CASE STUDY

The role of IPAs in integrating SMEs into Global Value Chains

The Challenge

SMEs are facing a globalization era full of challenge. The emergence of GVCs (Global Value Chains) require SMEs to increase their competitiveness to survive internationally. Trade and investment support institutions (TISIs) have a unique positioning as bridge institutions to help SMEs to integrate in GVCs.

Scholars have long argued that the competitiveness of SMEs in emerging markets depends on firms' ability to upgrade and create higher value products, allowing them to integrate into GVCs through production linkages with Multinational Companies (MNCs)[1]. With the right support of investment promotion institutions and the availability of knowledge and skills, strategic FDI projects can build a pipeline of export ready companies.

Integration of SMEs into GVCs is at times oversimplified and there exists certain barriers that may challenge the adoption of mature production systems and new technologies brought in by MNCs. While some believe that technologies, mature systems and standardised practices can be packaged and replicated by local suppliers[2], others might point out the following challenges:

1. MNC's standardised practices cannot always be easily translated from one context to another[3].
2. The success of the replication will depend on ex-ante capabilities and knowledge-base of the firms. For instance, Garrick Blalock and Daniel Simon's study on Indonesian firms found that SMEs do not benefit equally from downstream FDI, and benefits vary depending on the existing capabilities of the firms[4]. Building these new firm capabilities and knowledge across existing technology gaps and resource scarcities is a sizeable challenge.
3. MNCs have rigorous requirements for their suppliers, making it difficult for SMEs to access GVCs[5]. Oftentimes, MNCs contract their subsidiaries to find local suppliers, and these subsidiaries may have limited interest in guiding the training of lower tier SMEs[6].
4. This exposure to knowledge base is also constrained by the structure of the industrial organisation and overall governing structure of the GVCs[7].

The role of TISIs

TISIs have a key role to play[8]**,** focusing on creating collective resources of experiential knowledge and absorbing local supplier development costs, and can act as social and knowledge bridges across different supplier communities[9]. Through TISIs actions, SMEs can learn through both direct tutelage and social learning[10].

Corroborating this line of argument, parallel studies have found that suppliers appear to benefit from ties to MNC subsidiaries when they collaborate with TISIs that help them recombine experiential knowledge with the standards gained from the MNC subsidiaries[11]. Such knowledge gains are necessary because with GVCs, countries do not need to develop vertically integrated industries to participate in international trade; it is enough to develop capacities in specific segments of the value chain[12].

From a knowledge and capacity-building viewpoint, and to maximally gain from the positive externalities generated by FDIs and resulting MNC activities, local firms need to invest in learning to overcome the limitations of their ex-ante capabilities and to innovate in the absence of knowledge guidance from the MNC subsidiaries.

In addition to learning to maximising knowledge, TISIs, as the interface between government, MNCs and local suppliers, have in their reach the prioritization of strategic investment projects. These institutions can encourage policies designed to target strategic industries to, overtime, incorporate domestic suppliers into their value chains. While not all countries are equally placed to integrate into or upgrade within the GVCs, TISIs can help even the playing field in a variety of ways.

International Trade Centre

CINDE
COSTA RICAN INVESTMENT PROMOTION AGENCY

CASE STUDY

The role of IPAs in integrating SMEs into Global Value Chains

Investment Promotion Agencies, working in conjunction with Economic Development and Trade Promotion Agencies and local businesses have a key role in helping SMEs realise the direct and indirect benefits of FDI. In this context, understanding how GVCs operate is essential for export-oriented FDI as a mean to economic growth or transitioning from a reliance on primary sector to high-tech industrialised production[13].

Survival and success of SMEs in GVCs lies in continuous development and growth. UNCTAD identifies four types of upgrades:

Process Upgrade	Efficiency enhancement by optimizing organizational activities, accepting Good Manufacturing Practices (GMPs) and preferably through an ISO certification
Product Upgrade	Extension of existing offerings via, for instance, addition of after-sales or service-provision offerings
Functional Upgrade	Improvement of the activity-mix of the firm for greater value addition
Chain Upgrade	Moving upstream in a value chain by broadening the scope of the organization with a view to achieve vertical integration

TISIs can foster an atmosphere of learning and continuous improvement within local SMEs that are part of GVCs to enable and prepare them for greater agility by facilitating the four routes for upgradation identified above.

