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TNC FDI Firms and Domestic SME Linkages Reflecting on three SADC Case Studies

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Reflecting on three SADC case studies¹

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Abstract

The research process underpinning this article was focused on casting some light on factors influencing the way in which developing countries can enhance linkages between Transnational Corporation (TNC) Foreign Direct Investment (FDI) firms and domestic small and medium enterprises (SMEs). It sought to do this through identifying the major lessons from SME-TNC linkage programmes from three South African Development Community (SADC) case studies: Mozambique and the Mozal aluminium smelter; Lesotho and the clothing and textile investment related to the African Growth and Opportunity Act (AGOA); and South Africa's experience with SME suppliers and Toyota. The process of securing developmental impacts from FDI for developing countries has been a considerable challenge for many countries and has become a greater imperative in a context of relative declines in official development assistance in the past decade. Other authors have explained how FDI can compensate for domestic savings shortfalls and reduce BOP imbalances. This study tries to explore some ways in which FDI can contribute to lasting structural change in developing country production and productivity dynamics.

1. Introduction

The creation of Foreign Direct Investment or FDI-related linkages within host country economies has been an issue of discussion in the development literature for some decades. However, as FDI flows have begun to outstrip Official Development Assistance (ODA) flows to developing countries, the importance of increasing the potential sustainable developmental benefits of FDI has taken on a new significance (UNCTAD, 2007: 34). This includes the need for developing countries to reduce pressure on their current accounts through external capital inflows and increased exports, to increase public revenues through direct and indirect taxation, to enhance technology transfers and employment creation, and to maximise knowledge spill-over effects from FDI through the creation of Transnational Corporation (or TNC) and small and medium enterprise (or SME) linkages.

While acknowledging the potential beneficial impact of FDI in all these areas, both scholars and policymakers have recognised that such an impact is not automatic. Experience shows that the robustness of local economic development frameworks and related governance procedures is an important factor in securing such benefits, as can be the nature and approach of the TNC itself. In this sense, a systemic policy approach is needed, combining different levels of policy interventions and addressing both the area of FDI attraction and of SME development in an integrated manner.

This article provides an overview of the experience of business linkage activities between small and medium sized enterprises (SMEs) and Transnational Corporations (TNCs) in three Southern African Development Community countries (South Africa, Mozambique and Lesotho).² In a context where TNCs dominate global trade and FDI, often presiding over global value chains, the creation of linkages between domestic SMEs and TNCs provides some significant growth opportunities to upgrade the supply and business capacity of local firms. In addition to the three country case studies, the article also provides an analysis of lessons to be drawn from the experiences. The article concludes with some limited reflections on the way forward for SADC countries addressing linkage formation between domestic SMEs and TNCs.

² The Southern Africa Development Community (SADC) was created in 1992 to further socio-economic cooperation and integration, as well as political and security cooperation among 14 southern African states. It includes Angola, Botswana, the Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe. The Southern African Development Coordination Conference (SADCC), created in 1980, was the forerunner of the socio-economic cooperation leg of today's SADC.

2. Recent FDI trends in the SADC region

FDI flows to the African continent reached record levels of US\$36 billion in 2006 (UNCTAD, 2007: 34). UNCTAD's World Investment Report (UNCTAD, 2007) outlines how this figure was heavily influenced by the global boom in many commodities which stimulated considerable extractive industry investment globally and also on the continent.

In the last decade, FDI flows to the SADC region as a whole have been showing a general growing trend in absolute terms, from a very low base of US\$269-million in 1993 rising to a US\$7,502-million in 2005 (Muradzikwa, 2002; UNCTAD, 2007). Such flows, however, have been generally erratic, exacerbated by irregular and often large extractive industries projects, by oscillating foreign investment activities by South African firms and by mergers and acquisitions carried out in the South African market (UNCTAD, 2007). For example, according to UNCTAD's World Investment Report 2007, in 2006 absolute FDI inflows to the South African Development Community (SADC) region showed a drastic decline from 2005 levels and a substantial rise in outflows³ (see Table 1). It is also notable that, despite absolute increases, SADC's relative contribution to total FDI inflows to Africa is somewhat lower than it was a decade ago. Analysis of UNCTAD data (UNCTAD, 2007) shows that in 1995 SADC contributed over 40% on Africa FDI inflows whilst in recent years this has been closer to 25%.

Table 1: SADC FDI inflows and outflows: 2004-2006 (US\$ millions)

FDI category	1993-2000 (average annual SADC flows)	2004 (annual total)	2005 (annual total)	2006 (annual total)
Inflows	2,970	4,057	7,502	861
Outflows		1,374	1,222	6,792

Sources: UNCTAD (2000) as quoted in Muradzikwa (2002); UNCTAD, WIR (2007)

When examining aggregate FDI figures, it is important to keep in mind that there is a considerable degree of heterogeneity within the SADC regional grouping. For instance, the challenges faced by small countries or land-locked countries such as Swaziland can be very different from those of more populous or coastal countries such as Angola, with very different economic profiles. This becomes apparent when comparing the FDI inflows of the three case study countries under review (see Table 2).

³ Linked to a South African firm purchasing foreign mining operations.

Table 2: FDI Inflows 2004-2006 in SADC countries, Africa, Developing Countries and the World (US\$ millions)

Country / region	1995	2004	2005	2006
Angola	472	1,449	-1,303	-1,140
Botswana	70	392	281	274
Congo	-22	-13	724	344a
Lesotho	23	53	57	57
Madagascar	10	95	86	230
Malawi	6	22	27	30
Mauritius	13	14	42	105
Mozambique	45	245	108	154
Namibia	153	226	348	327
South Africa	1,241	799	6,251	-323
Swaziland	43	71	- 50	36
United Republic of Tanzania	150	331	448	377
Zambia	37	364	380	350
Zimbabwe	118	9	103	40
SADC*	2,359	4,057	7,502	861
Africa	5,655	18,018	29,648	35,544
Developing countries	115,369	283,030	314,316	279,070
World	342,592	742,143	945,795	1,305,852

Note: * Using the 2008 membership of SADC

Source: UNCTAD, WIR (2007)

The following sections provide an overview of three case studies examining the degree and nature of TNC-SME linkages in the SADC region: South African Automotives, Mozambique's Mozal Project; and Lesotho's textile and apparel sectors. The field research took place between 2006 and early 2008.

In all cases, a series of interviews were conducted with TNC firms, local SMEs, government officials and government funded agencies, as well as with a variety of independent experts.⁴ The material gathered from interviews was supplemented by relevant published reports.

⁴ The numbers of interviews conducted, using an open ended questionnaire, ranged from more than 20 for South Africa to around 10 each for Mozambique and Lesotho. The authors are appreciative of the support of national governments, organisations and businesses that made time and information available in support of the research.

3. Local suppliers in South Africa's automobile sector: networking to benchmark and upgrade performance

The first case study examined is that relating to small and medium firms supplying the South African plant of Toyota. The case is of interest in that it touches on three key intersecting themes that of some relevance to developing countries. In the first instance, it presents the experiences of a process where by firms and government collaborated in the formation of an industry inter-firm network geared primarily to enhance the capacity of existing automotive suppliers to sustain their engagement with major vehicle producers such as Toyota. Secondly, the case explores the nature of supply interactions – and therefore linkages - in a sector with a value chain that is increasing globalised. Finally, the case study also reflects on an active industrial policy framework and its impact on the creation of linkages.

South Africa's automotive sector developed during the last century under a framework of protection, supported by direct and indirect subsidies, with the aim of serving the local market. It was characterised by a mix of assembly and production operations generating relatively low volumes of a wide range of vehicles. In 1987 the seven automotive plants in the country produced 22 models, which increased to 34 by 1993, with total car sales only in the region of 250,000 units (Barnes and Kaplinsky, 2000: 779). The sector was characterised by low levels of productivity, high production costs and low levels of innovation.⁵

The post-1994 trade liberalisation period saw a dramatic reduction in tariff barriers, including a reduction in previously high import tariffs on the importation of both vehicles and automotive components. As explained by Lorentzen et al (1994:7), "duty levels on completely built up vehicles (CBUs) fell from 115% in 1995 to 40% in 2002 and are scheduled to reach 25% by 2012. Tariffs on completely knocked down (CKD) components are lower still". A range of previous subsidy measures, such as the General Export Incentive Scheme were also dismantled as the government sought to introduce an industrial policy framework compliant, to a large degree, with the country's obligations under the Uruguay Round.

Since 1995, South African exports have experienced a 9-fold increase from R4.2 billion to R39.2bn in 2004. South Africa's share of global auto production was 0.61% in 2000 and grew to 0.79% in 2006. Total vehicle production in 2006 was 621,900 units – more than double the units produced in 1999 (Naamsa, 2007). The case study explores the experiences of local suppliers to the largest vehicle producer, namely Toyota, under these circumstances.

