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Linkage Dynamics between Small and Large firms in Kenya

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This paper is concerned with small enterprise development in developing countries, focusing on the question of the potential for using linkages with large enterprises as part of a strategy for the development of the small business sector. The paper will review existing literature and policy experience on this topic, whilst also reporting some results from a longitudinal pilot investigation, undertaken in Kenya in 2005 and in 2014. The paper will draw on empirical evidence from a longitudinal pilot investigation in Kenya. At least five large firms from different industries were purposively selected and a series of qualitative interviews conducted in 2005 and in 2014 to determine: 1) their experiences in collaborating with micro and small enterprises (MSEs) and their assessment of the potential for doing so in the future; (2) groups of MSEs that they work with; 3) how they built the relationships and (4) whether or not the relationship has worked and the factors influencing this, from their perspective. The potential benefits of Foreign Direct Investment (FDI) to host economies is summarised here and five main types of linkage and spillover effects, by which MNCs can affect the development of businesses in the host economy are identified: *Backward linkages with suppliers,* which can range from arms length market transactions to deep, long-term inter-firm relationships; *Forward linkages with customers,* such as marketing outlets, which may be outsourced, such as petrol stations and restaurant chains; *Linkages with competitors,* since foreign investors may set new standards, which local firms may seek to compete with; *Linkages with technology partners,* since some MNCs may initiate common projects with indigenous SME partners, which are an important potential source of technology and know-how for local firms*; Other spillover effects*, including demonstration effects, as inward investors demonstrate new and better ways of doing things to local firms and human capital spillovers, when, for example, trained personnel leave the inward investor to work for a local enterprise and/or set up their own business. The evidence of positive spillovers, where it exists, is strongest in the case of backward linkages, with local suppliers in developing countries. Positive benefits stem from the information, technical assistance and training provided by MNCs to help raise the quality of supplier's products and services. More generally, empirical evidence suggests that the positive spillover effects from FDI do not necessarily occur in practice, influenced by the specific conditions pertaining in the host country as well as the rationale for the foreign company making the investment. The implications for policy will be considered, paying attention to the potential role of national governments, in both developing and developed countries, as well as international development agencies.Whilst this is not a new topic, a number of recent trends suggest there may be greater scope for developing such linkages in the future than in the past. These include the emergence of new sources of FDI in developing and emerging economies themselves, increasing signs of SMEs internationalising their operations rather than simply exporting from their domestic base, as well as a continued increase in outsourcing by MNCs.

Key Words: *FDI; SME; Developing Economies, Impact of MNCs on SMEs, SME Linkages*.

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Introduction

It is widely recognised(Moore, B. and Manring, S. (2009))that entrepreneurs and SMEs play an important role in economic growth and development, as well as contributing to poverty alleviation. At the same time, the nature and extent of this contribution varies between countries, reflecting differences in economic, social and institutional conditions, and ultimately the competitiveness of the SME sector. In this context, many transition and developing countries in particular, face a need to promote and strengthen the long term development of the SME sector, which requires access to market opportunities, as well as to new technology and management know-how, often in a situation of considerable resource scarcity

This is a mainly review paper, based on existing literature and case material, concerned with the potential role of FDI in relation to the long-term competitive development and internationalisation of the SME sector in transition and developing countries. Whilst this is not a new topic, a number of recent trends suggest there may be greater scope for developing such linkages in the future than in the past. These include the emergence of new sources of FDI in developing and emerging economies themselves, increasing signs of SMEs internationalising their operations rather than simply exporting from their domestic base; the continued increase in outsourcing by MNCs; and a growing recognition by the international community of the importance of raising incomes levels in the African sub-continent in particular. Whilst such trends undoubtedly present challenges to SMEs in transition and developing countries, they also present opportunities (Smallbone, 2004).

As in developed economies, the SME sector in developing and transition countries is typically very heterogeneous with respect to its size and sector composition, as well as growth orientation Although the details vary between countries, the SME sector in transition and developing economies includes petty traders; self-employed; and small business proprietors, many of whom operate at least partly in the informal sector; firms run by owners that may be better characterised as proprietors rather than entrepreneurs (Scase, 1997); as well as growth-oriented firms. Whilst the latter represent an important target group for policy makers, because of their leading role and disproportionate contribution to employment generation and economic development, the needs of other types of SME should not be ignored. Indeed, in relation to FDI-SME linkages specifically, a supply chain approach to policy, emphasising the interconnections between different types of enterprise could be rewarding, because of the importance of seeking to maximise the trickle down effects of any investment by, for example, a MNC. In this context, there may be opportunities for a wide range of small enterprises in the lower tiers of the supply chain.

In this context, the purpose of this paper is to investigate the existence of different types of linkage between large multinational enterprises and SMEs in transition and developing countries whilst also reporting some results from a research investigation, undertaken in Kenya in 2014. Besides reviewing existing

literature and policy experience on this topic, we examine whether MNCs in Kenya have adopted strategies to work with these SMEs; whether such relationships are enabling SMEs to grow and the experiences of the relationships from a sample of five Multinational Corporations (MNCs).

2. The Potential Benefits of FDI to SMEs in Developing Economies

Foreign direct investment is an integral part of an open, international economic system and a major potential catalyst for development. This has been recognised by the OECD in a report, which focuses on maximising the benefits for inward investment, while recognising the possible costs and ways of reducing them (OECD, 2002). The potential benefits of FDI for host economies include increasing the supply of capital; technology and knowledge transfer; the generation of employment and human capital; as well as the effect on enterprise development, through linkages and spillover effects. An additional source of capital is clearly important in countries where financial constraints act as a major barrier to development.

In principle, supplier relationships with inward investors offer business opportunities for local firms. For developing countries, exploiting these opportunities can contribute to the development of a balanced structure of enterprise sizes emerging in an economy, in which economies of scale are combined with the flexibility of small enterprises. New markets are opened up for SMEs, by firms, which offer regular payment for goods and services, and through subcontract type relationships, relief from development and marketing costs for their SME sub-contractors (Altenburg, 2000).

