented the most transparent and robust monitoring system.

### **Box 1: Unilever in Vietnam**

When Unilever first started operations in Vietnam in 1985, they had to overcome negative social and political attitudes towards the private sector as well as poor government policies and regulations. In order to achieve better relations, Unilever began working with local SMEs. They invested in plants, upgraded manufacturers and suppliers, and created distribution networks.

As a result of their efforts, by 2001 contract manufacturers accounted for 48 per cent of Unilever Vietnam's total production volume. Unilever was able to source 40 per cent of its raw materials and 80 per cent of its packaging from local enterprises. They benefited in terms of increased turnover and employment.

Unilever's employment policy to recruit, develop and retain local talent clearly benefited 7,500 Vietnamese workers (5,500 of these were new jobs) in its four plants and nine contract manufacturers.

Through its association with Unilever, Duy-Tan, a supplier of bottles, increased its total turnover from \$900,000 to \$6.67 million and employment from 160 to 664 between 1996 and 2002. By becoming part of Unilever's distribution system, the Hoang Phong Distributor increased turnover from 4,920 million VND to 45,800 million VND and employment from 10 to 55.

*Source: Ruffing, L. (2006)*

## 2 Conceptual Basis

### 2.1 Why support Market Linkages?

Large companies and donors in emerging markets are spending significant amounts of money on procurement of goods and services. As such, they provide a substantial business opportunity to stimulate the local economy by including local SME companies in their supply chain<sup>2</sup>. Currently, Transnational Corporations (TNCs) account for a large proportion of large firms in developing countries and often dominate their respective sectors<sup>3</sup>. It is therefore vital that market linkages between these firms and local SMEs are enabled in order ensure inclusive growth.

Market linkages that work well help large firms and implementing agencies to reduce input costs, increase specialization and flexibility, thereby bringing down costs and increasing efficiency. They also enable better technology transfer, overcome market failures and improve the domestic multiplier effect by keeping foreign exchange (from a TNC or Aid donor) in country. Linkages allow firms to increase local integration, provide access to local knowledge and provide companies with a license to operate, resulting in a positive social and economic impact in the wider community<sup>4</sup>.

Linkages enable SMEs to enhance their competitiveness and acquire critical missing assets such as access to international markets, finance, technology, management skills and specialized knowledge<sup>5</sup>. Building local SME capacity improves their ability to tender for procurement opportunities. Much of the literature points to the fact that SMEs that are able to tender for and win contracts are more robust and are able to respond to shocks, market demands and changing market conditions as a result of increased investment, business experience and a more skilled workforce<sup>6</sup>. Many developing countries suffer from the 'missing middle' syndrome. Through developing SMEs to fill this gap the economy can become more competitive, stable and more likely to achieve sustainable growth<sup>7</sup>. Further, from a development perspective, linkages can be used to ensure inclusivity, generate long term development and spill-over effects.

Given this, it is clear that all donors, practitioners, governments and businesses should be cognisant of the importance of linkages and to consider their development as an integral part of their programmes and businesses.

### 2.2 Why are Market Linkages weak in developing countries?

Whilst linkages are widely shown to benefit multiple actors, there are a variety of reasons why they remain weak and often fail.

From the buyer's perspective, key issues centre on **poor local SME capacity**<sup>8</sup>. The ability of local businesses to deliver products and services that meet the standards of large firms remains low. Furthermore, **poor reliability and the frequent delays** experienced when completing projects poses a critical issue to firms that rely on efficiency. This becomes particularly challenging for practitioners attempting to implement donor funded projects. Whilst incorporating market linkages initiatives is an attractive way to increase the

<sup>2</sup> IFC (2008) Developing SMEs through Business Linkages

<sup>3</sup> UNCTAD, 2010

<sup>4</sup> Jenkins, B. *et al.* (2007)

<sup>5</sup> 2001 edition of UNCTAD's World Investment Report, entitled "Promoting Linkages".

<sup>6</sup> Butler, A., Heady, L., Kuperberg, I., and McCord, S. (2012)

<sup>7</sup> Business Linkages programme Guidelines () UNCTAD

<sup>8</sup> Jenkins *et al.* (2007)

development impact of programmes, this takes time and patience, both of which are often at odds with the donor emphasis on narrower project defined results and quick wins.

In relation to suppliers, both **vertical and horizontal coordination failures** hamper the ability of suppliers to link with larger firms. **Poor availability of credit, shorter business histories, and limited management skills** are also key challenges that SMEs have to overcome when trying to access markets. **Lack of knowledge and poor access to technologies** further hinders SMEs from linking with larger companies.

**Information asymmetries and communication failures** impede the creation of linkages. Lack of information services makes it difficult for buyers to tap into local supplier networks. As such, accessing local networks, identifying partners and undertaking basic due diligence on local SMEs makes creating linkages a costly endeavour for large firms both in regards to the time it takes to identify local partners and in monetary terms.

**Limited access to tendering platforms** that international firms use to communicate opportunities to potential suppliers excludes many SMEs from bidding for local work. **Lack of experience and understanding of how to develop proposals** that meet international standards further inhibits SMEs from successfully bidding.

The wider **policy and business environment** in developing countries itself obstructs rather than facilitates market linkages. Evidence shows that linkages need to be accompanied by a coherent policy framework both at the national and international level, enabling enterprise development and the integration of domestic markets into global markets<sup>9</sup>. In many developing countries this policy framework is absent.

**Inadequate legal systems, contract enforcement and complex registration** processes also combine to deter both large firms and SMEs forming linkages.

However, despite these challenges, the examples provided in the following section illustrate that there is often more local capacity to build linkages than anticipated and assumed. Even simple interventions can make large long-term gains to maximise a programme's impact by enhancing the social impact of projects and through generating strong multiplier effects in the local economy.

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<sup>9</sup> UNCTAD (2010) Creating Business Linkages: A Policy Perspective.

## 3 Practical Application: Market Linkage Interventions

This section draws on the information collected during the literature review and the interviews to set out the practical steps that should be considered when implementing linkage strategies. First, the facilitators of market linkage interventions are described, defining what the key drivers of each are. This is followed by a detailed analysis of the particular interventions that can be implemented in order to address the challenges set out above. Although there is inevitably some cross over as to what activities can be utilised to tackle specific challenges, we have broadly categorised the interventions under the following headings as a guide to which activities are most suited to addressing the problems: 1) supplier and distributor development; 2) information and communication services; and 3) the strengthening of linkages through policy and business environment interventions. Each section sets out the benefits, theory of change, interventions and lessons learnt related to each of these areas.

In order to offer practical examples of each of the interventions, selected programmes that have undertaken market linkage activities have been presented alongside the interventions. It should be noted that most of these are drawn from specific market linkage programmes (private sector, donor and Government) rather than programmes that have developed market linkages to support the delivery of their objectives. This is because there are very few examples of the latter other than market development programmes (e.g. M4P initiatives) which by definition work to use linkages to develop markets.

### 3.1 Linkage facilitators

We have divided the facilitators into three groups, donors, B2B, and the public sector. Whilst there are obviously some common drivers for creating linkages for all of them, such as cost savings and more efficient delivery of services and goods, the underlying agenda of each participant is driven by different objectives. Understanding these is important when deciding which interventions are best suited to achieving those goals.

#### Donors

There are a number of donor funded programmes that specifically aim to support the development of market linkages as a programme output (e.g. Box 2), recognising that without support the development of linkages will be too slow, especially where the domestic private sector is very weak, such as in post conflict and fragile state situations. In addition, there is currently a largely untapped opportunity to increase the efficient delivery of donor programmes through integrating the development of local market linkages into their own programme delivery, whatever market they are operating within.

#### **Box 2: Business Linkages Challenge Fund**

The DFID-funded Business Linkages Challenge Fund (BLCF) supported the development of commercially-viable new economic activities by linking small and large enterprises in developing and developed countries. The programme also leveraged £50 million from the private sector. The fund operated across 26 different countries worldwide.

Over the course of the funds lifetime, 750 new products and services were created across 50 different enterprises and over 58,000 new jobs were created. In excess of 1,900 new business linkages were established at the regional and local levels. The export sales of participating business increased by 89.8 per cent.

Through developing local supply and distribution channels, donors themselves benefit through cost savings and the efficiency gains made through a more reliable, better functioning local supply networks. Furthermore, the absence of a social license to operate can be detrimental to the implementation of projects<sup>10</sup>. Engaging local SMEs involved in such chains can therefore provide donors with a means to obtain a license to operate and develop a rapport with the local business and policy environment.