⁵ Information drawn from Robbins, 2005 and Morris and Robbins, 2007

3.1 The Motor Industry Development Plan

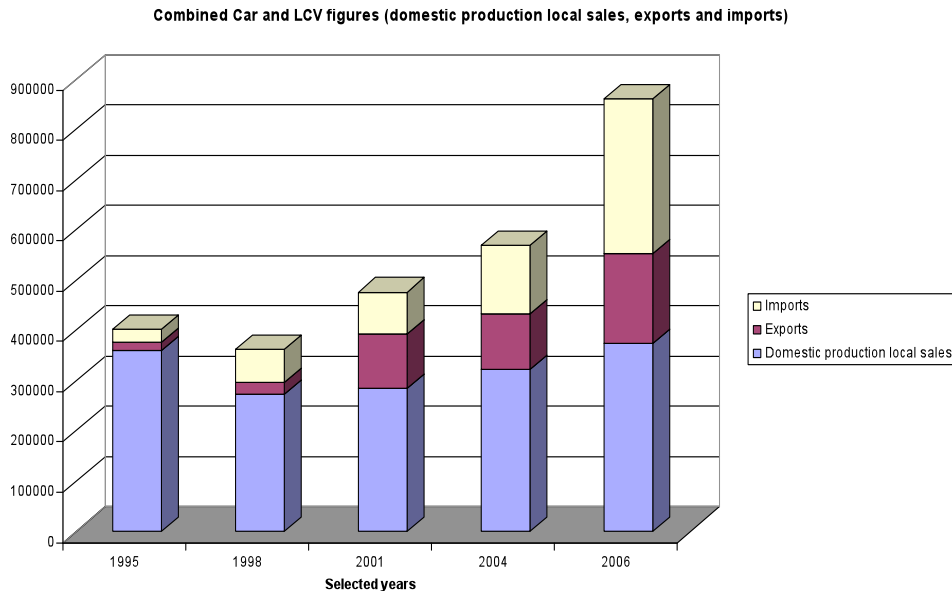
Alongside a commitment to trade liberalisation, the Department of Trade and Industry (DTI) has been eager to avoid potential pitfalls of de-industrialisation from rapid tariff adjustments. Through a programme known as the Motor Industry Development Plan (MIDP), introduced in 1995, the DTI sought to encourage the consolidation of domestic production around the output of a reduced range of vehicles (for each Original Equipment Manufacturer or OEM) allowing for export-scale production of these vehicles. The MIDP originally provided four key sets of incentives (Barnes and Morris, 2000: 800):

- A tariff reduction plan for the import of Completely Built-up Units (CBUs) and Completely Knocked-Down (CKD) kits;
- A duty free allowance for assemblers of 27% of the wholesale value of the vehicle;
- A small vehicle incentive in the form of an effective subsidy for the production of a more affordable vehicle based on a duty drawback related to the value of the motor vehicle;
- The replacement of previous minimum content provisions for OEMs with an import-export complementation scheme allowing both automotive and component manufacturers to gain export credits which could in turn be used to offset import duties and could also be sold on the open market.

The impact of the MIDP secured very substantial FDI commitments in the automotive sector. OEMs began, one-by-one, to systematically include South Africa into their global operations, while previously South African production activities had either been operations under license or had been viewed as somewhat marginal to core global operations. Initially, it was the German OEMs that moved to comprehensively reposition the production of BMW, Volkswagen (VW) and Daimler (later Daimler-Chrysler). More recently, United States (or US) and Japanese-based OEMs have begun to follow suit. As Lorentzen et al (2004:2008) outline, "the MIDP, together with the depreciation of the Rand from the mid-1990s, turned South Africa into a relatively competitive producer of both components and completed vehicles. The contribution of the auto sector to total manufacturing sales grew from 9.7% in 1994 to 12.8% in 2003". The figures below illustrate the growth of exports and output, as the MIDP began to take root in South Africa.⁶

⁶ However, in recent years the MIDP has been reviewed and adjusted, and tariffs continued to be reduced, in order to comply with World Trade Organisation (or WTO) commitments.

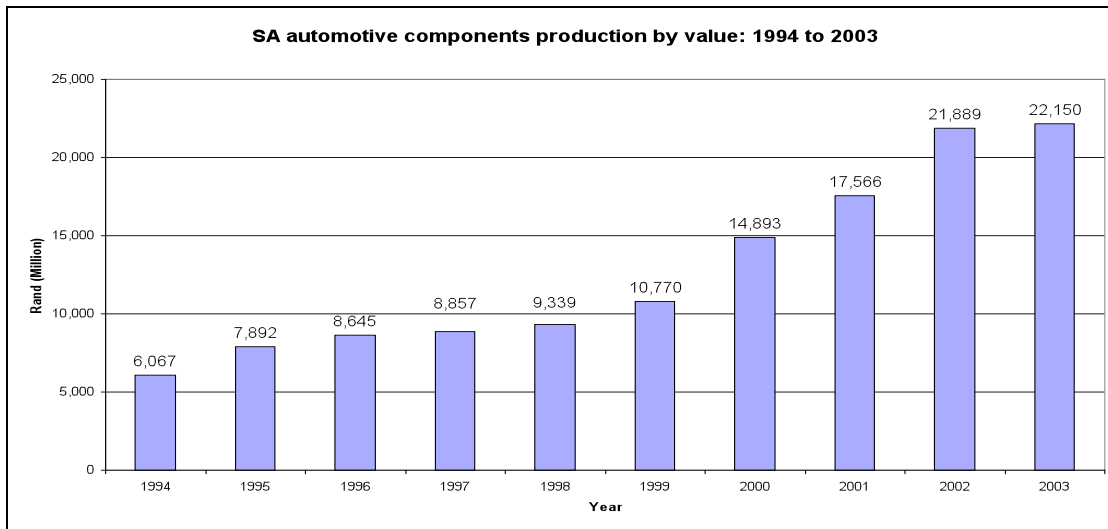
Figure 1: Domestic production local sales, domestic production exports and imports in the South African market



Source: Own calculations from National Association of Automobile Manufacturers of South Africa (NAAMSA) www.naamsa.co.za

However, for components firms the situation became very challenging. A depressed domestic market, extending from the 1990s through to the first couple of years of the new millennium, combined with often weak relationships with the headquarters of OEMs present in South Africa left these firms very vulnerable. Not only were orders being lost as models previously produced were discontinued, but in many cases volumes were under pressure with weak domestic orders. Furthermore, the entry of OEMs with local operations into global supply chains meant a larger emphasis on global sourcing, and consequently many local producers operating under license were placed under considerable pressure. However, the requirements of the MIDP for local sourcing in order for OEMs to access export markets and a period of currency devaluation did allow for some opportunities after in the period after 2000. In some instances, this entailed large foreign component producers entering the domestic production market through acquisitions or other forms of partnership such as joint-ventures. This allowed for the meeting of local content requirements and created a platform for some firms to become part of the OEM parent company global sourcing arrangements. Independent South African component producers were also able to use this period to adjust to new industry requirements and a considerable number of these also began to see benefits after the lean first years of the MIDP. This is reflected in the figures related to growth in output (by value) listed in Figure 2 below.

Figure 2: South African automotive component output by value



Source: Barnes and Johnson (2004: 8)

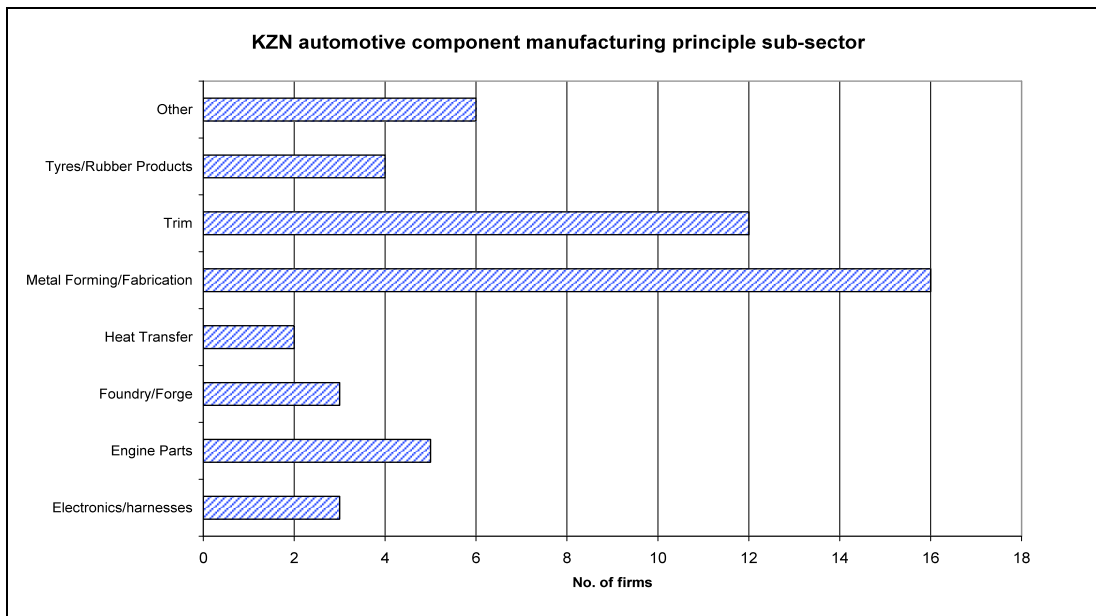
3.2 Automotive production in KwaZulu-Natal and the case of Toyota

As the bulk of Toyota's South African suppliers in value and volume terms were based in the Province of KwaZulu-Natal, the case study took this region as its focus. In the Province, SMEs made up the greater proportion of the auto components firms located in the region. Traditionally, in automotive supply chains, suppliers have been categorised according to three levels: first tier, second tier and third tier. The specific criteria for being identified as forming part of one or other tier are not necessarily fixed, and with Toyota, these have changed overtime. However, those in the first tier are generally assumed to be supplying components at scale directly to the OEM production facility, are often involved in sub-assembly and produce components seen to be core to the automobile (engines, electronic systems, body sections). These firms have often been said to work in much closer partnership with OEMs and operate on longer term more secure contracts. Second tier firms generally supply either the OEM directly or supply critical components to first tier firms and are either producers of scale or involved in specialist higher value activities that are needed in automotive production. Third tier firms often supply second or first tier suppliers rather than OEMs directly. It is common from them to be producing lower value and lower volume products using technology and processes that is not necessarily unique. They are often subject to much shorter term contract arrangements.