The Response of Costa Rica

In the present Case Study, ITC has further explored the argument of GVC upgrading by analyzing the success experienced by SMEs in Costa Rica as a result of the collaboration with the country's TISIs and especially with its Investment Promotion Agency (IPA), CINDE.

CINDE is a private, non-profit, non-political institution responsible for the attraction of FDI into Costa Rica. It has, since 1982, helped hundreds of companies to settle, and in the process, brought major benefits to the country. Effectively, over the years, CINDE has established a highly functional, cooperative and harmonious relationship with the decision-making divisions within the public sector and private sector and has positioned itself as the most recognized investment agency in the world (as per ITCs latest Benchmarking ranking). Acting as the main bridge for MNCs to enter the Tico economy, CINDE provides information for decision making to MNCs and supports them before and after establishment.

Organizational linkages

Partnerships with key institutions in the country

As one of their best practices, CINDE has built strong collaboration systems with Costa Rican TISIs to create an ecosystem that can support both MNCs and local SMEs. CINDE, COMEX - Costa Rican Ministry of Commerce - and PROCOMER – Trade Promotion Agency of Costa Rica - came together in 2011 to create a strategic alliance[14] with key representations from the public and private sector.

Through joint efforts, a number of reforms were implemented for better FDI-attraction and upgradation of country-outlook[15]. Collectively, the three organizations have, since 2011, signed eleven trade agreements with 42 countries that have gone on to support Costa Rica's inclusion and role in GVC.s Particularly in areas of medical and surgical equipment, automotive and electrical parts[16].

To make Costa Rica a more attractive destination for foreign investors and global conglomerates, CINDE and PROCOMER coordinated the creation of FTZs and the revision of FTZ rules and regulations. Simultaneously, CINDE started establishing key connections with a number of key market countries to be able to offer localized, real-time and up-to-date information to potential investors.

Linkages created through the partnership CINDE-PROCOMER-COMEX are also beneficial when it comes to processes and databases. CINDE has access to an importer/exporter database that has been managed and maintained by PROCOMER since 1998 as well as a comprehensive directory listing (sector and capability-wise) of all exporters and SMEs across different parts of Costa Rica that can potentially benefit incoming foreign investors.

CASE STUDY

The role of IPAs in integrating SMEs into Global Value Chains

PROCOMER has put in place well-designed and highly sophisticated systems to view, analyze, extract and present the data of exporters and importers through any given variable or combination of variables. This is a valuable feature for potential MNCs seeking to integrate Costa Rican SMEs into their production processes. The given information can provide an insight into top-performing sectors, their potential, capacity, specialization and location amongst other factors.

Moreover, PROCOMER has been the catalyst for a Costa Rican EXIM bank to provide capital for businesses wanting to expand and internationalize and has enhanced a comprehensive logistic support platform to help exporters move their products efficiently.

Overall, the linkages created with key institutions – Procomer, COMEX and Academia – have enabled:

I. **Information linkages**: Provided through assistance to investors in contacting with local suppliers through PROCOMER's Linkages department, assistance in contacting with domestic service providers and contract manufacturers and providing information on key Investment projects.

II. **Social and knowledge bridges[17]:** Including technical knowledge and networks creation for investors, SMEs, local professionals and producer communities outside GMA.

Responding to specific country needs

Understanding the specific needs of the country is essential to prepare the national offer. In order to provide the adequate technical skills demanded from international investors, CINDE has collaborated with academic institutions to revise existing curriculum along with the introduction of new courses and degrees that are congruent with the needs of the job-market and the industrial scene.

With ongoing collaboration, CINDE has secured exchange programs with a number of highly regarded technical institutes in the US and has established a Scholarship Fund for local students with support from HP, IBM, Intel, P&G and other MNCs.