Although developing such linkages requires some upfront costs, the longer term impacts will result in better overall value for money (VfM); as well as cost savings gained for future programmes able to contract locally. Building linkages ensures that the programme continues delivering benefits beyond the lifetime of the project.

Furthermore, as a result of supporting linkages, overall programme impact and spill-over effects can be increased significantly.

### Business-To-Business

Numerous businesses, especially larger companies, have implemented their own market linkage programmes. There are several drivers underpinning such strategies, as shown in Box 3.

As corporate entities, a key consideration for businesses is the cost savings that can be made through developing reliable local suppliers and distribution systems<sup>11</sup>. Improved linkages also lead to the development of local markets and ensure inclusive business. The ultimate development impact of such a scheme is increased jobs and incomes for those who, as a result of linkage initiatives, are included in large firm supplier and distributor chains.

#### **Box 3: Business Drivers**

- Lower procurement, production and distribution costs
- Improved productivity
- Opportunities for CSR combined with profitability
- Enhanced reputation and license to operate
- Integration into new markets
- Ability to reach new customers at BoP
- Reduction in foreign exchange needs through import substitution
- Flexibility in design and production changes due to proximity of local suppliers
- Compliance with local content rules

### Public sector

The public sector drivers underpinning market linkage support include overall improved private sector functioning. Developing linkages and supporting local SMEs enables the development of existing and new markets, both domestic and foreign, and enhances the efficiency of markets. Furthermore, by streamlining business related procedures, the public sector can take an active role in promoting inward foreign investment.

Ultimately, market development leads to increased local economic participation and growth, a key driver for governments. This helps generate jobs, higher incomes and therefore economic growth.

#### **Box 4: Public Sector**

- Improved economic activity and local economic development
- New markets (domestic and foreign)
- Increased employment and productivity
- Long term increase in local and regional competitiveness
- FDI attracted
- Diversified economy
- Added purchasing power
- Improved products and services
- Participation of large companies in local business
- Balance of payments benefits when products are exported and substituted for imports
- Development of local services providers catering to SMEs

<sup>10</sup> IFC 2009

<sup>11</sup> Ashley et al. (2005)

Better linkages also increase the cost effectiveness and efficiency of government procurement systems through improving local suppliers’ ability to participate in the procurement process.

The full list of drivers associated with public sector linkage creation and development of local supply and distribution chains are presented in Box 4.

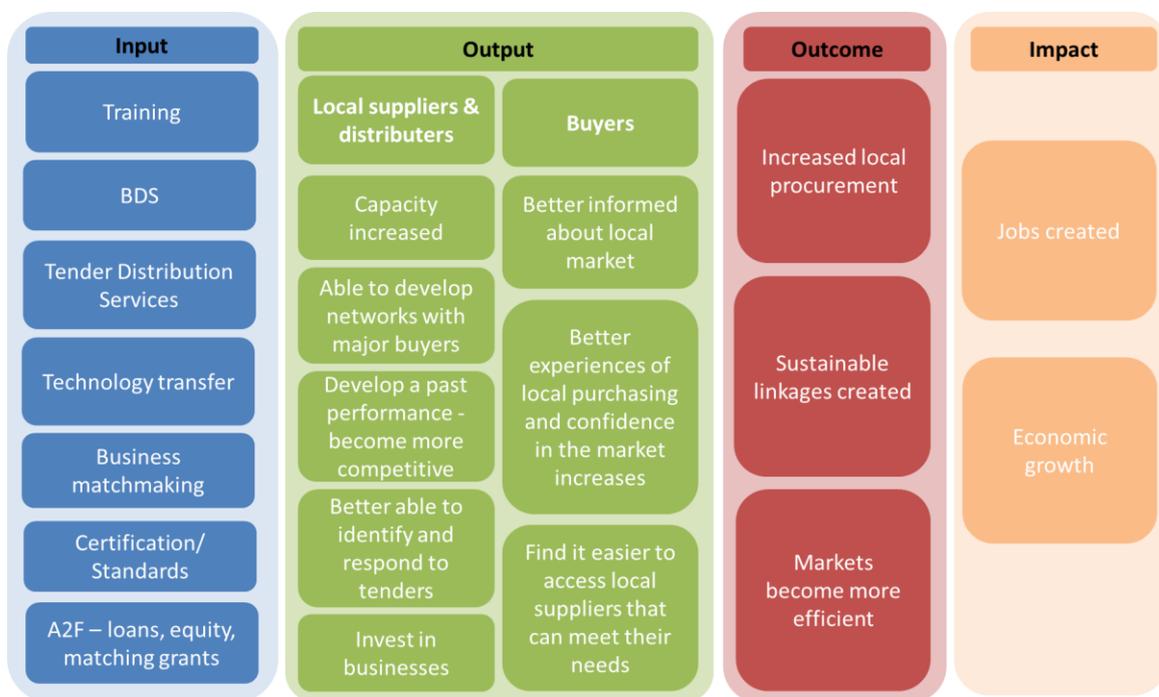
### 3.2 Supplier & distribution development

In many developing countries where businesses and donor programmes work, the key issues constraining market linkages are poor local supplier and distributor capacity. As such, many business, donor and government initiatives have focused on the development of local SMEs in order to overcome this challenge.

#### Interventions

Figure 1 presents the theory of change for the most useful interventions for local supplier and distributor development.

**Figure 1: Theory of change for supplier & distributor development interventions**



In practice, even simple strategies can promote market growth inclusive of local SME businesses. Various interventions have already been tried and tested and should be used as a clear roadmap for future practices:

**Training:**

Many local suppliers and distributors lack the technical capacity to undertake the provision of services and products to larger firms or programmes. Lack of experience and understanding of buyer procurement protocols also hampers their participation in global supply/distribution chains. Targeted training sessions can help local enterprises bridge these skills and management gaps to help them meet global standards. Evidence shows that providing tailored training courses to local companies covering the topics listed below will build local business capacity and help firms deliver global standard goods and services to larger firms.

- Procurement processes/tendering and bidding for contracts
- Improve supplier knowledge of business standards
- Basic business management
- Business accounting
- Sales and marketing support

While technical skills courses will vary depending on the target sector/industry, improving general business practices will ensure that basic systems are in place to meet the demands of suppliers.

**Business development services (including embedded):**

BDS are defined in the broad category of all non-financial capacity building services provided to local entrepreneurs and businesses. In the case of Business-to-Business linkages, evidence suggests that BDS is most effective when it is embedded as one company can share and develop best practices (through training, consultancy and business plan development) or even provide operational support such as transport, advertising and accounting<sup>12</sup>.

**Box 5: Capacity Building: Building Markets: Afghanistan**

Building markets aimed to prepare local suppliers to compete for contracts from international buyers operating in the country. Though training covered a variety of topics, it emphasised procurement procedures. This includes understanding evaluation methodologies, completion of forms, calculating DBA insurance, invoicing, understanding buyer criteria, etc.

From 2006 to 2012, the programme trained employees from 1,556 businesses. According to surveys undertaken by Building Markets, 64% of participants reported they had tendered for more opportunities. Suppliers attributed feedback related to 333 contracts worth \$144 million to their participation in the training sessions. Furthermore, 27% of contracts won with the help of Building Markets led to another contract. The programme was so successful that some companies even made training from Building Markets a mandatory condition for employment.

*Source: Butler, A., Heady, L. (2010)*

**“27% of participants who were awarded contracts with the help of Building Markets went on to win more”**

*Source: Butler, A., Heady, L. (2010)*

**Box 6: BDS example: East African Growers Association (EAGA)**

EAGA is a Kenyan-based exporter of horticulture products. Through the provision of embedded BDS services, it was able to link up with farmers to meet the growing demand for avocados in Europe. From the supply side, EAGA was able to identify producer groups and agreed to embed service arrangements to support steady export-grade production levels. This included services ranging from crop husbandry and pesticide application to collection and transport services. From the demand side, they provided a guaranteed market for farmers through contracts with committed buyers. This not only provided a guaranteed market for producers, but gave them better prices than those offered by local brokers. *Source: Macharia, M. (2006)*

<sup>12</sup> Value-chains.org; Business Services Market Development Experiences and Lessons, Peter van Bussel, Dec 2005.

**Technology transfer:**

There is strong evidence that the availability and use of technology can increase the impact of linkage interventions. Positive spill-overs into host countries through buyer-supplier linkages are more likely to occur when the technological gap between foreign and local firms is relatively small<sup>13</sup>.