In terms of technology and knowledge transfer, FDI in developing countries may contribute to the upgrading of local suppliers through technical assistance, training and the transfer of knowledge. It may also contribute to increasing the rate of adoption of new technologies by local industries, as a result of processes of imitation and competition. In terms of employment, inward investors can generate new jobs directly, but they can also contribute to raising skill levels, because their skill requirements may be higher than those required by domestic firms. At the same time, the extent to which MNCs actually facilitate such spillovers in practice has been shown to vary between sectors and contexts (OECD, 2002).

The potential benefits of FDI to host economies may be usefully summarised with reference to a framework developed by Dunning (1992), who identified five main types of linkage and spillover effects, by which the presence of MNCs can affect the development of businesses in the host economy. It serves as a conceptual basis for mapping SME potential linkages with MNCs. Dunning referred to:

(i) *Backward Linkages with Suppliers:* This refers to the extent to which components, materials and services are sourced from within the host economy, since this can create new market opportunities for local firms. Such linkages can range from arms length market transactions to deep, long-term inter-firm relationships. The productivity and efficiency of local suppliers can benefit from this type of

spillover as a result of direct knowledge transfer, higher quality requirements and increased demand levels.

Forward Linkages with Customers: These can include marketing outlets, which may be outsourced. Examples include petrol stations and restaurant chains; and linkages with industrial buyers, through, for example, value added after-sales services.

(ii) Linkages with Competitors: Foreign investors may set new standards, which local firms may seek to compete with. Although MNCs may hold a strong market position in relation to local firms, it should be noted that linkages with competitors may refer to second and third tier suppliers to leading inward investors, and not just linkages between first tier suppliers and the MNCs themselves.

(iii) Linkages with Technology Partners: Some MNCs may initiate common projects with indigenous SME partners, including joint ventures, licensing agreements and strategic alliances, which are an important potential source of technology and know-how for firms in the host economy. Whilst such co-operation may be a more common feature of more mature market economies, the number of inter-firm technology agreements involving partners from developing countries rose in the 1990s compared with the 1980s (UNCTAD, 1998).

(v) Other Spillover Effects: These includedemonstration effects, as inward investors demonstrate new and better ways of doing things to local firms, representing a source of, and stimulus to, innovation. They also include human capital spillovers, when, for example, trained personnel leave the inward investor to work for a local enterprise and/or set up their own business.

At the same time, there can also be negative effects, for example, where local competitors are squeezed out, as a result of being unable to compete on price and/or on quality. This can be illustrated with reference to the Kenyan soap industry, in which Langdon reported the entry of foreign MNCs to be associated with low-cost mechanised production, which led to local firms being unable to sell their handmade soap products in local urban markets (Langdon, 1981; Blomstrom M. 1996).

3. The Kenyan Context

In order to provide a context in which the case study material may be interpreted, a brief summary of current conditions in Kenya with respect to inward investment and also the key characteristics of the SME sector are presented.

3.1 Inward Investment

According to Ngowi (2001), the African continent has been receiving the lowest share of global FDI inflows over time; in fact, the continent receives less FDI than Singapore (Bjorvatn 2000). This is despite the fact that FDI is welcome and actively sought by virtually all African countries. The continent did not benefit from the FDI boom that began in the mid- 1980s. Since 1970, FDI inflows into Africa have increased only modestly, from an annual average of almost $1.9 billion in 1983-1987 to $3.1 billion in 1988-1992, and $6

billion in 1993- 1997. For comparison purposes it should be noted that the global FDI flows in 1998 reached a record $644 billion (UNCTAD 1999).

In Kenya for example, the policy environment for FDI is encouraging, in view of the fact that the government has introduced measures to attract FDI, which include establishing the Investment Promotion Council (IPC) and the Export Processing Zone (EPZ), as well as tax and other trade incentives. Studies (see for example Ngowi 2001) show that tax exemptions, tax holidays or tax reduction for foreign investors, and similar incentives can play a positive role in attracting FDIs into a given destination. Other types of incentives include: guarantees against arbitrary treatment in case of nationalization; government provision of infrastructure; tariffs or quotas set for competing imports; reductions/elimination of import duties on inputs; interest rate subsidies; guarantees for loans and coverage for exchange rate risks; wage subsidies; training grants and relaxation of legal obligation towards employees.

However, some of what is thought to be sufficient effort to attract FDI by Kenyan policy makers may not be adequate. For example, UNCTAD's 1998:91 World Investment Report presents some host country determinants of FDI, which include:

Policy Framework for FDI:

- *Economic, political and social stability.*
- *Rules regulating entry and operations (of FDIs).*
- *Standard of treatment of foreign affiliates.*
- *Policies on functioning and structure of the markets.*
- *International agreement on FDI.*
- *Privatization policy.*
- *Trade policy (tariffs and non-tariff barriers and coherence of FDI and trade policy.*
- *Tax policy.*

Economic Determinants:

- *Business facilitation:*
  - *Investment promotion (including image-building and investment-generating activities and investment –facilitating services)*
  - *Investment incentives.*
  - *Hassle costs (related to corruption and administrative efficiency)*
  - *Social amenities (for example bilingual schools, quality of life*
  - *After-investment services. (UNCTAD 1998:91)*

Most developing countries, including Kenya, have sought to put in place a range of measures designed to attract FDI. However, there still are problems that combine to hinder developing countries from increasing the volume of FDI they attract. These include: poor governance, inept legal systems, corruption, red tape and bureaucracy on the political front and poor national infrastructure (energy, water, roads and communication) and low domestic GDP on the economic front. Omuodo (2002) suggest that the legal and regulatory framework governing private business activities should be stable, transparent and reliable. The rules of the game must be reasonably stable and the judicial system able to enforce law and

contracts effectively and honestly. In Kenya, the judiciary is summarily corrupt, cases take longer than necessary to be concluded and a current constitutional review is in limbo. The investor's main concern is a climate free from bureaucratic interferences, nit-picking controls and arbitrary decisions and a government whose basic approach is to facilitate rather than harass business.