In 2018, US research institute Georgia Tech signed an agreement with Costa Rican investment promotion agency, CINDE, to train the country's young people in high demand technology areas such as analytics, cybersecurity, and data science.

International Trade Centre

CINDE
COSTA RICAN INVESTMENT PROMOTION AGENCY

CASE STUDY

The role of IPAs in integrating SMEs into Global Value Chains

Case: Sterilization Services in Costa Rica

As one of the main targeted sectors to attract FDI, the medical devices sector in Costa Rica continues to strengthen following the continual support and confidence of major international players; Abbott, Boston Scientific, Establishment Labs., Theragenics, Helix Medical LLC amongst many others. In 2017, the sector alone made a contribution of $2.9Bn towards Costa Rican exports, becoming the largest export sector in the countryThis was the result of strategies to diversify product types (and their level of sophistication) rolling out from the manufacturing units across Costa Rica, which was once limited to basic medical equipment.

The lack of sterilization facilities in the country, forced foreign firms to restrict themselves to low-tech disposable items. However, a major reform took place when CINDE successfully invited and assisted US-based sterilization companies to set up plants across Costa Rica (BeamOne in 2009, Sterigenics in 2011, amongst others.

This not only allowed Costa Rica to move up the value chain, and profitably, but also helped redefine the Costa Rican medical sector's landscape from being a manufacturer of low-cost expendables to high-value, avant-garde articles such as therapeutic devices and MRI machines amongst others.

The collaboration systems created with MNCs in this sector resulted in multiple noteworthy achievements. First, it led to the integration of local engineers for design, development and manufacturing which, in terms of spillover effects, promoted technology and skill-transfer and facilitated the inclusion of Costa Rica in the GVCs and Costa Ricans in the global economy.

The inclusion of local professionals in international value chains fostered the provision of training and learning opportunities preparing Costa Ricans to take on more technically engaging challenges. In terms of employment generation, the integration of SMEs positively impacted women employment given that women account for up to 90% of the workforce in the sector.

International Trade Centre

CINDE
COSTA RICAN INVESTMENT PROMOTION AGENCY

The role of IPAs in integrating SMEs into Global Value Chains

Challenges and risks

Despite the good practices demonstrated, there are several areas challenging GVC integration that can apply to many countries:

Trade costs, as a result of underdeveloped infrastructure, freight, insurance, state regulations and licensing requirements and information costs[18]. In the case of Costa Rica, the local government has a strong export-orientation regime underway, which eliminates most sources of trade costs – particularly thanks to efforts to create and provide EPZs. However, costs arising as a result of underdeveloped infrastructure are still a challenge. The inter-city road networks (highways) have not received due attention and the sector remains underinvested. This goes on to affect transportation and insurance costs.

Further to the above, concentration of MNCs in given regions, especially around the greater metropolitan area, hinders efforts to fully include SMEs in GVCs, particularly those that are located further away from areas of major activity (or EPZs for instance). CINDE is working to change such pattern by shifting its efforts for a more inclusive offer and to ensure MNCs commitments to further develop areas in need. However, it is still seen as one of the major challenges for TISIs.

Another key consideration is the need of alignment with corporate strategies of installed MNCs. The risk of attracting investors who might be seeking short-term gains should be taken into account[19]. Such risk would need to consider that the MNC presence in the country could simply be a reflection of the desire to avail the advantages offered by the host government or to gain access to a third market. To tackle this, CINDE has put in place a segmentation model for its investor's pipeline giving preference to long-term commitments that will revert with an increased integration of SMEs into GVC.

Weak education systems can also represent a challenge to attract and retain FDI. While it is worth noting that the Costa Rican education system has been considerably applauded particularly across Latin America, it is important to stress the need to continue working on developing technical skills while addressing the risk of an under-development of equally important soft-skills, which are increasingly demanded by large MNCs[20].