The technological capabilities of local firms are key determinants of their ability to qualify as suppliers to firms operating in increasingly competitive markets. A number of initiatives have adopted measures to encourage technology transfer from buyer firms to supplier firms and to strengthen technological cooperation between the two. A number of governments have set out technology transfer requirements to induce the transfer

of technologies from TNCs to local firms that are subcontractors of foreign affiliates. Other initiatives have involved buyers affiliating themselves as partners in technology upgrading programmes, offering them access to technological and managerial know-how.

**Finance<sup>14</sup>:**

Financing is one of the most common tools to develop supplier and distributor capacity. While there are several other interventions required to develop linkages, it remains an important part of improving the health of the local private sector. Capital inputs can be a necessary catalyst to advance key industries and allow them to be self-sustaining enough to not require similar levels of financing in the future. Financing schemes can come in the form of loans, equity investments, or matching grants/cost sharing. Within B2B initiatives finance may come from the purchasing company itself or through their support in obtaining external finance. Facilitators are also not always the direct sources of finance, but may also help enterprises secure support from banks or other sources of finance.

**Box 7: Technology transfer: Intel, Penang**

Intel arrived in Penang in 1972. Local managers crafted a supplier development programme called the "Smart Approach" to nurture existing and potential new suppliers.

As part of its approach, Intel assigned staff to SMEs to share know how and undertook a phased upgrading of technology from SME plant layout to design capability, flexible manufacturing and ISO certifications. Although data is not available to disaggregate the impact of the different interventions, the smart approach overall was highly successful. A number of the SMEs such as LKT and Eng Tek which participated in the programme have become TNCs in their own right. Eng Tek was recognized by Money Asia as the best SME in Malaysia, and LKT has won numerous awards for product, vendor and supplier excellence. Both SMEs are listed on the Kuala Lumpur stock exchange. They became, through the smart approach, "best-in-class" technology corporations.

*Source: Ruffing, L. (2006)*

**Box 8: Anglo American, South Africa**

Zimele is an enterprise development initiative started by South African mining business Anglo American. Started in 1989, Zimele served to actively seek black-owned SMEs to partner with, and in some cases, invest in.

Zimele staff seek out investment opportunities, and provide loans as well as taking on a minority stake of 20% in the company. By becoming a shareholder in the business, without taking full-ownership, Anglo makes a concrete commitment to support SMEs as an investment.

Since 1989, Anglo American has invested in over 100 companies, exiting from 70 of them. In 2004 it spent \$800 million on goods and services from SMEs and invested in 27 businesses to employ 2,000 people. It has clearly had a long-term impact: its SME partners have had a 90% survival rate, longer than the average life-span of 6 years.

*Source: Ruffing (2006)*

<sup>13</sup> UNCTAD, 2010

<sup>14</sup> Ruffing, Lorraine. Deepening development through business linkages. UN, 2006.

### Certification & Standards<sup>15</sup>:

To reduce both the time and costs associated with carrying out appropriate due diligence procedures, businesses can be supported to gain certification to meet an approved set of standards to work with either SMEs or large foreign businesses. In contrast to business verification, certification is a longer-term system of approval that is recognisable amongst buyers. Rigorous individual evaluation of local businesses is costly and inefficient. As such, credible certifications can give future buyers confidence in the ability of a wide range of SMEs. This will lower due diligence costs and encourage firms to work with a greater number of local suppliers.

#### **Box 9: Ecom Agroindustrial Corporation, Global**

Established in 1849, Ecom is an agricultural trading company motivated by the growing global demand for coffee and cocoa and the large production by smallholders. It views its approach as a pragmatic way forward to develop the future supply chain. In conjunction with technical and financial support, Ecom helps farmers gain various certifications from the Rainforest Alliance, Fairtrade and Starbucks.

Specifically, Ecom worked with the non-profit Conservation International to contract 2,000 farmers in Mexico to supply Starbucks by training them to follow the corporation's specific standards (CAFÉ practices). Ecom also helped link producers with specialist organisations to resolve other issues, such as finance, soil fertility and even healthcare. To date, Ecom's efforts have reached tens of thousands of farmers in the coffee business alone, enabling them to produce more efficiently and sustainably and to capture higher prices in the marketplace. Its efforts have also helped buyers connect with small producers at lower cost.

*Source: Jenkins, Beth, Anna Akhalkatsi, Brad Roberts, and Amanda Gardiner (2007)*

### Lessons learnt

There is substantial literature on the implementation of supplier and distributor development interventions. Many buyers have implemented some form of M&E strategy whilst executing linkage interventions and have subsequently identified a number of key considerations that make it more likely a linkages programme will have the right impact. The specific lessons that are most frequently cited in the literature include the following:

- **Multiple interventions:** Successful initiatives/programmes implement several interventions in conjunction, to varying degrees, catered to the desired market outcome. The Anglo Group's example of financing mining operations while contracting SMEs to meet service demands is one such example of a selective approach.
- **Start early:** Building the capacity of local businesses takes time – the earlier the program starts, the greater the opportunities<sup>16</sup>.
- **Anchor company participation:** Experience has shown that anchor companies are reluctant to participate in linkage programmes unless they have some control over the selection of local supplier and distributors. This is to ensure that they have confidence in the partnerships. Therefore, ensuring that large firms are involved in the selection process is critical to making linkage initiatives sustainable.
- **Commitment and culture of long term thinking:** Linkages take time to evolve and require patience. They require 5,10,15 years of effort and as such linkage practitioners need explicit support from senior levels and procurement managers<sup>17</sup>.
- **Performance measures and incentives:** Suppliers and distributors should be aiming at achieving targets with an incentive structure in place (e.g. increasing

<sup>15</sup> Jenkins, Beth, Anna Akhalkatsi, Brad Roberts, and Amanda Gardiner (2007) Business Linkages: Lessons, Opportunities and Challenges. IFC, International Business

<sup>16</sup> IFC (2011)

<sup>17</sup> Jenkins et al (2011), IFC (2011), IFC (2008)

contract size as performance improves)<sup>18</sup>. This is particularly relevant to those large companies implementing linkage schemes.

- **Measuring returns:** It is important to develop tools that help companies and practitioners measure the impact and/or financial return of their linkage activities, specifically the extent to which they create or protect value helps engender commitment<sup>19</sup>. E.g. Planning and Financial Evaluation Tool (FV Tool) designed by Deloitte, Rio Tinto and IFC.
- **Active participation of SMEs:** Participating SMEs must have a sense of ownership, play an active role in their development process, and demonstrate a willingness to change their business practices.
- **Defining criteria:** The selection of SMEs who can participate in the interventions should be focused, with only those that meet the criteria selected to participate in linkage intervention. This will ensure that SMEs without potential are filtered out. An ineffective selection wastes valuable resources and can jeopardize the sustainability of programme outcomes.
- **Sector selection:** Some sectors will deliver higher returns than others. The Building Markets initiative found that the top three sectors for employment generation were construction, healthcare, and transport/logistics. In Haiti, construction accounted for 51% of all jobs created, the vast majority of which were more sustainable over the long-term (higher than the average lifetime of 6 years).
- **Best practice guidelines:** In conjunction with large companies/programmes, it is important to develop best practice guidelines that are specific to industries and business activities. E.g. Unilever's sustainable tea initiative provides guidelines to tea farmers.
- **Enterprise centres:** Should initiatives have access to adequate funds then setting up a one-stop-shop for SMEs, where they can access contract opportunities, e-procurement systems, ICT, BDS, training courses, can aid the linkage development process.
- **Encourage diversification:** SMEs should be encouraged to diversify their client base to ensure they do not become totally dependent on one buyer and to safeguard their sustainability<sup>20</sup>.

### 3.3 Enabling market linkages through information and communication services

Information systems are fundamental to the creation of sustainable linkages. Procurement related interventions such as tender distribution services, supplier databases and matchmaking activities help both buyers and suppliers expand their networks. Whilst SMEs are better able to find opportunities, buyers benefit from receiving more bids. With better access to such platforms, practitioners are also able to source local partners more easily. In fragile and conflict affected states or in countries with a poor private sector, services which undertake due diligence of local businesses and which take a more hands on approach to matchmaking firms are particularly important as it helps increase trust in the reliability of SMEs. As a result, businesses that may not have felt confident enough to invest and start operation in that country are enabled somewhat to do so. Besides improving the quality of business services, information platforms can also act as a key tool for SMEs to research and find out about

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<sup>18</sup> Jenkins et al (2011)

<sup>19</sup> IFC (2011)

<sup>20</sup> IFC (2008)

good practice and innovation; disseminating knowledge (e.g. farming techniques) and market information (e.g. commodity prices).