3.2 Characteristics of the SME Sector in Kenya

Most enterprises in Kenya are very small. More than 90% employ less than 10 employees (Ndemo 2001). The sector is characterized with poor infrastructure, lack of financial resources, poor production capacity, low levels of health and safety standards, low awareness of environmental issues, lack of information that is essential for technology transfer process and dependence on large industries for the supply of raw materials, products, and technology. However, the sector continues to provide the majority (94.3%) of the additional employment (Economic Survey 2004).

As identified at a UNEP Round Table Discussion on knowledge sharing, SMEs in developing countries, including Kenya, are reluctant to change, often fearing that new technologies could possibly put them out of business (UNEP, 1995). Since many of these enterprises fall within several clusters scattered throughout the country, the impact of reluctance to change can be concentrated, with major implications for local economies.(UNCTAD 2003). It also makes it difficult to disseminate information where there are no clear channels such as industry organization.

4. An Empirical Investigation in Kenya

4.1 Methodology *and Sources of Data*

Since the empirical investigation is of a pilot nature, the approach used is a qualitative one, based on a non-random purposive design, in order to gain in depth insights into the participant experience (Creswell 1998), detailing information regarding linkages between selected case study companies and local firms. Specifically, the study drew upon data gathered from senior executives in five different MNCs based in Kenya in 2005 and in 2014. The data gathering exercise focused on common and sectoral related links to SMEs.

The research process first involved the identification of MNCs that had links to SMEs, followed by initial contacts being made to schedule an interview with the Chief Executive Officers, or one of their senior managers. Prior to interview sessions, we reviewed each company's literature (mostly Website based) and other relevant information to understand their operations. Detailed semi-structured interviews were conducted. For the purpose of clarity, we categorised SMEs as follows: "micro" 10 or fewer workers (including working proprietors and working family members), "small" between 11 and 50 workers and "medium firms" with between 50 and 200 employees.

Initially, a total of seven large firms were approached through letters of introduction and a follow up telephone conversations to schedule appointments. Two of the firms we had approached at the initial stages declined to be included in the sample.

Two CEO and three senior managers were the main respondents in 2005 although while analyzing the data, other officers assisted in follow up interviews that were necessary to verify the validity and reliability of the data (Lincoln and Guba 1985). In 2014, three chief executive officers and one General Manager were the respondents. One MNC declined to take the second interview. The aim of the research was to solicit for strategic responses with respect to the research questions: What are the linkage dynamics between SMEs and large firms? And what has changed significantly over the past eight years. In other words, the large firm's experiences with SMEs over the past few years.

In view of the qualitative, in-depth nature of this research, the authors recognize that the small sample size, the regional focus of the study, together with the early stage of the pilot research, mean that the findings must be viewed in context (Henry et al 2004). As a consequence, we shall not attempt to generalize the findings, but rather treat the cases as individual events from which evidence and themes can be drawn.

Table 1: Summary of Firm Profiles

Firm	Industry/Owner 2005	Industry/Owner 2014	Yr. Of Est.	Resp. 2005	Resp. 2014	SME Link 2005	SME Link 2014
Kenya Shell (BP)	Oil Anglo/Dutch	Vivo Energy	1900 Shell started operations in Kenya. 1928 Merger with British Petroleum (BP) & became consolidated Petroleum Company 1961 re-separated into Kenya Shell Ltd and BP Kenya Ltd, a marketing joint venture managed by Shell.	Corporate Affairs Manager	Chief Executive	160 Retail Stations employing between 20 and 50 staff. 2 Distributors 20 Resellers	Outsourced: Transportation (200) staff Engineering and Professional services (300 staff) Travel/Security and other (200 staff) Several retail stations
Safaricom/Vodafone	Communication Kenya/British	Communication Kenya/British	1997 by the Kenya Telcoms. 2000 Vodafone bought 40% shareholding. 2005 Vodafone bid to acquire majority shareholding.	Chief Executive	General Manager	62 Dealer with an average of 4 Sub dealers each supplying to more 6000 SMEs. Outsource services such as cleaning to SMEs.	84,743 Dealers and Agents Outsource services such as cleaning and security to SMEs employing hundreds.
American International Group (AIG) Kenya	Insurance American	Insurance Became Kenyan after 2008 Financial Crisis	1967 as Kenya American Insurance Company; 1987 Changed to American Life insurance Company (ALICO); 2004 Sold Life business and became AIG.	Chief Executive	Chief Executive	40 Brokers employing between 10 and 40 staff. 200 Agents Outsource legal, loss assessors, loss adjusters, garages and other supplies.	Expansion into rural areas pushed the number of Brokers and Agents to over 500. Outsource legal, loss assessors, loss adjusters, garages and other supplies.
Unilever Kenya	Consumer Goods Anglo/Dutch	Consumer Goods Anglo/Dutch	1943 as East African Industries (EAI). 1956 Bought by Unilever and a minority share by the Kenya Government through ICDC but retained EAI name. 2000 Became Unilever Kenya.	Distribution Manager	Declined Interview	45 Key Distributors (KD) with an average of 40 retail outlet for each KD. Out sources services such as Market research and manufacturing of certain consumer goods.	Declined Interview
General Motors Kenya	Motor American/Kenyan/Japanese	Motor American/Kenyan/Japanese	1975 with minority shareholding by Government of Kenya investment arm ICDC (37.8%) and Itochu of Japan (4.4%).	Corporate Affairs Manager	Chief Executive	7 Dealers in Kenya and 5 others from the region (finished products.) Outsourcing of parts and service from SMEs	18 dealerships in Kenya and 8 others in the region Outsourcing of parts and service from SMEs directly benefiting more than 20,000 people

4.2 Preliminary Findings

Presentation of the following findings takes the form of a brief summary of each case, followed by a discussion summarising emerging themes. Five case studies drawn from different industries are presented in Table 1 below. These are: the oil (Vivo), communication (Vodafone/Safaricom), insurance (AIG Group), consumer goods manufacturing (Unilever) and motor (General Motors Corporation) industries.

Vivo Energy previously Kenya Shell Ltd / BP Kenya Ltd

The oil industry has very strong forward linkages with SMEs through extensive investments in distribution outlets, which they franchise to small and medium entrepreneurs. Most of the business in the oil industry is done through retail outlets. Vivo for example, has developed has increased its outlets to 180 up from 160 in 2005 and fully outsourced its transportation and engineering business.Its retail enterprises have fully adopted international best practices enhancing strict international safety standards for storing highly inflammable products. In some of the retail outlets, it has built convenience stores for dealers to enable them to increase revenues and margins given the fact that there is increasing pressure on oil prices internationally.