Policies to include key population such as youth and women can be critical with respect to employment-generation and local integration into GVCs. Both demographic and equality arguments support the need to take into account such collectives when promoting investment and SMEs upgrading. In addition, the growing importance of CSR globally, might place stringent requirements from MNCs when it comes to gender-representation within their workforce.

Finally, a challenge revolves around the engagement of SMEs in the service sector. Specifically regarding the preference from large MNCs to set up self-owned and controlled setups rather than collaborating with local SMEs offering the same services. In these cases, MNCs recruit individuals from the domestic market rather than engaging with local service providers.

As a leader institution, CINDE has been able to bring success to SMEs, overcoming challenges and leveraging on new opportunities.

The Results

The role of FDI promotion – CINDE's successful initiatives

Costa Rica has witnessed steady and continuous evolution and transition in its export-orientation over the last 30 years:

From primary goods (coffee and bananas in the 1980s) to secondary goods (textiles and shoes in the 1990s) to tertiary goods (semi-conductors, medical equipment, and electrical components after the turn of the century) to becoming a prominent link in major GVCs today[21].

As a part of Amazon's international network or as IBM, Intel and Microsoft's South-American Hub(s) – Costa Rica, manufactures key components and provides vital support and services to a large number of countries across the continent[22]-.

CINDE's efforts have been reported to create an average of 7500 direct jobs annually between 2011 and 2014. In addition, in 2013, 40% of overall local exports were linked to GVCs[23]. By the end of 2017, CINDE had attracted almost 300 MNCs which had created more than 97,500 direct jobs and 50.056 indirect jobs.

The institution's success relies, partly, on its strategic approach to promote and attract FDI in the country. Leveraging on its networks and knowledge, CINDE has focused and prioritized key FDI initiatives to achieve a multiplier effect. Further, identifying the needs and market gaps in the Costa Rican economy, CINDE has been able to target and strategize on its priority investment sectors and collaboration projects.

There are several factors that can explain the success of CINDE to contribute to SMEs integration to GVCs[24]:

I. **A formal strategy to attract FDI**: CINDE has a defined strategy to identify critical needs and key investment projects. Therefore, the institution has focused effectively its efforts to achieve concrete results that reverberate in multiple opportunities for SMEs, MNCs and the local economy overall.

II. **Working with a constellation of institutions**: CINDE leverages on services provided by other institutions in exports promotion, SMEs development and professionals training, to coordinate investment projects that can benefit a broader pool of interested parties. Using its networks, CINDE is able to identify and communicate *how* and *why* to produce for MNCs and it can effectively transmit such information to implementing institutions.

III. **Providing crosscutting ties across isolated networks**: Emphasizing on suppliers outside the GMA area and promoting geographical diversification of investments, CINDE encourages the inclusion and upgrading possibilities for remote areas and communities.

Final Remark

Working for SMEs integration into GVCs requires a shift toward collaboration. Connecting with partner institutions and the private sector to develop new initiatives, establishing frequent communications on progress, and institutionalizing the use of collaborative tools can help cement the new mind-set.

One way to help foster collaboration for SMEs process upgrading is to find common strategic objectives, such as those on economic development and employment growth, and put in place protocols and incentives with relevant institutions to prove results progress and impact. Investing in IT tools and technical platforms for collaboration can be beneficial to support the level of flexibility and agility needed in such constellation of institutions.

At the same time, institution leaders must role-model desired behavior, such as spending time with external partners and actively looking for opportunities to increase collaboration.

TISIs can play a key role in all these tasks faced by SMEs when applying good practices. Cooperation with TISIs can grant a brighter future for SMEs in GVC era.