According to Barnes and Johnson (2004), in 2003, 10 firms in KwaZulu-Natal were first tier suppliers, 20 were second and third tier, and ten supplied the aftermarket, while a range of others supplied into a variety of industries. Figure 3 shows the product profile of these firms. Barnes and Johnston (ibid) point out that some second and third tier suppliers were not exclusive auto component firms and produced goods for other

sectors, but had the auto sector as a significant, if not the most significant, customer. Most of these firms were significant suppliers to the Toyota plant in Durban.

Figure 3: Profile of KZN component producers by product type, 2003



Source: Barnes and Johnson (2004: 16)

Although Toyota manufacturing production was, and still is, the largest in the country by some considerable margin, the process to transform the Toyota plant in South Africa from a local operation under licence to an subsidiary integrated into Toyota's global operations was somewhat protracted. This delayed the access of most components firms located in the KwaZulu-Natal province to MIDP schemes.⁷ However, many of these firms were also suppliers to other OEMs or to the after-market (spare parts), and this enabled many of them to take advantage of some MIDP export subsidies. The possibility of Toyota significantly scaling up local production operations in South Africa and of entering Toyota's global supply chain also attracted a handful of TNCs producing auto components on a global scale, such as the catalytic converter manufacturing firm Cataler, partially owned by Toyota itself.⁸

During the mid 1990s, the decision was taken by the South African owners of Toyota South Africa (TSA) to gradually sell their shares to Toyota Manufacturing Corporation (TMC) of Japan. However, it was not until the late 1990s that TSA made clear its intentions and acted to assume a majority holding of TSA and to

⁷ License conditions for Toyota South Africa (TSA) from Toyota Manufacturing Corporation Japan stipulated that TSA could only export a limited range of models to a handful of small African markets. This resulted in the imposition of severe limitations for TSA in taking advantage of the export-driven benefits of the MIDP.

⁸ Many OEMs have encouraged the production catalytic converter manufacture in South Africa as South Africa is a dominant global producer of platinum and palladium, used in the catalytic converters. Their relatively high value makes them an attractive component to meet the domestic content requirements included in the MIDP.

restructure its operations to take advantage of the MIDP export opportunities.⁹ This allowed TSA to substantially increase its production output with a plant specialised in the full manufacturing of two models (Hilux and Corolla) primarily for export. Through utilising the export credits available from these exports the company was able to import a wider range of vehicles to continue competing with other brands in the domestic market.

3.3 The restructuring of Toyota's relationship with its suppliers in the context of a changing competitive environment

The increasingly competitive domestic and global environment which TSA encountered led to the company having to make considerable operational adjustments. In this environment, the productivity and cost competitiveness of both TSA and its suppliers was, and continues to be, severely tested. Today the company competes domestically with local products from a number of other OEMs and imported vehicles from a wider range of OEMs located elsewhere in the world. Internationally the TSA plant has needed to continuously prove that its distance from major world markets would not undermine its cost and quality competitiveness vis-à-vis other car manufacturers competing in the very tough European markets to which TSA's exports are directed. The TSA plant in Durban must be competitive not only against other Toyota plants in a geographically expanding Europe, but also with the plants of other OEMs in Europe and worldwide. Part of Toyota's global strategy has been to increase its share of the European market and the restructuring of the South African plant has given the company the added production capacity in two of its key models to do so. This combination of the opportunity afforded to Toyota by the South African plant in relation to the European market and the related need to have production flexibility in responding to market shifts in Europe has been important in securing the company's ongoing interest in its local production facility.

Under these circumstances the restructuring process at TSA was largely designed to match the advantages of South Africa's industrial policy and trade systems with the European market opportunity. In meeting the requirements of the MIDP in its restructuring there was a requirement to increase local value-added. The plant shifted from producing seven different models, at relatively low volumes, to essentially two platforms at high volumes. In doing so it managed, in some areas of the supply chain, to secure greater local sourcing through raising the volume of targeted component orders. Furthermore, Toyota's International Manufacturing Vehicle (IMV) programme has also sought to create more substantial manufacturing platforms in key global supply plants so as to spread risk but also to enable scaled up production of regionally modified models off a common chassis platform. In line with this strategy, TSA also sought to draw in some South African suppliers into its global supply networks.

⁹ Barnes and Morris (2004) argue that the design of the MIDP favoured German-owned OEMs and their suppliers as opposed to Japanese and American firms. In the case of German OEMs such as Volkswagen and BMW, for example, local operations were already 100% subsidiaries of their German parent companies and no license restrictions were imposed on exporting. On the contrary, TSA was operating under license and its focus was almost exclusively on the domestic market. This not only delayed its integration in the MIDP system, but also determined the need to change its global strategy.

It is worth briefly illustrating, with some data, the changes in Toyota's supplier base that have taken place in the past few years. In 1990s, TSA produced 80,000 units over seven models (or platforms) for the South African market. The plant had 154 suppliers. By 2009, the plant will have raised production to over 200,000 (mainly Corolla and Hilux models) of which 65% will be for export to Europe. The firm will have 78 suppliers, 82 % of which will be what TSA refers to as global sourcing partners in that they are linked into global supply arrangements for the models produced in other regions, especially Europe. In 2003, only 28% of suppliers to TSA were characterised by the firm as global sourcing partners. Between 2003 and 2006, the proportion of supply into TSA from suppliers not party to global sourcing arrangements dropped from 41% of total sourcing to 18%. Between 2002 and 2006, Toyota's global sourcing strategy saw the costs for the production of the Corolla reduced by 32%. Whilst the number of suppliers has been gradually reduced, the value of supplies in the local market has been gradually increasing as order volumes increase. For example, in 2006, 70% of the Hilux was sourced locally up from 60% five years ago.

The changes outlined above brought with them massive pressure on many KwaZulu-Natal-based component firms – and in particular on those that were not first-tier global quality operations. In order to continue supplying OEM plants manufacturing for export, these firms had to rapidly adjust to increasing quality requirements arising from the motor industries' rigorous certification procedures, increased scale of production and production flexibility. Whilst those that had been, or became, part of international operations could draw on a measure of global expertise, many firms in the second and third tier supply categories needed to demonstrate a rapid turn-around in capability without support from international group operations.

The local content requirements of the MIDP did create some breathing space as Toyota and other OEMs had little choice but to work in partnership with local suppliers to upgrade their capabilities. Toyota also made the case that this approach was not only one of obligation, but also formed a key element of good-practice in running a large, internationally competitive export business. However, the reality was that, with a considerable reduction in models produced domestically, some firms that had survived off small lot production, either had to diversify out of automotive components supplies, or had to meet the escalating requirements of new manufacturing regimes.

The Durban region in KwaZulu-Natal Province has hosted auto-related manufacturing businesses for over 50 years. However, the survival of the sector was by no means guaranteed in a climate of rapidly escalating global competition and lowering domestic protection. It was out of a collective recognition of the importance of collaboration amongst local industry stakeholders and a strategic commitment by Toyota to seek enhanced supplier capacity that the KZN Automotive Benchmarking Club and ultimately the Durban Auto Cluster (or DAC, as it is commonly known) were formed. The following section explains the formation of these initiatives and the nature of activities and impacts.

3.4 The KZN Benchmarking Club and the Durban Automotive Cluster (DAC)

During the mid- to late 1990s, the Industrial Restructuring Project (IRP) at the then University of Natal in Durban (now the University of KwaZulu-Natal) initiated a series of co-operative pilot competitiveness benchmarking activities with a number of local automotive components producers as part of an action-research endeavour to support firms in critical local sectors respond to competitive pressures.¹⁰ These activities, and the subsequent development of a co-operative working relationship between the researchers and the firms, led ultimately to a decision in the year 2000 to form the Durban Auto Cluster with an initial provincial-wide membership of thirty automotive-related manufacturing firms. The matter of TNC-SME linkages was, and continues to be, intrinsic to the work of the DAC.

The DAC's predecessor entity, the KZN Benchmarking Club, was formed during 1998 as a firm-driven co-operative venture, supported in part by government grants, to help firms to consistently evaluate their relative performance in terms of both meeting customer demands and against competitor manufacturing process activities and to then share ideas on how to use such information to upgrade their performance. The former university-based facilitators subsequently created a special-purpose company to carry out the facilitation activities and perform independent (domestic and international) benchmarks.¹¹

During 1999, the KZN Benchmarking Club was approached by the Economic Development Unit of the then Durban Metropolitan Council (now the eThekweni Municipality) to broaden its membership and extend the nature of its activities beyond benchmarking-related processes. During the course of 2000, investigations and discussions yielded a strong commitment by almost 30 firms to work together in the form of the Durban Auto Cluster with a broader membership and focus than the Benchmarking Club. Initial funding was secured from local government in Durban and supplemented by some funds from the DTI and the KZN Provincial Government.

At its outset, the DAC was to be driven by a firm based governance structure in that firms would make up the majority on the decision making structure and lead the working groups driving various projects. Early members included Toyota and a few other smaller OEMs and a range of first, second and third tier firms. Firms were encouraged to join regardless of their ownership structure.

