

# Linkage Programs to Develop Small and Medium Enterprises

Helping small and medium enterprises forge business links with larger partners supported by IFC is an important strategy for promoting local enterprise—and thus economic development—in frontier economies. But what does it take to design and manage an effective linkage program? Success depends in part on whether appropriate steps are taken before a program is launched. Objectives must be clearly defined and based on a careful analysis of the underlying causes of market failure that make the program necessary. Program design must proceed from a careful scoping exercise, provide for the development of baseline data, ensure the most appropriate mix of specific program components, and balance the interests of various participants, including funders, major clients, and participating SMEs. A management system that ensures continuity and enables those involved in various linkage programs to exchange lessons is also essential, as are systematic monitoring and reporting of results.

## Program objectives

*The objectives of a linkage program should be understood and clearly articulated at the outset. Where there are multiple funders, each funder's aims and constraints should be clearly understood to ensure they do not conflict with the main project objective.*

It is perfectly legitimate for linkage programs to benefit the major firm and to support development of a stronger and bigger SME supplier base. But the two types of objectives can imply different programs and priorities. If the primary focus of a program is unclear, there may be confusion and misunderstanding among program partners, the large firm, donors, the government, IFC headquarters and the program manager.

Moreover, the aims of other funders may not always coincide with those of the IFC. This became evident when Ford Motor Co. stopped funding an automotive-suppliers program in Russia. IFC turned to the United States Trade and Development Agency (USTDA) to fill the gap, but the agency requires that non-U.S. contractors supply only 20% of the aid it grants—a requirement that conflicts with the IFC's goal of building local consulting capacity.

## The Big Picture

61 Linkage Programs in 40 countries (2004–07)

- Average cost per project = \$44,000
- Assisted 2,457 SMEs
- 61 programs linked to \$2.4 billion in IFC investments
- 1,291 new contracts for SMEs worth \$234 million in nine projects
- 1,388 new jobs created in seven projects
- Over 7,000 people positively affected
- \$23 million in finance facilitated for 169 SMEs

## Program design

**Scoping.** *A formal scoping survey should be undertaken before a program proposal is prepared. It should examine local market conditions to ensure that the proposed intervention is relevant and appropriate. The scoping report should form part of the program documentation, so that everyone involved in the program can clearly understand the starting point.*

Public funding is justified only when there is a clearly identifiable need for assistance and an equally clear market failure to meet this need. Scoping determines whether these conditions prevail. Thorough scoping before inception of a program also can prevent duplication of effort.

**Baseline.** *A proper baseline is essential for measuring the effect of the program. Baseline data should include information on participating and comparable nonparticipating SMEs, so that the effect of the program can be assessed accurately.*

**Rationale for IFC Intervention.** *Any proposal for IFC intervention should demonstrate the existence of market failures that are not being addressed.*

Large firms commonly cite a number of concerns about SMEs: lack of quality and reliability in their products and services; inadequate response to tender invitations; lack of business and financial management skills; lack of technology to add value to products; lack of capacity; limited access to credit and lack of cash flow management; and inability to keep to supply deadlines. But program designs often focus on such symptoms rather than the underlying causes of market failures.

## About the evaluation

The findings reported here are based on fieldwork by SQW Limited—an economic development consulting firm based in Cambridge, England—in four locations:

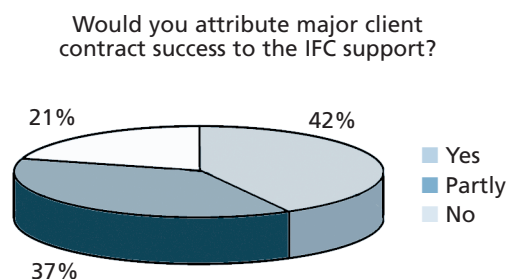
- Azerbaijan (BTC): A suite of interventions aimed at improving quality standards, assisting access to finance and supporting diversification among local subcontractors linked to Baku- Tblisi- Ceyhan (BTC) oil pipeline. The evaluation suggests that BP has done much to improve opportunities for local firms, but local businesses also need to do their share to ensure that they can meet the large firm's supply needs.
- Mozambique (Mozlink): A program to raise technical and managerial skills of local businesses acting as suppliers to the Mozal aluminum plant. Assessment indicates that service providers have improved their performance according both to Mozal's standards and to such indicators as turnover, profitability and employment.
- Peru (Cajamarca): Originally intended to improve Minera Yanacocha's relationship with local SMEs, the program grew to emphasize general SME support. The program addressed a serious dearth of consultants and trainers in the local market.
- Zambia (KSSDP): A program that helped SME suppliers forge sustainable links with the Konkola Copper Mine and to enable Copperbelt SMEs to diversify their customer bases to other mines and industries. Despite some successes, most suppliers have experienced difficulty obtaining longer-term contracts with the company, whose ownership changed. The new program phase is focusing on strengthening business linkages with a select group of five mines in the Copperbelt and facilitating access to finance.