CASE STUDY

The role of IPAs in integrating SMEs into Global Value Chains

References

1 Giuliani, E., Pietrobelli, C, & Rabellotti, R, "Upgrading in global value chains: Lessons from Latin American clusters", World Development, (2005): 549-57.
2 Gereffi, G., Humphrey, J., & Sturgeon, T. J., "The Governance of Global Value Chains", Review of International Political Economy, (2005): 12, 78-104.
3 Cabigiosu, A., & Camuffo, A., "Beyond the "mirroring" hypothesis: Product modularity and interorganizational relations in the air conditioning industry", Organization Science, (2012): 23(3)-686-703.
4 Blalock G, & Simon D, "Do All Firms Benefit Equally from Downstream FDI? The Moderating Effect of Local Suppliers' Capabilities on Productivity Gains", Journal of International Business Studies, (2009):40-7.
5 Draper, P & Pswarayi C, "Discussion Paper: SMEs and GVCs in the G20 Implications for Africa and Developing Countries", Global Economic Governance Africa, (2016).
6 Giuliani, E., Pietrobelli, C, & Rabellotti, R, "Upgrading in global value chains: Lessons from Latin American clusters", World Development, (2005): 549-57.
7 Gereffi, G., Humphrey J. & Sturgeon, T., "The governance of global value chains", Review of International Political Economy, (2005): 78-104.
8 McDermott, G., Corredoira, R. & Kruse, G., "Public-Private Institutions as Catalysts of Upgrading in Emerging Market Societies." The Academy of Management Journal, (2009): 270-296.
9 Ibid.
10 McDermott, G. & Pietrobelli, C., "Walking before you can run: rethinking types of knowledge, networks and institutions emerging market SMEs need to benefit from GVCs", Forthcoming in Advances in International Management, (2017).
11 Corredoira, R. & McDermott, G., "Adaptation, Bridging and Firm Upgrading: How Non-Market Institutions and MNCs Facilitate Knowledge Recombination in Emerging Markets", Journal of International Business Studies, (2014): 699-722.
12 Cattaneo, O., Gereffi, G., Miroudot, S. & Taglioni, D., "Joining, upgrading and being competitive in global value chains", World Bank Policy Research Working Paper, (2013).
13 Gereffi, G., Bamber, P., Frederick, S. & Fernandez-Stark, K., "Costa Rica in Global Value Chains: An Upgrading Analysis", Center on Globalization, Governance & Competitiveness, (2013): 17.
14 CINDE website
15 Cornick, J., Jorge, J., & Marcela, R. "Public-Private Collaboration on Productive Development Policies in Costa Rica" (2014) https://publications.iadb.org/bitstream/handle/11319/6393/CTP%20WP%20PPC%20on%20PDPs%20in%20Costa%20Rica.pdf?sequence=1
16 OECD 2013: INTERCONNECTED ECONOMIES: BENEFITING FROM GLOBAL VALUE CHAINS https://www.oecd.org/sti/ind/interconnected-economies-GVCs-synthesis.pdf
17 Mentioned as well at McDermott, G. A., & Corredoira R. A. 2010. Network composition, collaborative ties and upgrading in emerging market firms: Lessons from the Argentine autoparts sector. Journal of International Business Studies, 41(2): In press.
18 OECD and World Bank Group: Inclusive Global Value Chains (2015) https://www.oecd.org/trade/OECD-WBG-g20-gvc-report-2015.pdf
Trejos, A. Economic Growth and Restructuring through Trade and FDI: Costa Rican experiences of interest to Cuba (2013)
Trejos, A. Economic Growth and Restructuring through Trade and FDI: Costa Rican experiences of interest to Cuba (2013)
19 Including GVCs in …OECD
20 Trejos, A. Economic Growth and Restructuring through Trade and FDI: Costa Rican experiences of interest to Cuba (2013)
21 UNIDO, 2004 https://www.unido.org/uploads/tx_templavoila/Inserting_l

International Trade Centre

CINDE
COSTA RICAN INVESTMENT PROMOTION AGENCY

ocal_industries_into_global_value_chains_and_global_production_networks.pdf
22 CINDE, www.cinde.org, 2017
23 CINDE, www.cinde.org, 2017
24 The findings are coherent with McDermott, G. A., & Corredoira R. A. 2010. Network composition, collaborative ties and upgrading in emerging market firms: Lessons from the Argentine autoparts sector. Journal of International Business Studies, 41(2): In press.