‘‘We create value to our partners. It is the reason why you see many of our partners being highly successiful. We ensure they are taken care of because if compromise their success, we can compromise on our strict international standards. We therefore help them to set up service related businesses to complement the fuel sales at the same time satisfying the customer needs.”

All outlets are branded and as a result, the company maintains its competitiveness and values through strict requirements. These include: sales volume targets, health safety and environmental standards, training requirements, credit controls and stock management. On staff management, the dealers are required to pay at least minimum wage, provide job descriptions and maintain clean uniforms. This was confirmed by a senior manager.

‘We make sure that the people we lease our stations to, are trainable because training is key to our success. Minimum educational requirement to operators is at least “O” Levels. Some of the courses that we emphasize include: management skills, safety and product promotion. As a result we have managed to standardize our service throughout the branch network’.

The company meets the marketing and promotion costs, training both the dealers and their staff, and in some cases provides soft loans to some of their dealers to purchase equipment. Outside of its core business, the company is involved in some social responsibility projects, mainly in the areas of education, poverty eradication, health, environmental protection and safety.

In addition to retail station dealers, the company distributes its lubricants and liquefied petroleum gas (LPG) through appointed distributors, who may or may not

be branded. These distributors have a network of resellers mostly micro entrepreneurs spread throughout the country. On average most outlets make between 2 and 3 pence per litre of petrol. Unless the volumes are high, some do not make sufficient income. Over the years, the company has established that a dealer needs to sell at least 80,000 litres per month to break even. A higher volume may be required to break even in urban areas due to higher labour costs. The appointed dealers are required to meet target volume sales. These targets are set after a thorough analysis of the location potential. On few occasions some have lost dealership due to not meeting company requirements.

For many years, the oil industry was not liberalized. There were few players in the market, of whom most were multinationals. However, recent market liberalization has necessitated a number of small players to set up their own enterprises. Some of these entrepreneurs were former employees of multinational organizations, including Shell. Some of the new gas stations benefit from locally available engineering knowledge built from many years of working for MNCs in the sector.

Vodafone/Safaricom

Mobile communication is a recent phenomenon in Kenya but has created an enormous economic impact, providing jobs to thousands of people; contributing substantial revenue to the Government; and importing technology within a very short period of time. This could not have been achieved without creating international linkages, with Vodafone and local linkages with SMEs. Communication previously a luxury to many Kenyans is now affordable.

'Our subscriber base grew 2.7 million in 2005 to 21 million in 2014 and new products such as Mpesa that we started in 2007, has more than 19 million customers. Our growth has been phenomenal and our story can be told by our partners because they have benefited most.

Although Safaricom could very easily develop direct access to customers through its own managed retail shops, it chose to deal with a network of small suppliers. This has not only worked but has created a significant impact growing from 62 dealerships to 84,743 (See chart below). Each of the 84,743 dealers has an average 5 employees and further link to at least 4 sub-dealers who in turn sell to more than 6,000 micro enterprises throughout the country. The role of retail outlets runs parallel to dedicated dealers, but with more focus on customer service purposes.

'Our distribution model has largely worked because we have involved everybody and sharing our success with real Kenyans on the street. In turn we have created trust with the people of Kenya. We have almost 90 percent of the premium services in this country coming from young and innovative Kenyans. We shall continue with providing innovative products and hope that we continue to work with our partners".

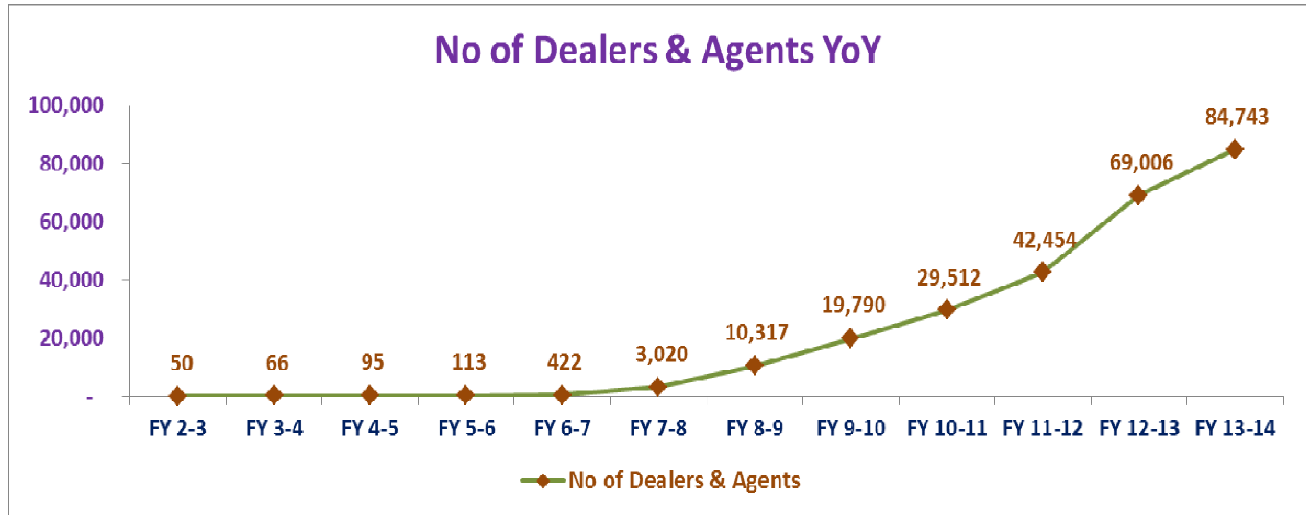


Figure 1: Growth of Number of Dealerships for Safaricom

The company has regular meetings with dealers, requiring them to attend seminars and all training programmes. Dealership staff are also required to undergo training regularly. More importantly, the dealers are supposed to espouse the company values.

'Our success is as a result of high ethical standards that we have maintained either when hiring or procuring any goods or services'.