The initial DAC business plan identified four working groups:

- The KZN Benchmarking Club would continue to operate as the first working group, open to firms willing to participate in regular and comprehensive benchmarking;

¹⁰ This research team, led by Professor Mike Morris, drew inspiration and direct support from the experiences of Professor Raphael Kaplinsky of the Institute of Development Studies at Sussex University and John Bessant of the University of Brighton.

¹¹ This company, now called B&M Analysts, runs benchmarking activities with auto firms in the Eastern Cape and Gauteng (www.bmanalysts.com).

- A second working group focusing on logistics matters would seek to develop a common approach and work to reduce costs and bottlenecks;
- Human resource issues would be handled by a third working group with an emphasis on matters such as improving literacy and numeracy as well as dealing with matters relating to HIV and AIDS in the workplace; and
- The fourth working group would tackle matters of supplier development by working towards the adoption of common frameworks and accreditation and support systems.

Participants in the DAC could choose their level of involvement. Some firms chose to participate purely in information sharing activities. However, if firms had wanted to access programmes such as training sessions or collective logistics negotiations they would have had to upgrade their membership. In a relatively short time membership grew beyond 30 firms and the bulk of members were committed to higher levels of involvement. The main objective of the firms participating in the DAC was to get access to information in order to enhance their decisions in the workplace (Lorentzen et al, 2004). Firms also indicated that informal networking beyond the formal processes of interaction at the DAC provided useful benefits to them.

3.5 Creating TNC-SME linkages in the DAC

Within the DAC working groups, it has been the Supplier Development Working Group and the benchmarking programmes that have had the most significant impact on relationships between the TNCs (inside and outside the DAC) and SMEs making up the majority of the DAC membership. The activities of the Supplier Development Working Group have ranged from sharing knowledge on complex certification and standardisation requirements to training purchasing managers and building a network of support from those firms wishing to upgrade their supply capabilities. In an industry with relatively high barriers to entry and increasingly sophisticated accreditation and technology management processes the working group programmes have enabled smaller firms to familiarise themselves with the sourcing requirements of first tier OEM suppliers and the OEMs themselves. A Toyota official participating in one of the DAC meetings indicated that the confidence of the company in the region had been greatly reinforced by the processes of the DAC.

During the course of 2002, as the DAC moved to securing a greater proportion of its funding from its own membership, a decision was taken in conjunction with the local government in Durban and KZN Province officials to redirect public sector funds to supporting emerging, largely black-owned, SMEs on the periphery of the sector to become accredited suppliers. The participating firms in the DAC committed themselves to working with a number of such emerging SMEs through a variety of support activities. The KZN Manufacturing Advisory Centre, a government funded institution, was also persuaded to work to upgrade some of the more generic manufacturing-related capabilities of the SMEs where required. Through this programme and ongoing subsidised participation in the workings of the DAC, a number of SMEs have successfully increased their supply commitments to the automotive sector.

The impact of the collaborative work between transnational corporations (ZNC) in the auto industry (OEMs and components producers) and local firms can be found in Table 3 which shows that South African firms' performance has improved over time against international benchmarks. The major achievement of the DAC and the KZN Benchmarking Club has been that they enabled firms to make the best use of opportunities offered under the MIDP framework to upgrade their supply capacity. It is unlikely that the MIDP alone, without the facilitated networking activity described, would have created the sustained impacts on the competitiveness of firms. This finding by Barnes et al (2003) has been reinforced by a survey done by Lorentzen et al (2004).

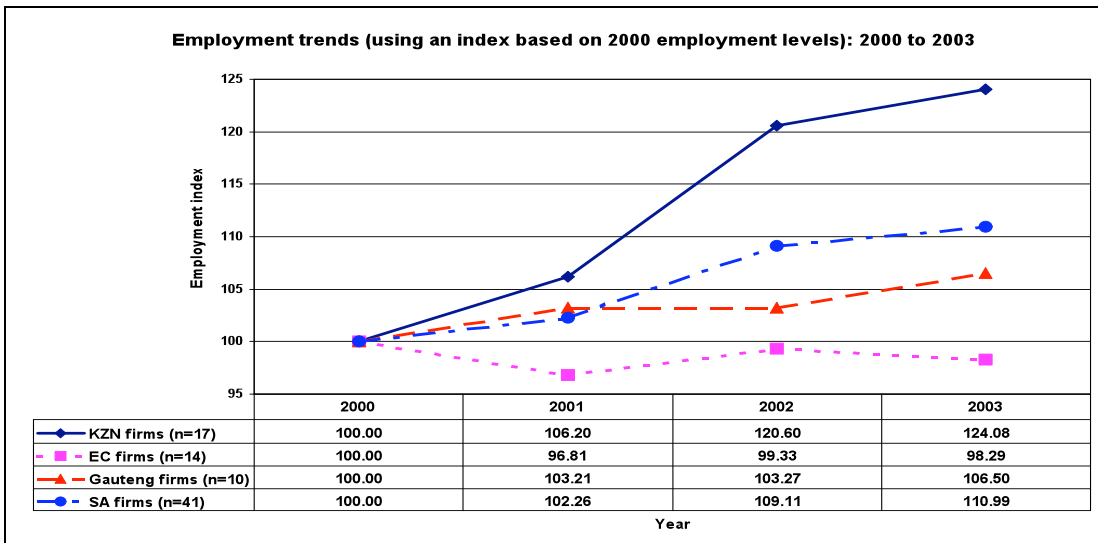
Table 3: Learning and comparative advantage in the auto components sector: 1998-2001

CSF	KPI	South African firms					Comparator firms		
		No	1998	1999	2000	2001	Improvement 1998/99-2001 (%)	W. Europe N=14	Emerging economy N=12
Cost control	Total inventory (Days)	32	62.6	54.3	47.6	42.0	32.8	31.2	38.6
	Raw material (Days)	32	32.3	27.9	25.2	21.8	32.7	17.2	19.2
	Work in progress (Days)	32	12.4	8.9	8.1	8.2	34.3	5.3	8.6
	Finished Goods (Days)	32	17.8	17.5	14.3	12.1	32.0	8.6	9.5
Quality	Customer return rate (PPM)	23	3270	2638	1406	1240	62.0	549	624
	Internal reject rate (%)	25		4.9	4.2	3.9	20.7	1.9	3.5
	Supplier return rate (PPM)	21		21989	14637	18518	16.0	8319	13213
Flexibility	Lead time (Days)	17		19.9	19.1	17.9	9.9	16.8	12.0
	Supplier on time & in full delivery (%)	23		78.7	82.1	82.2	4.5	92.2	92.3
	On time & in full delivery to customers (%)	25		92.2	92.8	92.7	0.6	96.1	93.5
Capacity to change	Training spend as % total remuneration	30		1.3	1.7	2.0	56.2	1.3	3.1
	Absenteeism (%)	27	4.4	4.3	4.1	4.0	9.4	4.2	5.7
Innovation capacity	R&D expenditure (%)	24	1.64	1.70	1.67	2.12	29.5	1.83	2.90

Source: Barnes J, Kaplinsky R and Morris (2003: 11); KwaZulu-Natal/Eastern Cape and Gauteng Benchmarking Club database

The impact of the DAC processes and the general policy environment has also been a positive one in terms of employment and investment by the firms. The Figure below provides an indication of the degree to which employment levels amongst the DAC firms picked up during the period 2000-2003.

Figure 4: Employment trends in DAC members compared to other regions: 2000-2003



Source: Barnes and Johnson (2004: 20)

In conclusion, it should be noted that the environment in which this linkage activity has been made possible has been considerably influenced by national government’s programmes to encourage small business development and in particular greater participation by black entrepreneurs in key sectors of the economy. This has, for instance, resulted in some of the major OEMs requiring their supplier development divisions to make particular efforts to increase procurement from SMEs. This pressure for change has impacted on the supply chain and has also encouraged components suppliers to examine opportunities to spin-off or outsource various supply activities to existing SMEs or to support the creation of new ones. The DAC has provided a very effective, accessible and consistent form of support for such processes. Both domestic and foreign-owned firms have been able to make use of its processes and found ways of developing relationships and learning than might otherwise have been difficult without the so-called “spill-over” effects of knowledge sharing in the DAC.

4. The experience of Mozambique in the aluminium sector: creating linkages with Mozal through the Investment Promotion Centre

Mozambique's remarkable recovery from a bitter civil war coupled with one of the world's highest growth rates over the last decade makes the country a notable success story. The country's political stability since 1992 has created a business environment that is conducive to investment. As a result, Mozambique has become a recipient of some of the highest levels of foreign direct investment (FDI) in Africa. The Government of Mozambique has embraced the opportunities provided by this investment, and has adopted a development strategy that is premised on liberal trade and monetary policies, which has enhanced the growth of the private sector, strong FDI and sustained GDP growth. The country's poverty reduction strategy (PARP) reflects the importance of strong economic growth to the reduction of poverty in line with the millennium development goals (MDGs).

4.1 Mozambique's economic environment and its approach to FDI and SME development

Since the end of the civil war in 1992, steady economic growth, driven predominantly by construction and manufacturing, has culminated in an average GDP growth rate of about 8% between 1994 and 2004 (IMF, 2006). GDP grew from an estimated \$6.8 billion to \$7.6bn between 2005 and 2006 (World Bank, 2007). Growth has been fuelled largely by services, FDI in large mega projects and by large flows of international aid (Castel-Branco, 2004, OECD, 2005, UNDP, 2006). Since the inception of these mega FDI projects, GDP growth has exceeded 10% between 1997 and 1998 and again in 2001 (UNDP, 2006).