Information and communication failures impact negatively on market linkages in a number of ways. In environments where local businesses have typically relied on informal networks to conduct business transactions, SMEs are often excluded from linking with viable business partners outside their networks (both regional and international) as they are unaware of many of the tender opportunities offered by larger firms.

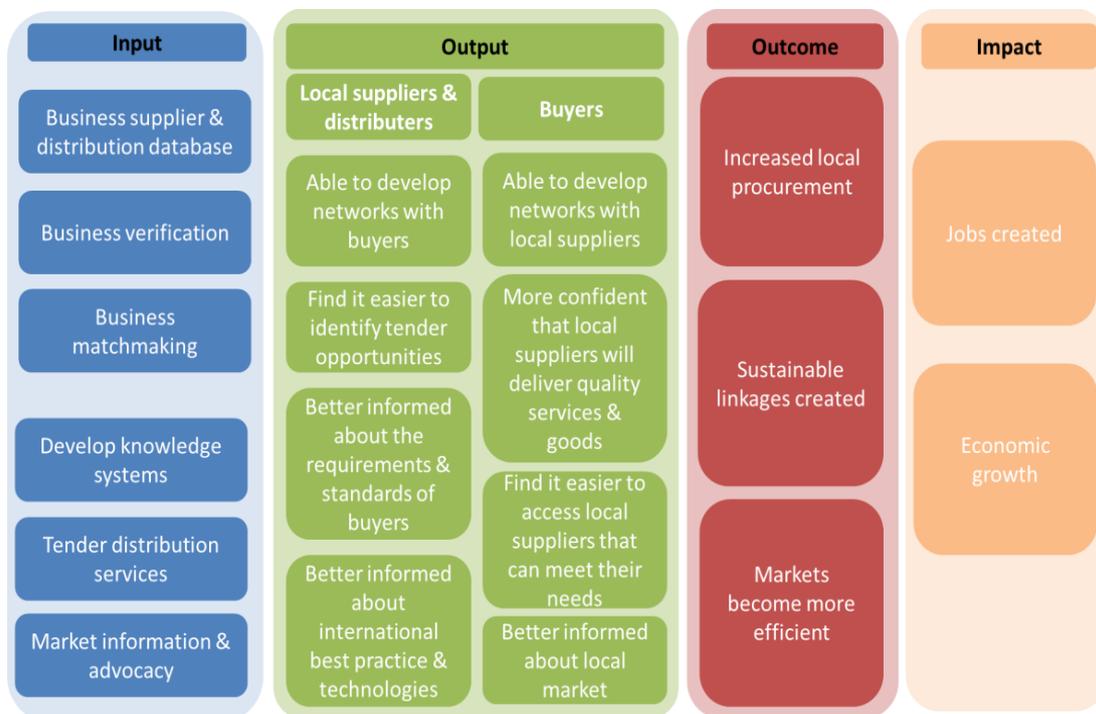
Similarly, without databases, matchmaking and tender distribution services, large international entities struggle to tap into the local supplier and distributor networks. From a practitioner’s viewpoint, where implementers of donor programmes are often setting up projects in countries where they have not necessarily worked before, it is apparent how difficult it can be to tap into local networks. When identifying partners to supply goods and services, there is a heavy dependence on collaborating with other firms who have experience in those countries. Without formal information platforms, firms must rely on informal networks and feedback from competitors and partners to identify local suppliers.

In order to overcome these challenges, many linkage initiatives have focused on interventions that aim to establish platforms and systems that collect, distil and disseminate information for both buyers and suppliers.

### Interventions

The theory of change underpinning the information services interventions is presented in

**Figure 2: Information services theory of change**



Source: based on the Building markets theory of change

**Business supplier databases and inventories:** Supplier databases keep a record of different SMEs and TNCs for businesses, donors and governments alike to access when designing programmes or business ventures. Buyers can use this type of database to find suppliers who meet their specific demands, and a regulated set of standards. Information on main business activities, past collaborations, financial data and other topics can help form effective linkages. It can also provide up to date information about innovative programmes and policies.

**Box 10: Market Linkage Working Group (MLWG), Zimbabwe**

MLWG, a partnership between several local and international actors ranging from banks to farmers' unions, worked with the FAO to develop a web-based interactive database, a platform for companies to indicate their need for agricultural supplies and for farmer groups to share agricultural practices. For those farmers who lacked access to the internet, NGOs working with such farmers helped relay information from the database.

The website has helped farmers gain access to market information to increase bargaining power, link them up with aggregators and buyers and general extension support. This resulted in an increase in farmer incomes and successful contracts to grow commodities for buyers to guarantee a stable market for their produce to give them a reliable stream of income.

*Source: Sibjenga, Bart. (2009)*

**Business verification:**

In order to give international buyers confidence in the local suppliers' ability to provide goods and services, intermediary actors can help identify and verify potential firms. Verification services help streamline the contracting process in an environment unfamiliar to new buyers. Intervention from an authorised body, be it from the private or public sector, can help enforce minimum criterion to ensure firms hold to set standards and promote the longevity of local businesses. This process may be accompanied with other BDS services to help ensure that quality controls are in place.

**Box 11: Health Initiatives for the Public Sector (HIPS)**

The non-profit organisation, HIPS, works in Uganda to strengthen the private sector to deliver health services. Private clinics are dispersed around the country, but often operate in isolation with no supporting services. HIPS acts as a broker between these clinics and the Ministry of Health to help them meet accreditation standards. HIPS also provides technical assistance, such as training, the supply of testing materials and lab equipment. Connecting clinics with the government also gives them access to free antiretroviral and tuberculosis drugs, which can only be administered by certified and trusted bodies.

*Source:*

<http://healthmarketinnovations.org/program/health-initiatives-public-sector-hips>

**Business matchmaking:**

For local businesses, connecting with one business (particularly a TNC) can open up the way to future opportunities and help the local market integrate into a global supply chain. Business matchmaking can help facilitate and speed up this process.

Business matchmaking services help connect national and international buyers looking for goods and services with verified local businesses. Business matchmaking is a more active approach of establishing contracts between international buyers and local suppliers, particularly when there are technological constraints. Both parties are able to identify the needs of the buyer and the capacities of the supplier. Interventions include site visits, vendor promotion events, product sample collecting, and networking events between buyers and suppliers (exhibitions and trade fairs).

**Box 12: Matchmaking Example: Building Markets, Haiti**

The Peace Dividend Marketplace-Haiti project (PDM-H) undertakes research for buyers with specific requirements and produces matchmaking reports. They also run targeted matchmaking events.

**Case study: Sonac-Agricole:** In 2010, Ernest Charles, owner of Sonac-Agricole, faced near bankruptcy as his firm struggled to find reliable importers who would pay on time and in full. PDM-H approached him and suggested he register his company on the PDM-H website. They helped match make him with Wampin Seafoods, a Hong Kong firm that imports sea cucumbers and which has a major share of the sea cucumber market in China. Haitian companies registered on the PDM-H website must fulfil certain criteria. As such, through his affiliation with PDM-H, Charles' company was viewed as a credible firm. Today, Sonac-Agricole West Indies exports 10.5 tons of sea cucumbers per month to China. They directly employ 20 people and work with 50 fishing cooperatives. Each co-op has about 100 members. The firm is also a major buyer of salt which is a key part of the drying process.

*Source: Butler, A., Heady, L., Kuperberg, I., and McCord, S. (2012)*

**Tender distribution services and tender simplification:**

The purpose of tender distribution services is to expose as many suppliers as possible to relevant tendering opportunities. It must help mitigate problems of access and awareness. A successful system collects tender announcements and business opportunities for distribution to local companies. Announcements can be distributed via the internet, local news outlets or radio. Through amalgamating tenders to make them available through one platform, local suppliers can easily find relevant opportunities, saving them both time and resources.

Tender distribution systems must be as inclusive as possible. Publishing tenders in local dialects can help rural communities access opportunities. Technological gaps can be overcome by traditional modes of communication, such as presentations to rural farm or microfinance collectives. TDS benefits both suppliers and buyers as it provides a simple and more open market to work in.