All dealer shops are branded and are supposed to maintain similar layout and other standards. Company staff checks frequently if the standards are maintained. Besides conducting consumer surveys, the company's field staff uses the distribution network to obtain feedback from customers.

'Our dealers are of great importance to us as they are the face of Safaricom to the ordinary customer who walks into their outlets to purchase a products or make an enquiry on particular services from Safaricom'.

Safaricom also has backward linkages with SME suppliers that provide many essential services, such as repairs and maintenance of their systems; cleaning services; and other supplies. Evidence of other spillovers including the knowledge gained from training by suppliers of technology is apparent as many of the dealers not only sell the product but are able to explain highly complex mobile telephony technologies.

In turn, the partners take home a huge junk of Safaricom success in commissions and other stakeholders (see chart below). Safaricom is the largest company by revenue today in East and Central Africa. It has created real entrepreneurs in its partnership programme.

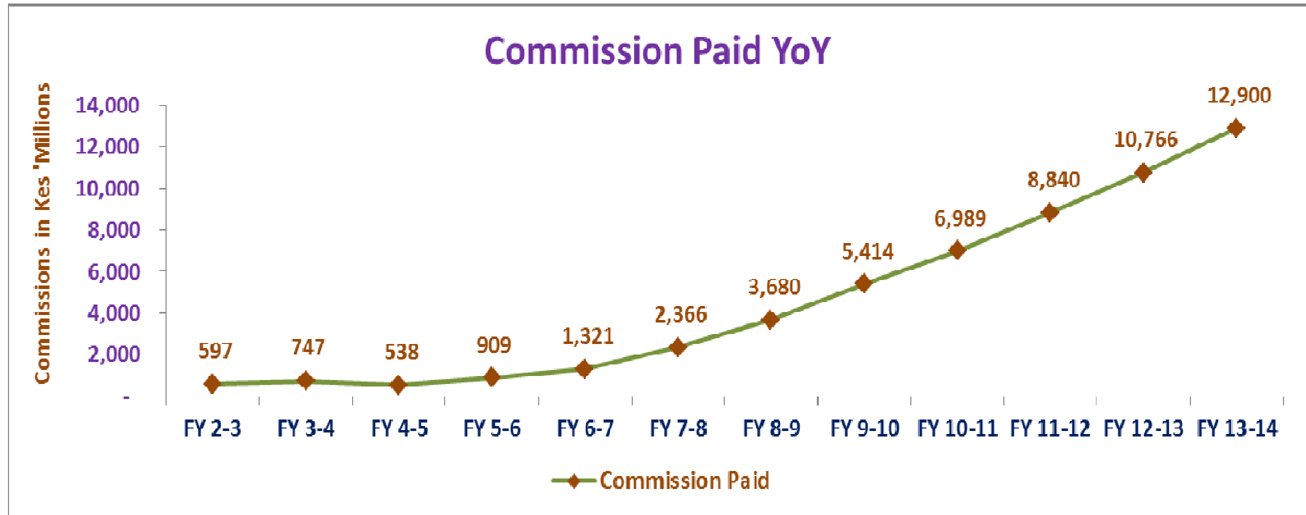
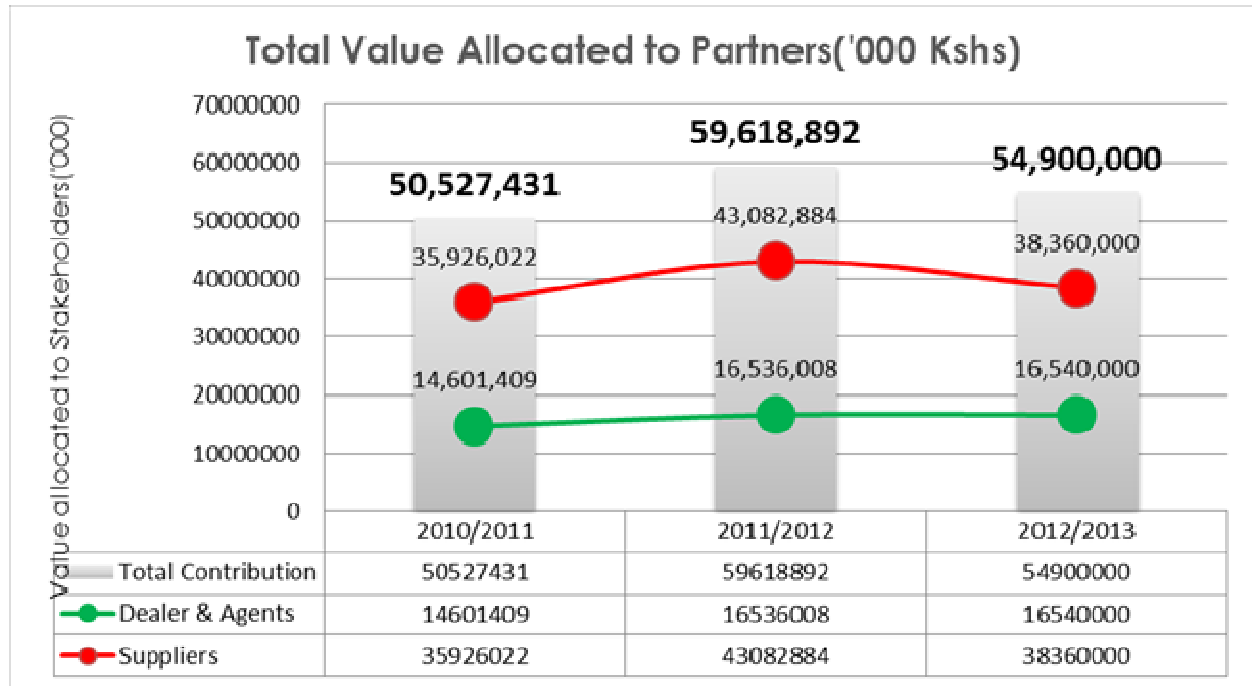


Figure 2: Commissions paid by Safaricom

The total value allocated to partners include that of dealers and other small enterprises that provide essential services to the company.