SQW also performed desk reviews of five projects:

- Ford, Russia: A program aimed at improving quality standards at four Russian automobile-components producers so that they could supply Ford Motor Co., and assisting western investment in Russian components companies as a whole. The program provided significant benefits for local small companies, but the removal of import tariffs and local supply rules will complicate efforts to develop a local supplier base.
- Ispat Karmet, Kazakhstan: A program to create an SME equity fund to provide loans and development assistance to help local SMEs win supply contracts with Ispat Karmet, a major steel producer.
- Kilombero, Tanzania: A program to develop the skills of local small-scale farmers and SMEs in a region where a major sugar producer operates and to create sustainable development and business opportunities for the community. Outgrower cane production and yield have increased since 2001-2002, but lack of performance targets and inconsistent recording of project outputs makes it difficult to assess the role of the program.
- Magadan, Russia: A development program aimed at increasing local SMEs' access to markets and finance, developing their managerial skills, reducing administrative barriers, improving the legislative base, and raising awareness of the importance of the private sector. Though well configured, the program produced fewer supply contracts for local firms than hoped because it didn't start until after the construction phase of an IFC-backed mine project. The program also was limited by the quality of local SMEs.
- Tigar, Serbia: A program to advise a rubber company on diversification and train its workforce on how to run spin-off companies.

Market failures could include information failures (imperfect information exchange about supply opportunities and required quality standards), externalities (SMEs may be unwilling to pay for training for fear of losing employees to competitors), supply-side failures (SMEs may be unable to respond collectively to major client requirements), risk aversion (purchasers and professional service providers may perceive high risks in dealing with SMEs), and credit-market imperfections (SMEs may have inadequate access to finance to fund business improvements). Linkage programs should contribute towards addressing these market failures.

### Company performance following IFC support



Source: SQW Economic Development consultants, interviews with SMEs participating in IFC linkage programs.

**Balance of interests.** *The design of a program should identify the primary objective and recognize that the mix of components and their relative importance will differ depending on whether the objective is to help the large firm or to strengthen general SME supplier capacity. But even when a large firm's needs are the primary objective, the sustainability of SME supplier capacity needs to be taken into account—for instance, by supporting some degree of market diversification.*

Linkage programs are designed to increase the capacity of local SMEs to supply both the major investor in the program and other large firms. However, there are some questions about the balance between the interest of the large firm and the development of local SMEs. In one program, there was little evidence of diversification of markets; although performance of participating SMEs improved notably, survey data showed them to be just as dependent on their major buyer near the end of the program as at the start. In another, only 18 SMEs received training and mentoring under two successive programs (SMEELP and Mozlink), and eight participated in both programs. The small number of participants and the fact that in some cases the same firm provided an increasing variety of goods and services suggests that the program focused on helping a small number of favoured suppliers rather than developing the capacity of more local SMEs to supply large firms.

**Choice of program components.** *Project components should be carefully chosen to ensure that they contribute to fulfilling program objectives. All components should be appropriate to the needs of the market.*

The choice of components should flow from the scoping work done before a program is designed. Program designers should avoid pro-

gram components that are either redundant or inappropriate given the primary focus of the program—even if they have considerable intrinsic value. Better scoping would have shown, for instance, that the Magadan program would encounter problems from an inadequate supply of local consultants to provide technical assistance. Similarly, scoping work at the proposal stage would have shown that the Business Linkages Company (BLC) strand of the Kilombero program would duplicate existing initiatives.

Access to finance is a particular challenge for SMEs and thus a component of many advisory programs aimed at them. Several interesting initiatives address this vital concern. The Cajamarca program, for instance, has used two new financial arrangements, a guarantee fund and an unsecured microloan program, and the BTC program is implementing a fund to make investments in SMEs in the oil, gas, and food processing sectors. But some challenges remain. In particularly small markets, such as Mozambique, the formal SME sector is so small that there is little incentive for banks to develop significant expertise to deal with it. One solution may be to develop a regional initiative in collaboration with a bank active throughout southern and eastern Africa.

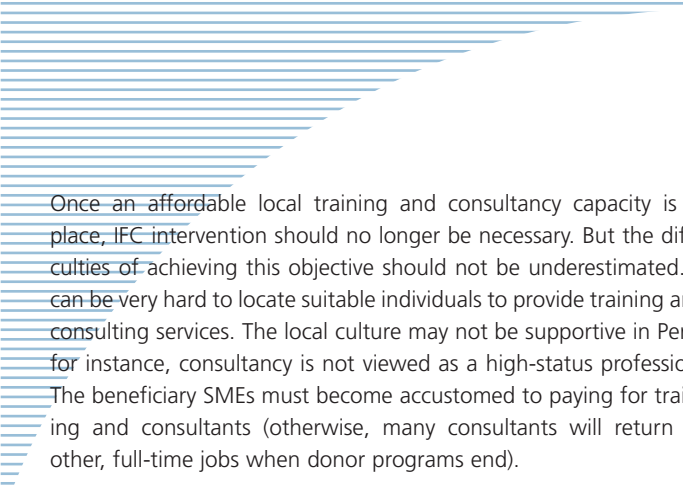
In many countries where linkage programs are run, corruption and a lack of transparency pose major barriers to local firms winning business contracts. Again, several innovative programs address this issue. SMEs that participated in the Mozlink program set up a new business association—the Mozambique Business Network—partly because they felt all existing business associations were self-serving clubs for a few firms already well in with government. In Peru a portion of the linkage budget was used to finance a program to simplify the license registration system in Cajamarca province; the monthly rate of SME registrations then trebled. In Chad, the linkage program launched an e-procurement scheme to allow local SMEs to bid for ExxonMobile contract.