Simplifying the procurement process also encourages local suppliers to bid for contracts. Reducing the size of contracts, simplifying procurement documentation and forms, ensuring procurement notices are written in local language are all means by which to ensure local SMEs are more likely to tender for work.

**Box 13: TDS example: Building Markets, Afghanistan**

Building Markets developed an online tender directory for potential suppliers. The system centralised the procurement opportunities, which were previously advertised on each buyer's website. The building markets team researched over 126 different sources, including websites and newspapers, to build the online database. TDS benefits both suppliers and buyers as it provides a simple and more open market to work in.

*Source: Butler, A., Heady, L. (2010)*

## Market information & knowledge management systems:

Information asymmetries to do with basic market information also exist. This is particularly important to suppliers whose only entry into supply chains is through unreliable middle-men. For instance, rural market participants can lack vital information on local market prices, demand for niche products (such as cash crops) and minimum bulking demands. Most existing systems focus on farmers, but small retailers would also benefit from knowing wholesale and competing retail prices.

Additionally, in many developing countries, the absence of efficient knowledge systems means that it is hard for local suppliers to find information on global best practice. Centralised systems are critical for local supplier capacity development as they can be accessed by multiple actors to capture knowledge and disseminate useful information. They function as a collection point for action research, guidelines on best practice, evaluations and reviews to help improve the technical ability of SMEs, as well as the inform the implementation of future programmes.

### Advocacy:

Advocacy targeted at buyers must not only stress the social benefits of sourcing locally (such as job creation), but also include detailed market research and financial analysis to speak to the lowered costs associated with buying from local firms. These measures can encourage businesses to source locally.

Furthermore, advocacy initiatives should aim to set up lines of communication between the buyers/suppliers and government in order to generate political momentum to influence policy. From a business perspective, policy and regulatory advocacy can be undertaken to promote and facilitate the formation of business linkages through strengthening enabling environment and engaging in public policy processes<sup>21</sup>. SMEs in developing countries often lack a voice at the national/government level. Large firms, however, have a platform and can use their influence to pressure governments into making reforms.

#### Box 14: Reuters Market Light

RML is a mobile-phone based information service launched in 50,000 villages across 13 states in India. It covers 300 crops, 1300 markets and boasts 1.3 million subscribers to date. The service is provided in all local languages, and includes crop prices, local and international agricultural info that may affect prices, local weather forecasts and extension advice.

Based on interviews and independent evaluations the following impacts were determined:

- 5-25% increase in income of RML subscribers (ICRIER)
- 8% increase in price realisation for farmers who sold to traders (World Bank)
- "80% of farmers changed information sourcing behaviour after using RML" (USAID).
- "12% reduction in price dispersion across markets" (London Business School)

#### Box 15: National Business initiative, South Africa

The National Business Initiative (NBI) is a coalition of more than 140 South African and multinational companies. As well as promoting business linkages within their own ranks, it also actively advocates for other businesses to follow suit. Using targeted research, it identifies areas where linkages could be strengthened and businesses that have the capacity to supply other firms.

Given that SMEs are too small, fragmented and unaware of opportunities to lobby the government and large enterprises, NBI advocates for government reform to develop the local business environment and encourage the larger South African companies to form sustainable linkages with local businesses.

<sup>21</sup> Jenkins et al (2007)

## Lessons Learnt

While information asymmetries in developing markets have been the subject of much research, practical interventions to address these constraints have been difficult to implement on the ground. However, both recent developments in technology and shifts in global business trends have made it easier to develop local capacity and establish supply chains in-country and internationally. The following lessons can be learned from past interventions:

- **Technology:** Information services are critically dependent on the quality of technology available. Many information platforms require suppliers and buyers to have access to the internet and mobile phones. While there may be a discrepancy between the level of technology available to different stakeholders, systems must be sophisticated enough to improve the efficiency of the programme while maintaining accessibility.
- **Use of third party in areas that lack ICT:** Use of NGOs or associations could act as a bridge between buyers and suppliers where suppliers are not able to access the internet.
- **Subsidy:** There are instances where subsidising certain services can help the initial set up of interventions/platforms, as long as there is a clear exit strategy as to how to ensure activities are weaned off such measures and become self-funding. In order to ensure the interventions continue beyond the lifetime of the programme, a strategy to transition of ownership and operations of linkage programmes to other partners is therefore fundamental to their survival. This is particularly important when a whole programme is specifically funded to build linkages. In essence, any interventions being undertaken in this respect are being subsidised by the project funds. As the benefits of various interventions are experienced by both buyers and providers, the importance of continuing the intervention should be seen. Ideally, given that the intervention is providing a service, users should feel that these services are worth paying a fee for. As such, provision of market linkage interventions should transition so that they are ultimately undertaken by local firms.

### Box 16: Use of subsidy

For instance, to increase the uptake and usage of modern agricultural equipment and technology in the southern African region, the South Africa Trade Hub, targeted bringing leading agribusinesses from around the region to South Africa to attend the largest agricultural trade show on the continent - National Maize Producers Organization. Rather than the project sponsoring individual firms to come on their own, it set up a system to build up "trade show visit organizers" where local consulting companies and travel agents marketed the value proposition for participating in the trade show to local agribusinesses. The project provided initial subsidy to the organizing firms, who sold the packages to their clients at market cost. Firms in Mozambique, Botswana, Malawi and Zambia are now doing this on their own, without further project sponsorship.

Source: William Grant, DAI interview 28<sup>th</sup> July 2014

## 3.4 Strengthening linkages through policy and business environment

Governments have a key role to play in facilitating the formation of business and market linkages. Poor business environments and inadequate policies deter both large firms and SMEs from establishing linkages in a number of ways. There is strong macro evidence<sup>22</sup> that inappropriate competition policy and the blocking of necessary reforms has had a negative impact on the investment climate, a central driver of private investment, job creation, growth and poverty reduction. The absence of a good investment climate makes it less likely that international companies will be attracted to the country or that

<sup>22</sup> Thomas et al., 2013

local firms will invest in their businesses and expand. This may have negative knock on effect in regards to the development of linkages.

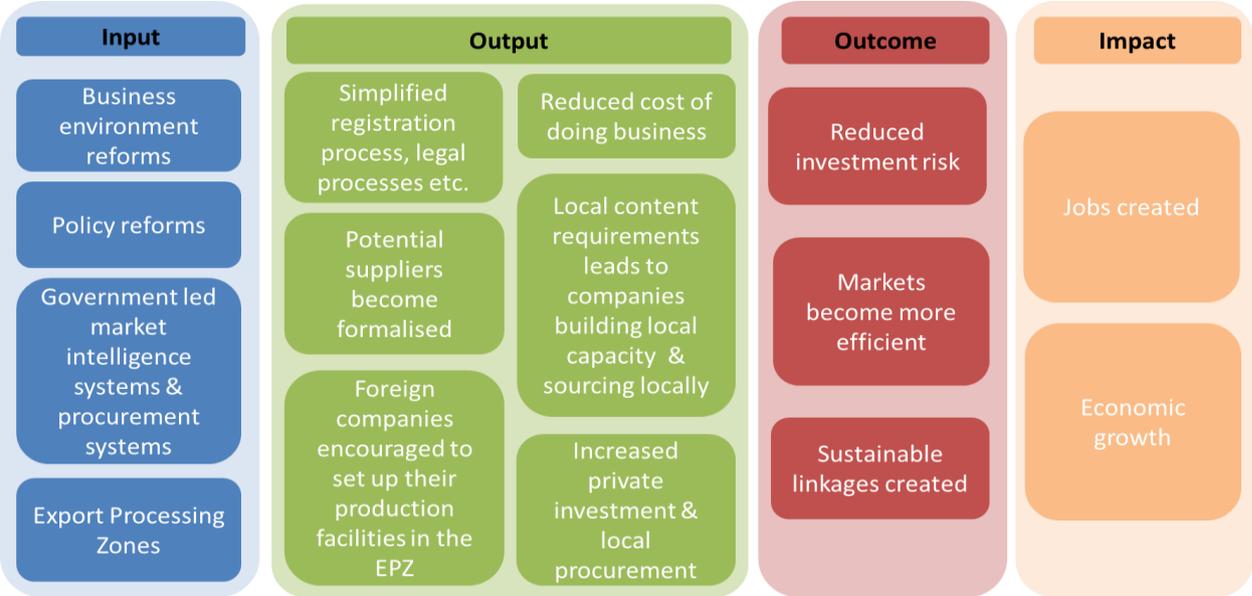
Furthermore, complex business laws and regulations obstruct the establishment of large firms in developing countries. Similarly, the time and monetary cost of complying with business regulations is often prohibitive to SMEs joining the formal sector. Reforms that ease these processes both encourage international firms to set up in developing countries and allow local firms to grow.