The incidence of poverty has declined markedly since the end of the war. The International Monetary Fund (IMF) suggests poverty had been reduced from 69% of the population in 1996 to 54% in 2003 (IMF, 2006). Poverty is distributed unevenly throughout the country, however, with the Northern provinces experiencing the highest rates and Maputo province recording the lowest headcount prevalence at 28.2% in 2003 (UNDP, 2006). An overall improvement in most development indicators, however, has meant that Mozambique's human development index rose from .366 in 2000 to .428 in 2004 (UNDP, 2006). The most recent data

shows a decline in HDI to .384 – leaving Mozambique ranked 172nd out of 177 countries with an HDI ranking.¹²

Since the end of the war, the Government of Mozambique (GoM) has implemented a series of policy reforms. The main policy thrusts of the immediate post-war period were the privatisation of State run enterprises, increased fiscal austerity and a general opening of the economy through the removal of controls on trade and capital (UNCTAD, 2001; Nasir et al 2003; UNDP, 2006). The government also made strong moves to decentralisation with the demarcation of 33 districts with their own representation (van Empel, 2006). The principal components of the GoM's medium term macroeconomic policy framework were to improve private investment and continuing economic growth with a view to addressing economic stability and poverty reduction (UNCTAD, 2001; IMF, 2006). Under the government's Poverty Reduction Strategy Paper (PARPA), export promotion through 'liberal trade and investment policies' was taken as the main approach to encourage 'broad based' economic growth (van Empel, 2006: 4). Mozambique, as member of the Southern Africa Development Community (SADC), has adjusted its tariff rates in line with its SADC commitments (OECD 2005). However, the prospects of these planned tariff reductions are not particularly clear. The GoM also lowered the maximum tariff rate from 25% to 20% to all trading partners as of January 2006 (IMF, 2006). As for its exports, Mozambique enjoys tariff breaks for designated exports to the United States under the African Growth and Opportunity Act (AGOA) as well as preferential trade status in the European Union accorded through the Cotonu Agreement and the Everything-but Arms Initiative¹³ (Goldin, 2004).

In line with an increase in international efforts to attract FDI, Mozambique has assembled a package of incentives to lure investors (UNCTAD, 2007). Policy steps towards improving the overall business climate in Mozambique have included: improving infrastructure, strengthening of property rights, enhancement of governance and various labour market reforms (IMF, 2006). Industrial Free Zones (IFZs) were introduced following the implementation of the 1993 Investment Law (UNCTAD, 2001; Pretorius 2005). This legislation stipulates that investments made within the IFZs have to contribute to the social and economic development of the country and have to be managed 'in line with national economic policy' (UNCTAD, 2001). The IFZ legislation, for example, contains employment clauses to ensure the employment of local labour and to regulate the use of expatriate workers (Pretorius, 2005). There are, however, no local content clauses in any of the investment or industrial policies currently in place.

The creation of an investment friendly environment was achieved with extensive cooperation from both the private investors themselves and international institutions such as the IMF and the International Finance Corporation (IFC) (Pretorius, 2005). With respect to mega-projects, the Government of Mozambique encourages investments through the provision of free industrial zone status, reduced corporate tax obligations, various tax deductions linked to infrastructure development and tariff exemptions (IMF, 2006). In

¹² <http://hdr.undp.org/en/statistics/>

¹³ Council Regulation (EC) No 980/2005 of 27 June 2005: Applying a scheme of generalised tariff preferences.

line with the objective of improving the overall business climate, the government's Investment Promotion Centre (CPI) has changed its position as a regulatory body and is now tasked with facilitating investment in the economy and promoting linkages with local firms (UNCTAD, 2001).

Mozambique has become one of the top recipients of FDI among least developed countries and has, in recent years, been in the top 20 FDI recipients in Africa (Pretorius, 2005). The amount of FDI increased steadily in the years immediately following the civil war and rose from an average inflow of US\$21m per annum before 1995 to US\$153m in the period between 1995 and 2000 (UNIDO, 2002). Between 2004 and 2006, FDI inflows fluctuated significantly (likely the result of mega project investments), but in 2006 FDI inflows of US\$154m were in line with the ten year average (UNCTAD, 2007). Since the end of the war, FDI stock has also increased markedly from US\$882m in 1990 to US\$4.7bn in 2006 (UNCTAD, 2007). Between 2000 and 2006, FDI as a share of GDP has increased from 50.5% to 65.4% (UNCTAD, 2007). The ratio of FDI to total investment is high, with FDI accounting for 36% of all investment between 1990 and 2003 (Castel-Branco, 2004). The picture changes significantly, however, when the contribution of mega projects is not included (Castel-Branco, 2004).

Mozambique employs a strategy of promoting SMEs in order to promote poverty alleviation and job creation. The SADC Regional Indicative Strategic Development Plan (RISD) and the New Partnership for Africa's Development (NEPAD), in both of which Mozambique is a member, endorse the promotion of SMEs to create dynamic forward and backward linkages between sectors and to serve as the 'engine of economic growth' (Thomas 2005). Together with the stimulation of the private sector, government introduced the 2003 science and technology policy with the objective of "developing the innovate capacity of the national productive sector" (UNDP, 2006: 37).

On the whole, private sector growth and investment have been growing significantly since 2000. The largest 100 firms in Mozambique reported 34% year-on-year revenue growth (Goldin, 2004). Mozal is ranked as the largest industrial firm in Mozambique, while Cervejas de Mocambique (CDM) and Coca-Cola are the largest in the food and beverage sector (Goldin, 2004). The agricultural sector has also benefited from FDI. Due to investments in sugar and tobacco, the sector grew by over 7% in both 2004 and 2005 (OECD, 2005).

4.2 'Mega projects' and their impact on Mozambique's economy

The current developmental impact of mega projects, which takes up a large share in FDI inflows to Mozambique, is mostly derived from increased investor confidence (IMF, 2006). In the case of Mozal, extensive investment in the upgrading of infrastructure such as 'harbour facilities, roads, telecommunications, electricity and water supply' has also been significant (Thomas 2005: 7). The main limitation on the developmental impact of mega projects in Mozambique, however, include: "imported inputs, debt service, profit transfers, dividends, and royalty repatriation, as well as workers' remittances, which are predominantly transacted off-shore" (IMF, 2006: 10). FDI is also spatially lopsided with over 75% concentrated in the Maputo province and very little penetration into other parts of the country (Pretorius,

2005). Moreover, the current flows of FDI into Mozambique concentrated in mega projects are largely capital intensive and, thus, do not have a significant impact on employment (UNDP, 2006). Employment figures for all TNC investments in Mozambique were roughly 13,200 in 2004 (UNCTAD, 2007). Although some analysts have pointed towards the employment benefits derived from Mozal, critics (see Castel-Branco, 2005) have suggested that these employment statistics do not justify the government's mega-project attraction strategy.

Mega projects currently account for approximately 60-70% of total exports from Mozambique (IMF, 2006). The Mozal aluminium plant outside of Maputo is the largest mega project in the country and accounts for 75% of mega project contributions towards GDP, tax revenues and balance of payments (IMF, 2006). Other significant mega projects include the Cahora Bassa hydroelectric dam, the Moma Titanium Minerals Project and the Sasol gas pipeline running between South Africa and Mozambique (IMF 2006).

The Mozal plant was launched in 1998 at a cost of around \$2.2bn (Thomas, 2005). The project has since been expanded in 2001/02 (Mozal II) and both the original construction and the expansion were completed ahead of schedule and well under budget (Thomas, 2005; CPI Interview 14 December 2007). When the first phase was completed in 2000, it doubled Mozambique's exports and brought \$400m worth of foreign exchange (UNIDO, 2002). Partners and sponsors in the project are a mixture of public and private sector stakeholders that include:

- BHP Billiton (Australia),
- Industrial Development Corporation (IDC) (South Africa)
- Mitsubishi Corporation (Japan)
- Government of Mozambique
- Development Bank of Southern Africa (DBSA) (Thomas, 2005)

The 660 hectare Beluluane Industrial Park, officially opened in 2005, has been established as an Export Processing Zone (EPZ) directly adjacent to the Mozal facility in order to attract linkages with the plant (UNCTAD, 2001, Thomas, 2005). The park fits within SADC's spatial development initiative (SDI) model which is designed to attract 'industrial clustering' around large export projects (Thomas, 2005). Mozal has been granted IFZ status by the Government of Mozambique which allows it to import inputs duty free, is exempt from VAT and pays no more than 1% of total sales as corporate tax (Castel-Branco, 2004).

4.3 The Mozal Linkage Programme – creating linkages between TNCs and local SMEs

The idea of creating or improving linkages between TNCs and local SMEs was conceived by government between 1997 and 1998 with a view to ensuring greater benefits from FDI. The investment attraction strategy

for 1997-2000 created the policy platform for TNC-SME linkage programme. A private consulting firm informed the design of the original linkage programme implemented by government. Support from the World Bank was also influential (CPI Interview 14 December 2007).