	2010/2011	2011/2012	2012/2013
Total Contribution	50527431	59618892	54900000
Dealer & Agents	14601409	16536008	16540000
Suppliers	35926022	43082884	38360000

Figure 3: Total Value Allocated to Safaricom Partners

AIG Kenya

AIG Kenya formerly American Life Insurance Company (ALICO) deals with General Insurance after its life division was

sold to a local consortium (an amalgamation of three medium enterprises) after the 2008 global financial crisis. AIG decided to focus on the general insurance market, because of the declining growth in Life insurance coupled with the strategic change to focus on general insurance in Africa, risk in life insurance was too much to bear considering the fact that a number of policy holders in the Kenyan context were infected with HIV/AIDs. Since 2005 a lot has changed. AIDs infection rates have dropped, there are new medicines to prolong the lives of AIDS patients. But even with the emerging development, AIG remains a General Insurance company.

After the spin off, AIG is now focusing its strategy on core business and out-sourcing non-core business activity to SMEs and developing new products by targeting partnerships with micro financial services providers. These new products have enabled the company to expand into rural areas where they are discovering new customers. They see this as an area of growth and one they want to dedicate a number of agents to. With a lean staff of 100, the company has managed to remain the second largest general business insurance company by working through brokers and agents. The company pays more attention to about 80 brokers as they bring more than 80% of the business to the company. Although the brokers do not sell AIG brand, the amount of information passed to them is sufficient to sell AIG before considering any of the competitors.

'We have maintained our reputation for paying claims uniquely on time and that is why an honest broker will sell AIG first. All of our brokers have service level agreement and they know our ideals and speed with which we deal with our customers'.

Whenever there is change of direction with respect to their product, AIG ensures that all brokers and their staff (number of employees for each broker range between 5 and 100) are trained and know the product well. Most of the more than 200 agents who sell AIG products undergo rigorous training and have access to all materials with respect to the company products offered.

'In future we may have dedicated agents selling only our brand but for now we are satisfied with the present set up. Managing dedicated agents in a third world may not be easy because they may actually sell competitor products on the side'.

The company does not have its own loss assessors and adjusters instead, it out sources the services from the SME sector. They have confidence in these service suppliers as they learnt their trade from previous employment with MNCs before the onset of restructuring and refocusing on core activities.

'These people are not just Jua Kalis (micro entrepreneurs that often work out in the sun); they have the experience and know how to do the job at the lowest cost possible. Most of these people were one time employees of MNCs'.

Other services out sourced include legal services, garages and other suppliers. The company prefers small firms to large firms because of their efficiency and effectiveness.

Experience has taught them that larger enterprises sometimes cause them losses. For example, in garages where they refer client vehicles for repair, smaller ones pay more attention to the problem and in most cases would do it within a reasonable time and charge fairly.

Unilever Kenya

After several attempts to meet with the senior leadership of Unilever failed, we decided to leave the 2005 information. This is because it is still relevant in terms its linkage with local SMEs. Unilever is one of the largest fast moving consumer goods (FMCG) companies in the world. In Kenya it distributes its products throughout the country via 45 appointed and dedicated key distributors (KD), each serving between 500 and 600 retail outlets. The retail outlets are not obligated to only sell Unilever products, although the KD must ensure that all Unilever supplies required by retailers are supplied when and where they are needed. Major super markets buy their products directly from the company.

The demands on the KDs are varied including: adequate transport (usually 4 -5 distribution vans), adequate stock levels with a replenishing plan, a route map to ensure that all places are covered and regular reports to ensure target volumes are achieved. In addition the KDs must be available and their staff for regular training seminars and also assist the company with promotions in their respective territories.

"Each KD is reviewed annually using measures such as sales volume, coverage and how effectively they have managed their respective territories. Majority of them understand our work ethic".

The company manufactures most of its brands. However, it has started to contract out manufacturing services to small companies in tea packing and corn flour milling. These companies have to meet the strict quality standards, volume and delivery targets set by the company. The majority of marketing products such as posters, t-shirts and other promotional materials as well as services are sourced from local SMEs often set up by former employees of the company. Other services contracted out include: laundry and canteen services to former employees of the company.

The KDs are the company's foot soldiers, who gather information with respect to competitor activity and other market dynamics. In return the company has invested enormous resources in stock management software, Tally which links the company directly to all KDs.

Tally tells us everything about stock movement at the regional KD's warehouses. We sometimes get to know some things with respect to stock movement before the KD is aware of it. This system is very important to us because of the counterfeit products in the market.

The company also sets rules for those of whom they have backward linkages with. Some of the rules include: hiring people of high calibre and good morals, ensuring high standards of health, safety and the environment they work in and maintaining

international standards that the company is reputed for.

Our inspectors go round sampling all products manufactured on contract outside of our premises to ensure that we maintain international standards.

The company is aware of counterfeit products coming from Asia, which they are fighting through incentives to KDs. Unilever Kenya started cutting costs, through a total productivity maintenance (TPM) programme, which is a Japanese management model that seeks to cut production costs by ensuring that workers do the right thing at the right time and at the right place. In 2000, savings from this programme have enabled the company to give higher margins to KDs, thus making it harder for counterfeiters to use the normal distribution systems.

The company that once had more than 3,500 employees now employs about 800 people, as a result of out-sourcing most of its non core functions. In 1995, for example, it entered into an agreement with Tibbett and Britten Kenya Limited (T&B) which, is part of the United Kingdom based Tibbett and Britten Group Plc, to provide warehousing and distribution services. Although T&B is not a local company, it brought expertise to its Kenyan workers who have now branched off to set up their own services.

General Motors Kenya

General Motors East Africa (GMEA) has grown its dealer network to cover East, Central and Southern Africa. It provides core support to each dealership in the region. The company is 57.8% owned by General Motors Corporation (GMC) of USA. Other shareholders include ICDC 20%, ICDC Investments (17.8%) and Itochu of Japan (4.4%). Since its inception in 1975, the company has expanded to cover the regional market. The plant, assembles three brands, namely Izuzu and Chevroret and Opel. Several SMEs provide up to 60% content for some models assembled.

'Since 1975, we have seen most of these suppliers grow from micro enterprises to where they are now. Some of them like the two large body builders are no longer small enterprises'.