A number of governments, donors and businesses have undertaken interventions to encourage policy and business environment reforms in order to address the challenges above. The following examples of interventions suggests they have had mixed results.

**Interventions**

Figure 3 sets out the theory of change as a framework for the interventions under this section.

**Figure 3: Theory of change for policy and business environment interventions.**



## Business Parks and Export Processing Zones (EPZ)

Business parks and EPZs encourage foreign companies to set up their production facilities in host countries<sup>23</sup>.

Incentive structures such as tax holidays, dividends being exempt from taxation, and duty-free imports of raw materials and capital goods can help attract foreign investment into these zones. Criteria can be set requiring tenants to work with local businesses. Similarly, low rental rates for plants and equipment in business parks and EPZs can also attract large international companies.

### **Box 17: EPZ established in Mauritius**

The Government of Mauritius helped create additional incentives to bring foreign companies and multinationals to the EPZ, including subsidizing public utilities, developing government-run servicing facilities for external marketing and quality control and even helped organise technical training schemes. These interventions helped to promote business-to-business linkages and supplier and distributor development described in the earlier sections of this report.

The EPZ helped develop vertical networking between Floreal Knitwear, a leading Mauritian firm, and the global textile multinational, Woolmark plc. Floreal Knitwear, the world's second largest manufacturer of Woolmark sweaters, has progressed from producing sweaters from imported coloured woollen yarn, to utilizing coloured yarn produced within the EPZ. Benefits of vertical networking between Floreal Knitwear and Woolmark has led to product specialization, and the genesis of horizontal integration of the textile industry in Mauritius. EPZ has led to large productivity gains and the remarkable growth in the production of manufactured goods. This has resulted in a marked shift in the composition of the country's export basket towards manufactured goods that command higher international demand. Results include:

- Export diversification – output grew annually by 9%. EPZ accounted for 60 % of total exports. Textiles make up 80% of EPZ output.
- Fast growth – Economy grew 8.5% '84-'89 and 5.5% '90- '96.
- Employment – EPZ largest employer in Mauritius (30%).

*Source: Hussain, N. (2000)*

## Policy reforms

Policy reforms can have a direct impact on linkages. Both those policies that act as incentives (e.g. tax breaks etc.) and those aimed at enforcement of local procurement (e.g. local content requirements) have been utilised to good effect. When implemented in the correct way, these have worked to attract large firms to establish themselves and their markets in developing countries and encouraged them to work with local SMEs to build their capacity and increase their participation in their supply chains.

With respect to the use of local content requirements (LCR), some studies have argued that, under certain circumstances, mandatory measures can be useful in giving local firms the opportunity to build supply capabilities. The case for local content requirements rests essentially on the need to promote infant supply firms by providing support (in the form of assured demand) during their learning periods. The issue is thus similar to that of infant industry

### **Box 18: LCR Example**

For foreign mining exploration companies to operate in Senegal they must use an assigned local laboratory for testing and they must ensure that their subcontractors register a local businesses to help provide supporting services. This policy has helped to guarantee that backwards linkages are formed with local economies and have helped produce multiplier effects in the local economy.

*Source: Increasing Local Procurement by the Mining Industry in West Africa, World Bank report Jan. 2012*

<sup>23</sup> Hussain, N. (2000) – Export Processing Zone and vertical linkages in textile industry.

protection. Government-enforced LCRs can be particularly beneficial, if not essential, in resource rich nations to help build local linkages. Where used carefully, with offsetting measures to ensure that suppliers face competitive pressures and have access to the technology and skills they need to improve their capabilities, they can foster efficient suppliers<sup>24</sup>. Enforcing either a value-based (cost of goods sourced) or physical (number of inputs sourced) is critical to striking a balance between protecting local industries and attracting foreign companies to operate in a country<sup>25</sup>. However, where used in a protected setting, with few pressures to invest in building competitive capabilities, local content requirements can result in inefficient suppliers that saddle the economy with high costs, outdated technologies or redundant skills. Despite the expectations, local content requirements that are imposed on incoming foreign companies for the purpose of lifting the local procurement ratio of foreign affiliates often prove to be ineffective in achieving the desired goal<sup>26</sup>.

**Figure 4. Pros and Cons of Local Content Rule Enforcement**



### **Business Environment reforms:**

Strategies, both led by governments or donors, that aim to improve the wider business environment can have a significant impact on the facilitation of market linkages.

Through simplifying businesses procedures, entry barriers to the formal sector faced by SMEs are reduced. Streamlining the number of steps required of foreign

#### **Box 19: IFC Yanacocha SME linkage program in Peru**

This SME programme, developed around IFC's investment in the largest gold mine in Peru, used an enabling environment for linkages approach. The local government in conjunction with the IFC undertook general work to address market and policy failures. An example of their work includes an admin simplification project that reduced the number of steps it takes to register a business (from 75 to 2). This resulted in a sharp increase in registrations of small businesses, bringing them into the formal sector for the first time. In addition, the IFC worked with local municipalities to optimize its revenue management systems to ensure that tax payments and other contributions to the budget effectively funded basic social and economic infrastructure. *Source: Jenkins et al. (2007).*

<sup>24</sup> UNCTAD, 2010

<sup>25</sup> Munson and Rosenblatt 1997

<sup>26</sup> Urata, 2005

companies to set up branches in developing countries will also encourage their entry into these markets. Increased participation of formal SMEs and larger businesses increases the competitiveness of markets and can lead to the development of more linkages.

### Lessons learnt

The role of the public sector in such schemes is complex. The following lessons have been cited in the literature.

- **Private/Public sector partnership:** A key success criteria is that public sector programmes must be implemented hand in hand with the private sector. Interventions must ensure they preserve the most valued aspects of the private sector such as competition and innovation. They can do this through ensuring communication platforms are set up that allow for broad-based and representative consultations and institutionalised dialogue.
- **Local content requirements (LCRs):** The implementation of policies directed at increasing local procurement, such as local content rules, must be applied carefully in order to avoid alienating large firms. For LCRs to be effective, they must be:
  - (a) limited in duration and incorporate planned evaluation phases;
  - (b) focused on technologies and components for which technical expertise is available and global market entry barriers are manageable;
  - (c) linked to additional mechanisms, such as training and promotion of business linkages and measures to support other stages of the value chain and wider services that are integral to success of selected industry.
- **FDI strategy:** The public sector's key role in relation to market linkages should focus on developing their long term FDI strategy, selecting sectors and setting the national and industrial policy so that they facilitate rather than hinder linkages. Furthermore, the public sector should have a targeted FDI strategy to attract TNCs with a positive corporate philosophy and willingness to delegate to local managers to develop linkages<sup>27</sup>.
- **Use of Investment promotion agencies:** IPAs can be instrumental in coordinating activities<sup>28</sup>. They provide one-stop services that cover marketing the country as an investment destination, identifying and targeting foreign investment, creating and managing databanks of potential foreign investors and local suppliers, providing matchmaking services to partners, organizing skills training for domestic entrepreneurs and providing post-investment services to investors.

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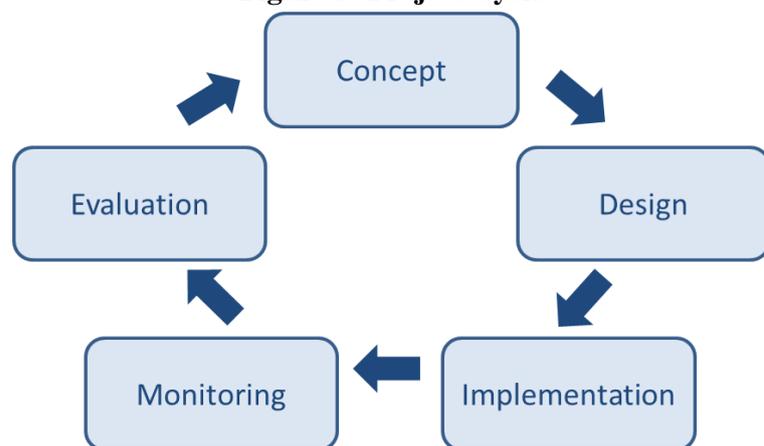
<sup>27</sup> Ruffing, L. (2006)

<sup>28</sup> UNCTAD, 2010

## 4 Implications for Development Partners

Whilst there have been and continue to be donor programmes specifically aimed at developing market linkages within developing countries, as well as numerous business to business and government led initiatives, other donor funded initiatives with their various objectives have been slow to incorporate market linkage development as an integral part of their approach to deliver their outputs and outcomes. All programmes, whether they focus on health, environmental, education or other social issues, engage with markets. Given the benefits discussed throughout this paper that arise from the use of locally linked businesses, both in immediate efficiency gains as well as through longer term sustainability and positive multiplier and spill-over effects, it seems clear that donor funded programmes should pay more attention to this area.