In the early conceptualisation of a formal SME linkages programme, Mozal represented a good test case for implementing the linkage strategy. The simple objective of this initial linkage strategy was to help local firms engage with Mozal as much as possible. The Mozal linkages project was initiated in the context of poor SME performance in Mozambique. Poor SME performance is explained largely by three factors: local firms were not competitive, smaller firms have very poor access to credit, and a relatively small market size in Mozambique. Goldin (2004) describes the origins of the Mozal linkages programme as follows:

“In response to Mozal’s planned expansion (and limited use of domestic firms during the first phase of construction) in 1998, the CPI conducted an evaluation of 370 national firms, uncovering a weak network of supporting businesses. It renewed its linkage efforts, creating a more developed database of potential product and service providers (900), and worked with Mozal, the Africa Project Development Facility (APDF) and the World Bank to better prepare local companies and incorporate them into its procurement” (Goldin, 2004: 7)

The objective of this initial linkage strategy was to help local firms engage with Mozal as much as possible. The main components of the strategy included: database of local firms and their services (supply side); technical auditing of the SMEs in the database; identification of firm potential and existing gaps; identification of potential markets (demand side); and introduction of local firms to Mozal (CPI Interview 14 December 2007).

Box 1 Evolution of the Mozal Linkages Programme

1997: Linkages form a key component of the government’s Investment Attraction Strategy for 1997-2000

1998: Mozal I is constructed as the original smelter (built ahead of schedule and under budget)

1998: CPI undertakes an audit of local firms in anticipation of the construction of the Mozal plant

2001: Mozal II is an expansion of the original plant and is also constructed ahead of schedule and under budget

2001: SMEELP is initiated for a two year period to assist local firms to win contracts for the expansion of the Mozal plant

2003: Mozlink I is introduced by Mozal to build on the successes of SMEELP

2007: Mozlink II is an extension of Mozlink I and is planned to continue until the end of 2008

4.4 The Mozal Linkages Programme's objectives, structure and activities

The primary objective of the Mozal linkages programme was to increase the level of local SME participation in large investment projects in Mozambique. At the outset, it was difficult to select specific outcomes or targets for the Mozal linkages programme. It was not clear what type of progress or outcomes could be expected given generally weak supply capacity of Mozambican SMEs. Thus, the only indicator used to gauge the success of the programme was the number of firms that would become capable of supplying to Mozal (CPI Interview 14 December 2007).

From the Mozal respondent's perspective, quantitative indicators did not tell the full story of Mozal's impact on local firms and communities. Some of the indicators that are monitored, however, include: number of training programmes implemented, amount spent on contracts with local firms and amounts spent on local contracts. These indicators point towards the successful implementation of the linkages programme, although all of the stakeholders approached during the field visit emphasised that there is still substantial scope to improve the number of firms involved in the linkages programme and that creating successful linkages with local firms and large investment projects in Mozambique is an ongoing process (CPI Interview 14 December 2007; Mozal Interview 14 December 2007).

The Mozal linkages project has been implemented in two distinct phases: the construction phase of Mozal II (SME Empowerment Linkages Programme-SMEELP) and the operational phases (Mozlink I and II). During the construction phase in 2001/02, the CPI and the IFC (through its African Project Development Facility (APDF)) initiated the programme with support from Mozal and 15 local SMEs participated (Pretorius, 2005; Thomas, 2005; IFC Interview 13 December 2007). Selection of SMEs into the programme was done by Mozal and the CPI. SMEELP was originally scheduled for a 24 month period after which the programme was handed over to the CPI to manage (Pretorius, 2005). SMEELP consisted of a number of important components (Thomas, 2005; IFC Interview 13 December 2007):

- The redesign (unbundling) of larger contracts into smaller ones by Mozal and the CPI;
- A target of 25 local SMEs was originally selected;
- The goal was for 3-4 local firms to bid for each contract;
- Local SMEs participated in a training programme prior to bidding for a contract;
- The training programme included:
 - Training on how to work with large TNCs;
 - Training on how to successfully bid for contracts;
 - How to deliver and manage contracts; and

- Marketing skills

In June 2003, the implementation of a new linkages programme (Mozlink I) was announced by Mozal (with support from the CPI and the IFC) and was driven by a need to create real and ongoing linkages with the Mozambican economy. The motivations for Mozal were largely the Public Relations benefits of engaging with the local economy and the potential for increased flexibility in terms of delivery times and sustainability gained from contracting locally (IFC Interview 13 December 2007). The programme was to run for another 12 months and was based on the successes of SMEELP (Pretorius, 2005; Thomas, 2005).

Mozlink I was designed as a replication of SMEELP but also had several important differences. First, there were other players apart from Mozal involved and these included: Sasol, CDM, EDM and Coca-Cola. These stakeholders formed the steering committee for the project and provided additional markets for SMEs, mentorship, technical assessment and training. For Mozlink II (the current linkages programme and an extension of Mozlink I) all of these players made a financial contribution to the programme. Professional consultants were hired for the technical training and assessments (IFC Interview 13 December 2007; CPI Interview 14 December 2007).

Outside of these main linkage programmes (SMEELP and Mozlink I & II), several stakeholders have initiated programmes to support linkages between local SMEs and MNCs. The Project for Enterprise Development (PODE), with financing from the World Bank, for example, was designed to facilitate linkages between local firms and large investments in sectors such as 'construction, graphics, electrics and metal/mechanics' (Goldin, 2004). Similarly, the IFC through its Private Enterprise Partnerships Programme (PEP) has initiated an SME competitiveness programme which focuses on large industrial projects in the minerals and energy sectors in Mozambique (Thomas, 2005). The objectives of the programme are similar to those of SMEELP and Mozlink and the investors include: Mozal, Sasol, Maputo Port and Chibuto Corridor Sands (Thomas, 2005).

Mozal itself created the Mozal Community Development Trust (MCDT) to promote the social development of the communities surrounding Mozal (Thomas, 2005; Mozal Interview 14 December 2007). The project has a budget of \$2 million per annum and has a particular focus on training and educational initiatives that create an enabling environment for small businesses (Thomas, 2005). In 2004, the IFC offered support to the MCDT in the form of financing for a school in the community that promotes the types of skills that could result in employment or a contract with Mozal (Thomas, 2005).

Finally, Mozambican SMEs themselves have been stakeholders in one of the most important components of the linkages programme. The IFC facilitated the creation of the Mozambique Business Network which is a network of 15 local SMEs that offer a forum for sharing ideas and experiences pertaining to contracts with large TNCs in Mozambique (Thomas, 2005; IFC Interview 13 December 2007). The membership of the network was originally formed from participants in SMEELP and Mozlink I and it now holds monthly meetings to connect firms, banks, corporations and other relevant stakeholders (Thomas, 2005; IFC Interview 13 December 2007).

4.5 The impact of the Mozal Linkages Programme

The impacts of these linkages programmes have been acknowledged by a range of stakeholders and researchers. Thomas (2005) observes that the case of Mozal is unique in that strong examples of both success and failure provide lessons for linkages in other SADC countries. Pretorius (2005) and Goldin (2004) note that one of the most significant impacts of the programmes reported by participant firms has been the experience gained in supplying to a large international firm with strict quality and delivery standards. Similarly, Goldin (2004) argues that SMEs themselves support the presence of large firms. In a survey of SMEs, 80% indicated that the existence of large firms in the Maputo area was important to their own operations (Goldin, 2004). The majority of these SMEs did not begin their operations as a direct result of Mozal, but an overwhelming majority (nearly 90%) had an expectation of winning a Mozal contract at some stage. In terms of revenues, those firms in the survey that reported having a contract with a large firm indicated that those contracts contributed an average of 55% to total revenues (Goldin, 2004).

In terms of the number of successful contracts derived from the linkage programme, 27 Mozal contracts worth over US\$5m were awarded to local firms within the SMEELP programme that took place between 2001 and 2003 (Thomas, 2005; CPI Interview 14 December 2007). Under SMEELP, 36 SMEs completed the training programme and the direct costs of SMEELP came to only US\$500,000 even though Billiton had originally budgeted US\$1m. According to the firms surveyed by Goldin (2004), 88% described the SMEELP programme as helpful or useful. Roughly 10% of these firms considered the occasion to meet with other firms and hear about upcoming business opportunities as the most important aspect of SMEELP (Goldin, 2004).

In 2005, the first phase of Mozlink-the successor to SMEELP- had generated US\$11m worth of contracts to local SMEs (Thomas, 2005). Between 2002 and 2007, Mozal increased its monthly spending with local firms from US\$5m to US\$17m per month (IFC 2007). Over this same period, Mozal increased the number of firms from which they source locally from 40 to 250 (IFC 2007). In describing the success of the programme in building local capacity, Thomas (2005) notes that one firm involved in Mozlink was recently awarded a US\$2 million contract with one of the aluminium smelters in Richard's Bay, South Africa. Mozal is satisfied with the extension of Mozlink and is actively involved with the extension of the linkage programme. It has been particularly influential in communicating to other large firms the importance of the linkages model. There are currently 25 SMEs in the Mozlink programme and the target number for the extension of the project is 100 firms (IFC Interview 13 December 2007). By 2005, 18 SMEs had already undergone the diagnostics process, 17 firms had been assisted with tender training and 12 firms were in the mentoring stage of the programme (Thomas, 2005).

The success of the linkages programme as a whole was primarily measured, from the perspective of the IFC, on the additional revenues accrued by the participating SMEs. This was an indicator that was originally included in the IFCs project proposal. One problem with the indicator, however, was that firms outside of the programme which had also benefited from the programme were not adequately captured. There is some

information on additional revenue accrued to participating SMEs, which suggested that the programme has been a success. Some of the SMEs have won contracts worth around US\$400-600m.