In most cases the company imports the engine and chassis, while the majority of vehicle parts are manufactured by different small and medium enterprises. Due to tax incentives encouraging local assembling of vehicles, motor imports that cannot be manufactured locally are imported as completely knocked down (CKD) kits then assembled at the plant. Body building for most of the vehicles is done by various small and medium enterprises.

As part of maintaining high standards of quality, GMEA is ISO 9001:2000 and ISO 14001 certified: the best known testimonials to world class quality and environmental standards respectively and has encouraged all its sub contractors to aspire towards ISO certification. To provide highest quality all employees of the company and the dealers have to go through training regularly. It has a unique problem in its relationship with local builders who have grown too big. Training sometimes become a problem.

We have for example tried to improve the quality of body building locally but failed because the large body builders see no reason since the market takes whatever they make. We invited Marcopolo (Builds more than 50 percent of coaches in Brazil) from Brazil to train but that did not work. This I guess are the problems you get when your partners grow too big.

The company has however maintained continued training programme for many other builders and mechanics in the burgeoning vehicle industry in Kenya.

'We have an established a customer care and dealer training centre to provide service benchmarks throughout the dealer network. The service you get in Nairobi is the same as in Kampala'.

The more than 30years' experience, or more, in local assembly and service is paying off as its market is expanding to neighbouring countries and some as far away as Mozambique. The outcome is increased FDI to meet the growing demand. At the same time its extensive technology transfer from GMC is developing the motor industry in Kenya. Skills developed over time are benefiting new competitors in the industry. Large investment in ultra modern service centers with state of the art equipment and skilled personnel now characterize some its activities in the region.

GMEA is at the forefront lobbying the Government to create a fair playing field. Although the Government encourages local assembly through tax incentives as a way of employment creation, the incentives are not sufficient to fight off imported used cars from Japan. The company is at the forefront fighting the dumping of used cars into the Kenyan market and has suggested that an anti-dumping tax is required coupled with favourable policies for local manufacturers. The argues that local manufacturers create local jobs.

5. An Overview of MNE-SME Linkages in Common Linkage Practices

Dunning's (1992) framework reviewed earlier in the paper, which was used to guide the structure of the data collection, is used to summarise case study results.

5.1 Backward Linkages

The international evidence of positive spillovers, where it exists, is strongest in the case of backward linkages, with local suppliers in developing countries. This can be illustrated with reference to manufacturing firms, such as Unilever and GMC in Kenya. Positive benefits stem from the information, technical assistance and training provided by MNCs to help raise the quality of supplier's products and services (OECD, 2002). All five cases in the study are focusing more on their core-competencies, and outsourcing some of the administrative and business services, which have previously been provided in-house. Through backward linkages, services like cleaning, legal, maintenance, canteen, health and market research are being taken up by SMEs. Manufacturers have gone further and contracted assembly operations, warehousing as well as transportation.

5.2 Forward Linkages

Empirical evidence suggests that MNCs adopt certain strategies to relate to customers through SMEs as intermediaries. The most common of this link among the five firms was the development of marketing outlets to start off SMEs. Vivo Energy and GMC for example, have invested substantial resources in the physical structures of their marketing outlets. Altenburg in particular argued that MNCs *"which outsource the distribution of brand name products often make considerable investments in the performance of their marketing outlets, e.g. automobile dealers, gas stations, restaurant chains and travel agencies."(Altenburg 2000:II)* For BP, the investment has made it possible for them to expand their market, develop standardised products, and at the same making significant contributions towards the growth of SMEs through capacity building.

5.3 Linkages with Competitors

According to Altenburg (2000), competition is the main driving force for technological learning. As a result, the presence of a major player, such as Unilever, in the market increases the efficiency of both large and small competitors. Unilever for example, has had a significant impact in the development of some of its competitors like Bidco Oils, who have improved their production of oils to the extent that it acquired Unilver's major brand, KIMBO. Altenburg suggests that MNCs entering a developing country's market may induce competing companies to accelerate improvements.

5.4. Linkages with Technology Partners

In a global market economy, strategic alliances enable business to gain competitive advantage through access to a partner's technologies, capital and people enabling junior partners to grow and expand faster and efficiently. Fast growing company like Safaricom had to rely heavily on Vodafone's technology and resources to sustain its phenomenal growth. Empirical evidence show that the number of inter-firm technology agreements involving partners from developing countries rose in the 1990s compared with the 1980s (UNCTAD, 1998).

5.5 Other Spillover Effects

Spillovers such as human capital occur whenever MNCs train personnel beyond their own needs (Altenburg (2000) and Crespo, N. and Paula, M. (2007)). A number of former employees in all the cases have moved to either work for companies in the supply chain, or have started their own companies to benefit from either backward or forward linkage with MNCs. Former GMEA employees are helping small companies (sub-contracted by GMEA) to meet the quality standards required by the company. Even if MNC employees do not participate in training activities, they may acquire certain skills, attitudes and ideas just be working in a plant that conforms to international production standards (Altenburg (2000).

Table 2 below shows the types of services outsourced from SMEs, since the trend in all the five organizations is to increasingly concentrate on core competencies. Some services like Market research in two organizations are undertaken by former employees who set up small enterprises to

offer the services. Canteen services that were previously offered by the companies are either provided by former employees, or by other small enterprises in the industry.

Table 2: Services Outsourced

Service	Number of Organization
Equipment Maintenance	5
Cleaning services	5
Manufacturing/Parts	2
Canteen	5
Training	4
Legal	5
Market Research	2
Health Services	5
Sales	4

5.6 Long term FDI benefits

The Chinese utilization of FDI offers longer term perspectives on FDI benefits. Their FDI strategy entailed four stages. In Stage I, firms established assembly plants in China to benefit from low wages and exported the final product. In Stage II, some low-end imported components were made within China and the infrastructure and expertise to make other inputs were developed. In Stage III, all inputs to the assembly plant were mostly made in China, with access Chinese markets. The final product is assembled for both exports and internal consumption. Stage IV involved the globalization of the Chinese firms itself. Chinese firms will be able to establish foreign subsidiaries and export components from China to these subsidiaries thus capturing a larger fraction of the global value chain. The massive backward linkages in Stages II to IV have created numerous jobs and contributed to raising disposable incomes, which in turn have helped to increase internal consumption of goods and services. Most large firms in China are nearing Stage III (Konana et al 2005).