**Figure 5: Project Cycle**



This section sets out a framework for how donors and their partners can ensure that the development and the use of market linkages are included throughout the whole project cycle (Figure 5).

### 4.1 Concept Stage

For linkage interventions to become part and parcel of all donor funded programmes, donor organisations need to understand why linkage development is both efficient and important for programme delivery. At programme concept stage, consideration should be taken of the markets in which the programmes will operate and the efficiency of these markets pre project/programme.

The expectations of what the implementing agency can achieve should be set realistically at this stage. These expectations should also be considered in conjunction with the types of outputs the programme is anticipated to achieve.

Donors are often aiming at cross-cutting impacts with respect to gender, youth, environment, climate change etc. We have not uncovered through this review any examples of targets in these areas being specifically incorporated into market linkage development initiatives. However, there is no reason why these elements cannot be incorporated and if this is to be the case, then the implications must be taken into account right from the concept stage.

The resource package for the programme also needs to be considered at this time. The pattern of funding will be different if a linkage approach is incorporated and there may be additional resources required. Consideration must be given to how best to develop local horizontal linkages as well as vertical linkages with international buyers.

## 4.2 Design Phase

Once the concept has set the need to consider the development of market linkages, the designers of the programme will examine in-depth the situation in the markets and supporting markets where the programme will be engaging. This understanding will then allow the design to set an appropriate time frame for linkages to deliver results and if necessary set the objective in transferring delivery from external suppliers of goods and services to local or regional. If programmes are being implemented in countries with a functioning, albeit weak, private sector, then implementing a linkage strategy as part of the delivery of the programme should be relatively simple. If programmes are being undertaken in fragile or conflicted states then linkage development will be more complex but should still be incorporated as part of the overall strategy. A key point to note is that despite the perception that there is very little capacity within companies in conflict affected or fragile states, there are usually a significant number of capable firms able to deliver<sup>29</sup>.

The expectations of what the implementing agency can achieve in regards to linkages should also be set realistically. In more complex environments, building linkages takes time and there are higher levels of risk to be managed (the reliability, capacity etc. of local providers is unknown). The design needs to build in flexibility for the implementer's approach so that firms do not fear penalties if there are set backs on the way. Therefore, whilst the development of these linkages must be embedded in the programme design, if implementing partners are to be encouraged to undertake such risk alongside implementation, donors should ensure that the performance criteria set at this stage encourage rather than discourage linkage creation.

During the design stage, the planned resourcing of the programme also needs to reflect the process and time frame involved to develop linkages. There will be numerous programmes for which developing linkages will in any case offer the lowest cost approach for efficient delivery. However, in many markets, a linkage approach will require an initial investment that delivers a return later in the programme and especially post programme completion. In these cases, the programme will need resources to support the development of linkages using some of the tools discussed earlier. This does not mean the overall cost of the programme will necessarily be higher, but the pattern of resourcing will be different from an approach based on sourcing goods and services at the lowest current cost.

***"Much more private sector capacity exists on the ground than is generally assumed, even in post conflict and fragile state situations."***

***–Scott Gilmore, Building Markets***

### ***Box 20: Hypothetical case for a design to allow for linkage development***

A 5 year donor funded programme that aims to distribute nutritional biscuits to children may initially import biscuits from abroad as the quality and reliability of local providers fails to meet international standards. However, given that there is demand for such biscuits in the target country and that the donor expects that the programme will be extended for a further 10 years, the programme should consider whether over the lifetime of the project there is budget available to develop the capacity of local factories to produce the biscuits locally. This would lead to both cost and management efficiencies in the long term as well as creating jobs for the local community.

<sup>29</sup> Scott Gilmore, Building Markets, telephone interview 1st August.

The design should also set out the procurement procedures that should be used, or developed to source local goods and services and to award funds as these set the framework as to how to build linkages. In regards to the procurement of goods and services, donor organizations have their own procurement rules must be adhered to by both international and local firms. However, given the complexity of many of these procurement systems, it is often very difficult for local companies to win tenders that use these. While donors cannot step outside these rules, there are a number of options for adapting them to facilitate local participation:

**Box 21: Modifying procurement systems**

UNNATI is a 5 year DANIDA programme developing the market systems around 3 value chains in Eastern Nepal. The programme uses three procurement mechanisms to deliver its aims of improved incomes for the poor. This allows a clear focus on developing local market linkages and capacity of local organisations to ensure system efficiencies achieved are sustained. Service providers for the programme are contracted using DANIDA's own procurement rules. The programme develops MoUs with Government for their supporting functions and a 'value chain fund' provides grants to the private sector with the rules for provision of matching grants set out by the programme and agreed by DANIDA.

- (i) Local government procurement systems are often simpler to use than international donor systems. Using these systems is potentially an option that implementers could be empowered to use to encourage local providers to bid for tenders.
- (ii) Implementing agencies increasingly manage funds on behalf of donors in addition to their management contracts. These funds offer a great opportunity to support linkages. Specific procurement procedures can be developed for the funds within a programme that are approved by the donor before implementation commences. This is an important element of the design process. There are already many cases where this is occurring (challenge funds, matching grant schemes, various accountable grant processes). However, these have not generally been put in place specifically to support market linkage development and there is great potential to tailor these instruments to achieve this.
- (iii) If the programme is funding the recipient government then usually a Memorandum of Understanding (MoU) will be used. As part of the MoU, the donor could ensure that the procurement rules used by the recipient support local procurement. For instance the MoU could stipulate that goods and services up to a certain level will be procured through local SMEs.

Designers must deliver a design that offers value for money (VfM). As we have stated above, the return on linkage development may be achieved both at the latter stage of programmes and after they are closed or through benefits to follow on initiatives. There is a risk that a linkage approach will *appear* to offer poorer VfM than an approach based on simple minimum cost procurement through international tenders. To avoid this, designers need to be tasked to take a wider and longer term view of VfM.

### Sustainability

Key to the success of market linkage creation is a strategy which sets out how to ensure the sustainability of interventions post-programme closure. A number of practical lessons learnt from previous programmes can be considered at the design stage to aid practitioners to ensure interventions are more likely to be sustainable in the long term.

- **Information services:** Online platforms such as tender distribution services (TDS) are comparatively cheap and simple to run, and they have a significant impact. As such, they offer good VfM and transitioning ownership post programme closure is relatively simple. For instance, the success of Building Market's TDS in Haiti meant it was identified as a service to transfer to the Ministry of Commerce. Ongoing mentorship by outgoing project staff ensured a smooth transition.

- **Selection of SMEs:** Clear criteria should be set out at the design phase for the selection of SMEs to ensure that only those with the most potential are included. This will increase the likelihood of success and ensure the sustainability jobs and growth.
- **Diversification:** During the design phase a strategy should be devised in order to ensure SMEs are encouraged to diversify their client base so as to avoid them becoming solely dependent on the project.
- **Large firm participation:** Large firm participation in the market linkage is critical to making linkage initiatives sustainable.
- **Exit strategy and ownership:** In order to ensure the interventions continue beyond the lifetime of the programme, an exit strategy to transition of ownership of linkage programmes to other partners is fundamental to their survival.

### 4.3 Implementation Phase

With a clear mandate to deliver a programme using local markets, and making linkages in the process, the implementing agency must first ensure that it has an in depth understanding of the organisations and their capacities in the markets in which they are engaging. Effectively, even though the implementer will only be involved for a limited period, it needs to integrate into these markets as deeply as possible. This mapping and analysis will generate an understanding of the market failures, enable risk assessment, help identify partners to work with and enable the identification of the tools and approach to be used. Box 22 illustrates an example.