A number of participating SMEs are also growing at a phenomenal rate. One major success of the programme has been the formation of several networking forums. The first is the Mozambique Business Network which is a forum for SMEs, banks and various other stakeholders to exchange ideas and talk about successes, failures and lessons. The second is a participatory process associated with the business diagnostics exercises that accompany the programme. SMEs participating in the linkage programme are required to give presentations to the diagnostics team on a regular basis. There is also a scoring system which has revealed that a number of SMEs are improving the quality of their services in line with international standards. Workshops are also conducted so that the findings of the diagnostics assessments can be communicated back to the SMEs. According to IFC, local SME performance has improved by roughly 20 % through the Mozlink programme (IFC Interview 13 December 2007).

Perhaps one of the impacts more difficult to measure is potentially numerous 'spin offs' that come from supply chains in which Mozal are connected. In an SME survey, for example, 79% of firms answered that a contract with a large firm had caused them to increase inputs. Moreover, the firms reported that the 'reputation effect' of having a contract with Mozal allowed them to gain easier access to other corporate contracts (Goldin, 2004). The Mozal respondent, in an interview conducted in December 2007, emphasised that the impacts from the linkages programme extended far beyond the SMEs that participated in the formal programme.

Also important for SMEs, according to Mozal, was that the need to meet stringent quality and processing requirements helped them to update their services in line with internationally accepted standards. This is particularly relevant to health and safety standards and for each firm's HIV/AIDS policy (VCT and education). As a result of newly imposed standards, some of the local firms have now applied for ISO9000 status, and some SMEs are also expanding to service projects other than Mozal, i.e. diversifying their production (ICC Interview 14 December 2007).

Mozal has also had an impact on employment both at the plant itself and through firms engaged in the supply chain. The official employment statistics for Mozal are understood to be:

- Mozal I: 745 full time jobs and 2,500 indirect jobs through linkages;
- Mozal II: another 376 full time jobs (2001-present);
- 9,000 construction jobs;
- 5,000 workers trained during construction phase;
- Mozal II resulted in over 6,000 temporary jobs during the expansion phase (Thomas 2005: 8).

Each of these employment categories feature predominantly Mozambican employees – ranging from 65%-90% (Thomas, 2005). Other employment impacts from Mozal come from SMEs with contracts. According to Goldin's (2004) firm survey, between 50%-73% of the small firms canvassed reported that they hired more employees as a result of either increased business derived from a contract with a large firm or to meet the demands of the contract itself. Mozal currently has an estimated 400 employed people on site to deliver a number of service contracts valued at roughly US\$35 million per annum (Thomas 2005). Between 2002 and 2003, US\$80m was awarded in contracts to 130 local firms (Goldin, 2004). Mozal also benefits from these linkages and, as the Mozal respondent stated, 'Mozal's efficiency and profitability is due to positive and effective linkages with local firms. A part of that success is the people'. Overall, both Mozal and GoM respondents indicated that they felt the programme was achieving its goals (CPI Interview 14 December 2007; Mozal Interview 14 December 2007).

4.6 Challenges associated with the Mozal Linkages Programme

An initial challenge associated with the Mozal I project was that the Mozal contracts were large and contained a range of different components that local SMEs found difficult to address (Thomas, 2005; IFC Interview 13 December 2007). The main beneficiaries of the Mozal project in terms of both construction (60%) and the supply of technical inputs (60%) have been large South African firms (Pretorius, 2005). One of the main reasons for this outcome is that smaller local firms have neither the capacity to supply technical services or to make use of aluminium ingots (Pretorius, 2005). Local research has suggested that poor standards, quality and delivery are serious constraints for the vast majority of local firms (Pretorius, 2005). Also, the contracts were written in English and some of the Mozambican firms could not deliver services in English (Thomas, 2005).

A World Bank and Confederation of Business Associations of Mozambique (CTA) firm survey in 2002 revealed that the three main constraints that prevented investment in Mozambique had been: a lack of access to finance; an uncertain policy and regulatory climate; and poor infrastructure (Nasir et al , 2003; Goldin, 2004). The same set of constraints prevailed in the years after the survey. One South African firm contracted to Mozal also noted that its own linkages with local firms were limited, due, to a large extent, to a general lack of technical capacity and skilled labour (ODM Interview 13 December 2007).

The general consensus was that Mozambican firms have not reached the technical capacity to manufacture aluminium products from the ingots (Goldin, 2004). A consultancy firm contracted to facilitate the diagnostics and training of the local firms participating in the linkages programme found that the main challenge to improving linkages was the sheer gap between the production technology, scale, and efficiency that was required by a mega contractor like Mozal and those that could be offered by local SMEs. In a case where a contract was won, some local firms had used almost all its resources to service Mozal; such that the growth would not be sustainable without the Mozal contract (ICC Interview 14 December 2007).

With respect to the design of the Mozal linkage programme, the main challenge was that the local SMEs were in need of more financial and technical support than the programme was offering. In particular, local SMEs would need help in accessing credit in order to implement whatever was learned in the programme. Management capacity of SMEs should also be further addressed through the training programme (CPI Interview 14 December 2007). Many local SMEs, which were family firms, required technical support in improving their marketing, diversifying their production, and developing an export strategy. According to the IFC interview, “[Local firms] need help with a vision. They keep doing the same things they have been doing for years.” All the interview respondents emphasised that each stakeholder should have a role in this, and that access to credit, in particular, was a potential area for government intervention.

The problem of access to credit had been addressed, within the linkages programme, through a capacity building programme aimed at two financial institutions (Thomas, 2005). The CPI respondent, during an interview, mentioned that efforts have also been made to persuade banks to reconsider the risk profile of SMEs with Mozal contracts, though the banks seemed to remain hesitant to approve finance. Banks such as ABSA and Barclays have initiated a tentative plan to extend credit to Mozal contract holders, but it has been very paper work intensive. When several bank loans did come out of the process, the plan that was sketched was not implemented.

Another challenge is related to a palpable lack of transparency around the government’s procurement clauses with respect to contracts with Mozal. Few stakeholders outside the government had a clear understanding of the actual process to get local SMEs contracted to Mozal works. There has been a tangible feeling among many local SMEs that Mozal contracts mostly went to foreign firms with operations in Mozambique (IFC Interview 13 December 2007). A further criticism of the linkages programme is that it has only benefited firms in the south: there are firms in the north (mainly agricultural) but logistical problems have prevented them from participation in the linkages programme.

During interviews conducted for this study, some respondents expressed views that FDI in Mozambique, often dominated by mega projects like Mozal, could be promoting backward linkages with South African firms rather than with Mozambican counterparts. Overall, respondents suggested that there was still significant scope for promoting linkages, especially in other sectors and in other parts of the country. As the CPI respondent suggested, “Even Mozal can issue more local contracts- all sorts of smaller things could still be supplied locally (e.g. office calendars and all kinds of small things)” (CPI Interview 14 December 2007).

The Mozal respondent agreed with this assessment and added that a key challenge for them was finding the right types of local entrepreneurs. During the selection process, it was important for local firms to display they were striving to create a successful business rather than just winning a Mozal contract. Another related challenge was creating commercially viable businesses with these entrepreneurs. In order to encourage more TNCs to form linkages with local SMEs, there was a need to address the concerns of some large firms that engaging with local SMEs was not a viable strategy, because of conventionally perceived problems such

as lack of production quality and delivering capacity of local SMEs. “There are really no excuses for large TNCs not to engage with local suppliers for procurement” (Mozal Interview 14 December 2007).

As an ongoing process, the Mozal linkages programme has attempted to address some of the key challenges to promoting enhanced SME participation with large firms. SMEELP attended to some of the challenges experienced during the first construction phase of Mozal and, perhaps most significantly, encouraged the ‘unbundling’ of larger contracts into smaller, more manageable packages (Thomas 2005, IFC Interview 13 December 2007). The programme also identified services that could be sourced locally and provided more extensive training for local SMEs (Thomas, 2005; IFC Interview 13 December 2007; CPI Interview 14 December 2007).

The key to these successes has been constant and productive dialogue between all stakeholders involved in the linkages programme. This particular success has prompted a number of analysts and stakeholders to point to the Mozal experience as a ‘good practice’ model for SME-TNC linkage promotion in the SADC region. The combination of clear and unambiguous government support for the creation of linkage-partnerships and the willingness of a trans-national company to commit its own resources to such a process created a solid foundation.

5. Experience of Lesotho in the textile sector: setting up an Inter-Ministerial Textile and Apparel Industry Task Force and the issue of linkages

Lesotho is a small landlocked, mountainous country that falls entirely within the geographical territory of South Africa (up to 66% of the terrain is mountainous). The population consists of 1.8m people (2006). As of 2006, Lesotho's GNI was US\$1.1bn with a GDP annual growth rate of 2.8% (World Development Indicators database, April 2007). Given its geography, the limited natural resource base and limited industrial experiences, Lesotho has a relatively small domestic economic base and has over the years relied on remittances from its citizens employed in South African mines, farms and industries. However, the flow of remittances has been on the decline because of mine closures and retrenchments. In response to the decline in remittances, Lesotho's government aimed at developing a sound garment and textile industry in light of its employment creation capacity. Today, the clothing manufacturing industry makes up the bulk of the country's workforce and it contributes about 20% of Lesotho's GDP and close to 70% of exports (IMF, 2006).