**Program adaptation.** *Regular monitoring is essential to identify problems or changes in market circumstances as soon as possible. Action is then essential to make any necessary changes in a timely manner.*

Given the developing nature of markets in which linkage programs operate, conditions can change significantly during a program. In general, the IFC's programs have demonstrated adaptability although some proposed changes have not been fully implemented.

**Time scale.** *Three years is probably too short a time span for most linkage programs. A four- or five-year term might be more sensible—provided it includes regular strategic reviews. Any decision to renew a program should be taken as soon as possible to ensure continuity between successive phases.*

Linkage programs generally last up to three years, with shorter underlying interventions. This is not sufficient time to make sustainable changes, given the extensive support SMEs require. In some cases, successor programs can solve this problem, but relying on them entails a substantial risk of discontinuity and a loss of momentum.



Once an affordable local training and consultancy capacity is in place, IFC intervention should no longer be necessary. But the difficulties of achieving this objective should not be underestimated. It can be very hard to locate suitable individuals to provide training and consulting services. The local culture may not be supportive in Peru, for instance, consultancy is not viewed as a high-status profession. The beneficiary SMEs must become accustomed to paying for training and consultants (otherwise, many consultants will return to other, full-time jobs when donor programs end).

It should be a priority to identify providers who are likely to continue after a donor-funded linkage program expires. Providers embedded in local institutions—for instance, members of the training departments of the major client or local banks—are most likely to continue after donor support ends. Members of local chambers of commerce or appropriate business associations may be willing to train or mentor SMEs for a fee.

**The role of the major client.** It is essential to gain a full commitment by the major client to the aims of the program. The point of contact with the client should preferably be a key manager in the client's procurement team often complemented by the person responsible for corporate social responsibility.

In standalone programs, everything revolves around the major client. To win such clients' commitment to the aims of the program, it helps to have a strong program champion in the major firm, someone who can influence procurement.

Major clients have a mix of reasons for participating in linkage programs, but programs are more likely to succeed—and be sustained—if the major clients are motivated mainly by a desire to increase the efficiency of procurement, rather than to meet corporate social responsibility objectives. Mozal, for instance, was committed to realize long-term savings by increasing the amount of local purchasing, despite the short-term costs. Its program manager was responsible for procurement across the whole business and could influence the procurement practices of different departments.

If sufficiently motivated, large firms can make life easier for the local SMEs in several ways without lowering quality standards. They can purchase a range of general products (uniforms, local raw materials, small equipment) and services (catering, nonspecialized cleaning, transportation) from local SMEs that may not be able to provide highly specialized equipment. They can divide contracts into smaller sizes or encourage groups of SMEs to come together as joint pro-

ducers. And they can help SMEs overcome cash-flow problems by making advance payments and settling invoices quickly.

Large firms also can push their SME suppliers to improve performance standards and to improve the range and quality of their supplies. For example, Mozal has introduced the ISO14000 environmental standard for its operations and is now requiring its local suppliers to meet the same exacting standards. It also helped SMEs manufacture uniforms that meet a higher standard and use special materials not previously available in Mozambique.

## Program management

*It is important to foster ownership of linkage projects by all relevant IFC parties, at the head office and in the field, and to encourage teams—including, where relevant, standalone linkage programs and PDFs—to share their experiences.*

Because IFC programs have several strands, they require coordination at the program level. The most effective program management occurs when a full-time SME linkage coordinator is on the spot in the program location. But this may not be practical when linkage programs have relatively small budgets.

To address this issue, increasingly linkage programs are designed jointly by a member of IFC's core linkages team and the field program and implementation is the primary responsibility of staff in the field with ongoing support from the center.

## Program monitoring

*A common reporting format should be introduced for all linkage programs. Scoping and development of a baseline should form the basis for creating the program budget. Targets should be appropriate to the characteristics of the local market and the scale of the program.*

Reports follow a standard format that spells out the effects and benefits of program funding. These reports should distinguish between deadweight (the pre-intervention level of activity), displacement (the extent to which the new activities generated by the intervention simply replace old ones) and additionality (the amount of activity above the deadweight level that may be attributable to program interventions). To make this possible, a monitoring plan should be put in place at the outset.

Better baseline data and monitoring should include data on the change in the performance of SMEs that do not participate in linkage programs, so that it is possible to gauge whether improvements are due to the linkage programs or to general economic improvements.

### Monitor

Monitor shares key findings from in depth reviews of advisory services programs and projects conducted by external evaluators. These reviews address the relevance, efficiency, effectiveness and sustainability of the Advisory services programs.

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