The appropriate approach and tools will vary depending on context;

- The nature of the market weaknesses and failures will determine the area of focus between the three broad areas identified in this paper: building capacity; information asymmetries; and advocacy and policy reform. In each of these there are a range of tools and interventions that can be made which range from simple low cost to more complex higher cost approaches and interventions;
- the type of programme and the amount and level of control of funds involved will influence the approach;
- the procurement systems that have been agreed and established will affect the framework for programmes that are spending significant funds in country themselves;
- Programmes that need to deliver quick outputs using services that are simply not available locally will have to use a phased approach to develop linkages.

A key lesson from the initiatives reviewed in this guide is that there are many things that can be done that are not costly and that risks are often not as high as has been assumed.

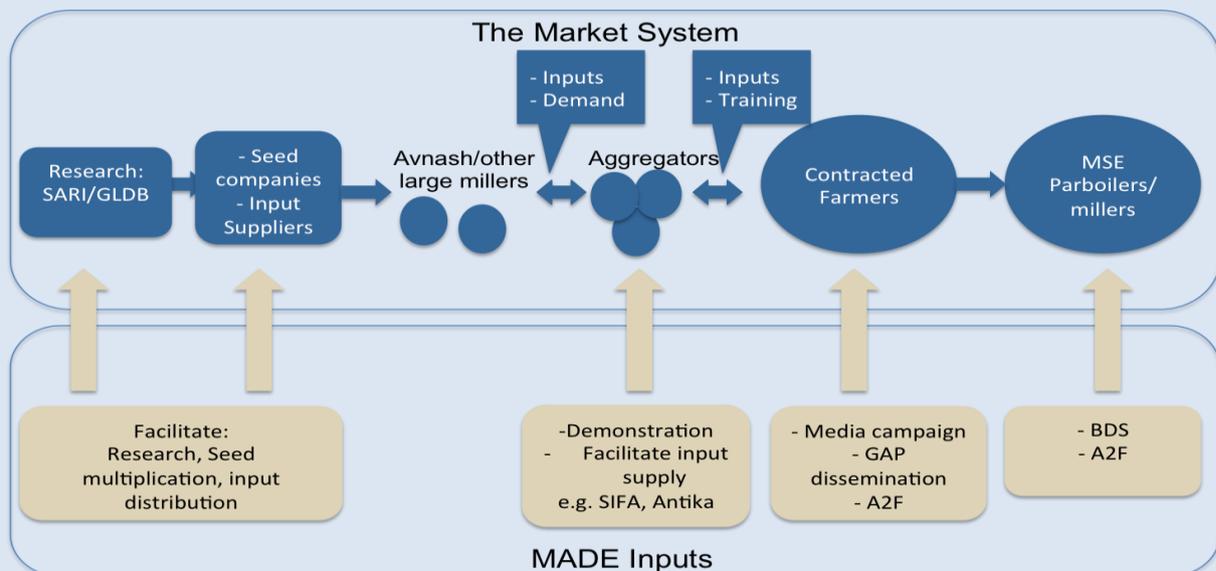
**Box 22: Ghana MADE**

Ghana MADE is a 5-year DFID funded programme that aims to develop 6 agricultural markets in northern Ghana, including rice. Most rice consumed in Ghana is an imported variety, despite the high potential for the variety to be grown domestically, there are a number of reasons why it is not. The programme is working to overcome these. While the interventions required could be provided by contracting services from a number of unconnected service providers, the programme is instead developing market linkages and capacity within the existing organisations.

Key interventions include using accountable grants to work with:

- a local aggregator to develop the paddy rice supply chain by linking up rural farmers with processors/millers with agreements to provide a guaranteed market and income for paddy producers. This also includes organising demonstration plots and visits for farmers.
- a seed producer and public sector seed R&D organisations to support farmer contracted multiplication services of certified seed varieties of rice developed by SARI.
- local firms to provide BDS to “middle-women” rice parboilers.

As well as this the programme organised a media campaign working with the public sector to inform farmers of market trends, demand of rice varieties and farming techniques. The figure below illustrates how MADE’s interventions are being applied all along the supply chain. This is helping to harness the local capacity of businesses, and is developing the market mechanisms to consolidate a supply chain to output high-grade rice:



Source: Ghana MADE Intervention Plan

The example shows that the programme is developing the capacity and linkages between businesses, public sector service providers and farmers along the rice supply chain as the most effective way to achieve its aims to improve the livelihoods of the poor in Northern Ghana.

## 4.4 Monitoring & Evaluation

Programmes developing local capacity to deliver their outputs will need to modify their approach to monitoring progress. The key difference will be to monitor the performance of the companies that they are working with and the linkages between them as well as the progress towards delivery of contracted outputs. Service contracts can be performance based and include milestones as an in built monitoring tool, but it will nevertheless be important for the implementer to engage directly on a regular basis to ensure that any problems are identified early.

With respect to evaluation, the key difference is the inclusion of measurement of the benefits that result from the development of better linked markets. These will also go on delivering benefits after the end of the programme. As well as benefits derived from increased efficiency within the firms, there will be benefits through increased employments and multiplier effects from the increase in income and purchasing power introduced. While measurement and attribution of these benefits to the programme may be difficult to measure precisely, it is important they are included. Without capturing the full range of both direct and indirect benefits of the approach, there is a risk that the VfM analysis of the programme will not reflect its true cost effectiveness.

## 5 Conclusion and Recommendations

There is a huge opportunity to increase the long term impact of the Aid spend by ensuring its use supports the development of domestic private sectors. Donors have been slow to recognise and target this opportunity. All programmes operate within a market context and building linkages within these markets can be a way of strengthening any programme and of increasing long term impacts. The objective of this topic guide has been to show what can be done and how it can be done. The lead has come from the private sector where larger businesses have invested heavily in developing linkages both on the supplier and distributor ends of their supply chains for many years. There are implications for donors in terms of risk management and reform of internal policies to ensure that their procurement rules and approach supports the integration of market linkage development. Encouragingly the evidence suggests that there are almost always some local businesses that have capacity and it is wrong to assume that there is no chance of receiving the goods or services required locally.

All programmes rely on markets in some way or another. As such, given the holistic benefits of developing local markets, donors, international businesses and other implementing agencies have a responsibility to build linkages regardless of the type of programme being implemented. The Review has shown that developing local supplier and distributor capacity allows SMEs to engage in markets that might otherwise have been closed to them and allows large firms to increase local integration, lower costs and provide companies with a license to operate. Reducing information asymmetries can help align incentives and empower small businesses to provide goods and services (e.g. creating a more efficient agricultural market when farmers are aware of input costs and wholesale prices). Governments can also take an active stance to enforce policy measures to support programmes through private sector development, such as EPZs or tax incentive schemes to help establish manufacturing bases to produce computers or other school-related supplies. In short, any interventions that increase market efficiency help bolster the efficacy of any type of development programme, while spurring sustainable economic growth.

This Topic Guide has set out the key interventions available to practitioners in order to develop market linkages. Based on the lessons learnt from past and present programmes, the following key recommendations should be taken into consideration when developing/implementing any market linkage activities:

- (iv) **Planning and early analysis:** Early preparatory work into potential sectors, markets, and capacity on the ground will ensure that market linkage strategies have the best chance of achieving success. Identification of the main constraints to growth and the areas that offer the most potential, will aid the selection of the interventions that will most likely bring about results.
- (v) **Multi-pronged approach:** Where possible a range of interventions should be implemented that complement one another.
- (vi) **Multi-stakeholder buy in:** Given the long term commitment required in order to build linkages, real buy in and support through all levels of the organization is imperative. Furthermore, other stakeholders, such as SMEs and public sector organization, must have a sense of ownership and be actively engaged in the process to ensure sustainability post-programme.
- (vii) **Private sector participation:** Ultimately, the private sector must be engaged in the market linkage process as market and business linkages are dependent upon large firms and SMEs.

- (viii) **Technology:** The global spread of new technology means that there is now a relatively cheap and highly efficient means of collating information to share with both buyers and suppliers.
- (ix) **Exit strategy:** From the outset, an exit strategy should be devised to ensure that interventions can be handed over to another entity to run after programme closure. Throughout the programme interventions should ensure that participants do not become solely dependent upon the project.

Promoting market linkages is the best strategy to make long-term investments to develop the domestic economy alongside initiatives to address short-term challenges. Donors and practitioners should understand that designing programmes that promote market linkages require patience and may not result in immediate impacts, but will have longer-lasting effects compared to other interventions that ignore promoting local business growth. Programmes that incorporate local markets into their design will simultaneously develop local economies and create a business environment where future programmes are more feasible and that make it easier to include local stakeholders in the process.

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