6. Conclusion and Implications for Policy

6.1 Conclusion

The pilot nature of the empirical investigation reported in this paper limits the extent to which firm conclusions may be drawn from it and makes policy recommendations that are specific to the Kenyan context inappropriate. However, what the cases show is that MNC-SME linkages can offer some benefits to local firms, in practice, with capacity building effects. In each case, MNCs imported technology from their home countries.

Some, especially those involved in manufacturing, sought backward linkages with local SMEs to procure part of their product content and service. All of the five cases sought forward linkages through either finishing the product or packaging it for the market. Some local benefits such as influence on competition, human capital and technology partnerships can be directly attributed to these companies.

At the same time, a larger scale and more comprehensive investigation is required in order to fully assess the scale of these impacts; the specific effects on supplying companies; any negative impacts at a macro level, such as, crowding out effects; and any change in inter-firm relationships and linkages over time. Perhaps the main conclusion from this work is that it shows sufficient evidence of linkage benefits, to justify a more in-depth investigation, in a context where the SME sector is experiencing demand-side deficiencies, combined with a need for technological and knowledge upgrading, in a situation of resource scarcity.

The extent to which potential positive externalities from FDI are likely to be achieved in practice is affected by a variety of factors at the macro- and micro- levels, including the general climate for business development and the strategies used by individual MNCs. In this regard, it is important for policy makers to recognise that any investment by a foreign company has to make business sense, without depending on support from publicly funded initiatives. In addition, spillovers of technology and human capital do not follow automatically from foreign investment, since these are affected by sectoral and domestic external conditions, together with the potential capacity of local SMEs to take advantage of any new market opportunities presented. In general, human capital spillovers from FDI in developing countries appear to be mainly indirect, occurring more as a result of government policies seeking to attract FDI through enhanced human capital, than directly from MNCs themselves. However, human capital spillovers can occur where FDI involves acquisition of a local firm by a foreign company.

Whilst there are 'a priori' arguments to support the potential role of FDI-SME linkages between enterprises as a development strategy in developing countries, and some positive case examples, empirical evidence suggests that the potential benefits do not always materialise. For example, there is some evidence to suggest that some SMEs in transition and developing countries have experienced the negative effects of foreign companies seeking co-operation partners as a short-term expedient, faced with uncertain local market conditions. Such firms may experience few of the learning benefits and capacity building that is one of the justifications for this type of strategy in the longer term, from the standpoint of the partner in the host economy. One question that arises concerns the factors, which influence the ability of partner companies to co-operate effectively, with sustainable mutual benefits, particularly where the partners are drawn from different national and cultural environments. In this context, good practice illustrative cases are required

in order to be able to analyse the key elements in successful partnerships of this type.

6.2 Implications for Policy

Although it is premature to draw policy implications from the Kenyan pilot study, the wider knowledge base does enable certain policy implications to be drawn. Whilst FDI represents a potential means of growing and diversifying the SME base in developing countries, whether or not this potential is actually achieved in practice, depends on a variety of factors, some of which are under the influence of policy makers. An essential prerequisite in this regard is the creation of a facilitating environment for all businesses in developing countries, since this is necessary in order to encourage both foreign and domestic investment.

One of the key factors that policy makers need to consider, in seeking to attract and exploit the potential benefits of FDI, is the large number of locations in the world with similar characteristics, which clearly affect the bargaining position of individual governments with potential investors. In the absence of other location advantages, competition between places typically focuses on offering lower costs, which can contribute to the so-called 'race to the bottom'. As with business strategy, competition between places based on non-price advantages is ultimately more sustainable than that based on price alone, which emphasises the importance of policies that seek to upgrade local economies in terms of infrastructure, human capital and a competitive potential supply base.

Key policy issues relate to creating the conditions to attract foreign investors in the first place, together with policies to encourage and facilitate different forms of co-operation between inward investors and domestic SMEs. Defining the role for policy to attract FDI includes promotional activities; creating an appropriate and effective legal and regulatory framework; capacity building programmes for potential suppliers that include training and quality assurance; and the wider role of business support services and other intermediaries that might include partner searching facilities.

Policies need to pay attention to the broader business environment in developing countries that affects both SME development and their ability to attract FDI; to making SMEs more attractive as business partners for inward investing enterprises; and to a strategy for encouraging this type of co-operation. In this regard, Morisset (2000) has underlined the importance of reforms aimed at increasing macroeconomic stability, democracy and a commitment to economic reforms. At the same time, Morisset (op cit) stresses the importance of high profile publicity efforts, aimed at informing potential investors of improvements in the business environment, on the basis that potential investors need to have an up-to-date and accurate picture of the contemporary business environment, rather than one based on (negative) perceptions inherited from the past.

Backward linkages with suppliers have traditionally been seen as the main vehicle to promote technological and other

spillovers from MNEs into host economies. In this regard, some governments have sought to impose domestic content requirements on inward investors, in order to increase market opportunities for local firms. However, the increasing liberalisation of investment rules, combined with practical problems of implementing such measures, and the possible disincentive effect on potential investors, means that such mandatory supplier requirements are declining in importance. Moreover, in a context where the competition for FDI is becoming increasingly fierce, there is a risk that mandatory measures may discourage MNCs from investing at all. As a consequence, the current policy challenge is to exploit the development potential of local supplier networks through voluntary means, although some attempt to building the capacity of local SMEs to supply is almost certainly required, facilitated by intermediaries, as well as by active promotion. A recent example is the Uganda Business Linkages Promotion Programme, which was initiated in July 2003 by Unilever to encourage the development of linkages between MNEs, large local enterprises and local SMEs (UNCTAD, 2003).

Finally, developing policies to encourage and facilitate SME development in developing countries through FDI linkages requires co-ordinated actions on a number of fronts, involving various partners including policy makers in developed countries; those in transition and developing countries; donors and international organisations; FDI enterprises; and SMEs in transition and developing countries

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