5.1 The clothing and textile industry in Lesotho

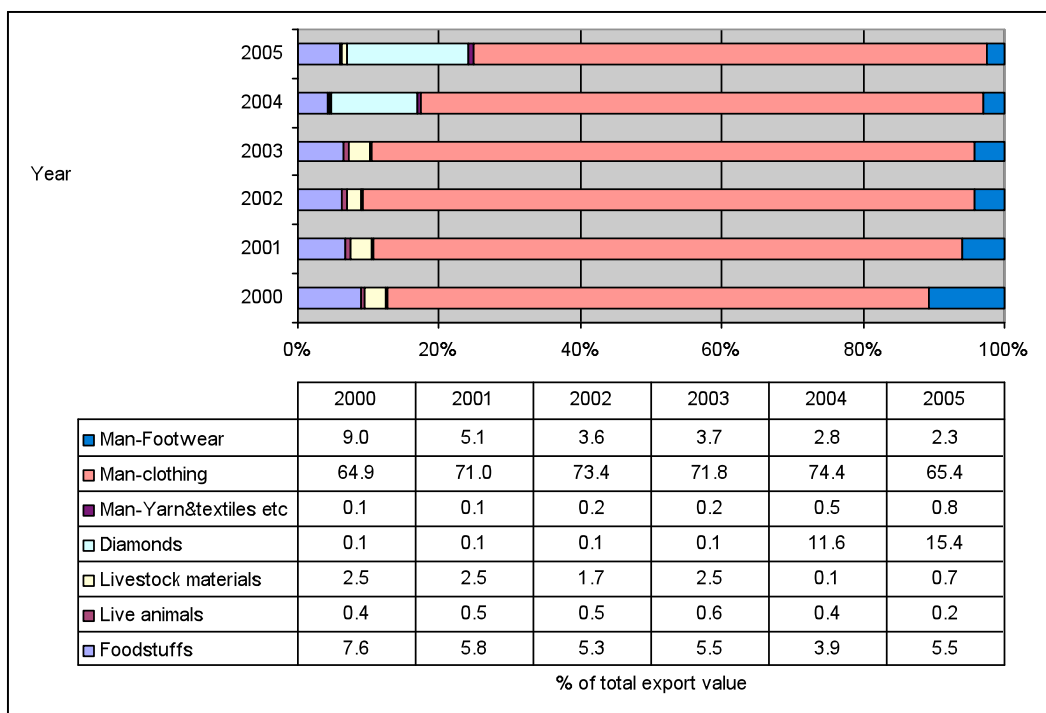
The clothing manufacturing industry in Lesotho is dominated by affiliates of foreign firms, largely of Taiwanese origin. There are also a few Chinese and South African owned firms. The key input in garment production, fabric, is in the main imported from the above mentioned countries or other Asian countries. In 2004, a US\$100m textile mill opened – which makes ring spun yarn (sold in South Africa only) and denim fabric (sold in Lesotho and elsewhere in the world). It is important to note that few fabrics are sourced in Lesotho because there is only this one fabric supplier. To a limited extent low value material such as packaging is sourced locally. The fact that Lesotho's manufacturing base is limited to very few firms is a constraining factor in local sourcing.

While there is a considerable body of literature around the Lesotho clothing industry, very little has enquired on the nature and extent of relationships between the large foreign firms (that is, Transnational Corporations or TNCs) and local enterprises. The government of Lesotho notes that “the garment and clothing industry is mostly foreign owned and well connected to the global markets ... but has limited linkages to the rest of the economy particularly the local private sector comprised of micro and small enterprises engaged in trade,

services, construction and sandstone” (Government of Lesotho, 2006). Domestically owned businesses are largely detached from the production, supply and service value chains in Lesotho’s clothing industry.

The clothing industry has been the main source of earnings from manufactured exports between 2000 and 2005.¹⁴ Figure 5 illustrates the composition of recorded exports for the period 2000-2005. Since 2000, clothing had been the dominant export earner accounting for 74% of total exports in 2004. Diamonds became another major contributor to the country’s export earnings from 2004.

Figure 5: Composition of recorded exports, 2000-2005 (millions, Maloti)¹⁵



Source: Central Bank of Lesotho (as cited by the IMF, 2006)

Lesotho is one of the few Sub-Saharan countries that have, since 2000, seen a year-on-year increase in the exports of clothing products to the United States. Over the period 1999-2005, garment exports increased from US\$100m to US\$460m, an average annual growth of more than 58% (Commark Trust as cited by the MFA, 2005). To a large extent this was made possible by the provisions of the African Growth and Opportunity Act (AGOA), which gave duty and quota free access to US markets whilst using fabric imported from third countries.¹⁶ These provisions attracted FDI inflows from Taiwan and China. Consequently, 93% of

¹⁴ Some respondents argued that such exports would have been greater had the local currency, the Maloti not been pegged to the volatile South African Rand which in 2004 experienced considerable appreciation against the US dollar hence making Lesotho’s exports relatively expensive.

¹⁵ These figures do not include sales in the South African Customs Union (SACU) which are estimated by Bennett to be at the level of around 15-18% of total non-SACU exports.

¹⁶ On 18 May 2000, AGOA was signed into US law. In principle, the law aims to support LDCs, using trade as a stimulus to investment and employment creation. Under AGOA, Lesotho and other LDCs qualify for duty free access to the US. Two of the most important aspects of AGOA are its Rules of Origin and the 3rd Country fabric provision. With reference to the former, duty free access to the US is only possible when garments are made of 85% US yarn and fabric or other yarn and fabric from other AGOA compliant countries, however limited to a maximum of 3.5 % of all US apparel imports (UNCTAD, 2003b). In addition to the rule of origin, LDCs like Lesotho can also source their fabric from

Lesotho's garments are currently being channelled to the United States market.¹⁷ For instance, of the 26m pairs of denim jeans that are manufactured in Lesotho, 98% are sold in the United States, and smaller volumes in the European Union, Canadian and SACU¹⁸ markets (Bennett, 2006). The direction of trade, especially that associated with clothing exports is "no accident of nature, geography or industrial advantage" but is rather the result of the "tariff and derogation benefits provided under AGOA" (FIAS, 2006a). With regard to the sustainability of export growth, Lesotho faces a number of challenges if it is to survive the post-AGO period¹⁹. Issues of market access, product competitiveness, productivity, investment promotion and HIV/AIDS are some of the key challenges (MFA Forum, 2005). To overcome the challenges, Lesotho needs to improve the human resource capabilities. Beyond the clothing industry, Lesotho also sees the efficient utilisation of its water resources as the key to continue generating stable export earnings and creating more employment opportunities. Through its newly initiated US government Millennium Challenge Account (MCA) project (administered by the Millennium Challenge Corporation or MCC)²⁰, the government of Lesotho recognises the significance of improving industrial water supply to secure future textile and other investment.

5.2 The dynamics of the global garment industry and its impact on Lesotho

The global clothing and textile industry has over the years been subject to a number of changes with respect to international trade and global governance. Foremost amongst these recent changes was the expiry of the Multi Fibre Arrangement (MFA) and its successor, the Agreement on Textiles and Clothing. The MFA came to an end on 31 December 2004. The MFA system was essentially a quota system that restricted imports into United States and European markets in an effort to protect the domestic industries.²¹ Whilst the quota was applied to all other countries, not all countries, especially those in Sub-Saharan Africa were able to meet their production quotas. Consequently, Asian countries that had exhausted their production quotas spread production to other regions (Kaplinsky, 2005 in Morris and Sedowski, 2006).

A conspicuous characteristic of Lesotho's clothing manufacturing industry is the dominance of foreign-owned export-oriented manufacturing plants (Salm et al, 2002). Table 4 reports the number of clothing manufacturing firms in Lesotho by country of origin. Taiwan Province of China is the main country of origin

any other country in the world through the 3rd country provision. Through sourcing globally, Lesotho firms can benefit from the "most competitive fabrics and tap production and supply networks in Asia" (FIAS, 2006a). In recent times, fabrics and trims from China and Taiwan have been preferred by influential global buyers. By sourcing fabric from a small number of factories, buyers and agents gain economies of scale and quality control.

¹⁷ The EU in early 2008 extended a similar benefit to Lesotho (and some other SADC countries) via the recent Economic Partnership Agreements (EPAs) negotiated as a replacement to previous Africa-Caribbean-Pacific (ACP) targeted arrangements of the Lome Convention.

¹⁸ Other SACU members, in addition to Lesotho, are Botswana, South Africa, Namibia and Swaziland.

¹⁹ The Africa Investment Act 2006 (AGO IV) extends the AGOA textile and apparel provisions programme until 2015, and the third country provision until 2012 (and increases the cap to 3.5 % beginning October 1, 2006).

²⁰ The objectives of the MCA project include: the construction of the Metolong dam for water supply into the industrial sector; improvement in household water supply and sanitation; improved health sector infrastructure facilities for the treatment and prevention of HIV/AIDS; and promotion of private sector development through transforming the investment climate (Government of Lesotho, 2003).

²¹ It should be noted that both the US and EU introduced so-called safe-guard quotas that are under review on an annual basis.

for clothing manufacturing firms operating in Lesotho. There are no Basotho-owned clothing manufacturing firms except for small, often informal, enterprises servicing niche local markets such as school uniforms and single-order designed outfits. From the interviews, it was found that the bulk of the export-oriented firms are run by production managers of foreign origin and firm activities are therefore coordinated from the company headquarters located in either Taiwan Province of China or China. A majority of firms (71% of all firms) manufacture knitted garments while 19% of the firms deal with denim jeans/woven garments. The Formosa Mill is the sole textile manufacturing plant in Lesotho (see Table 5).

Table 4: Lesotho clothing manufacturing portfolio (exporting firms): 2005²²

Country of origin	Number of firms	%
China	2	5.6
Taiwan	30	83.3
Singapore	1	2.8
South Africa	2	5.6
Mauritius	1	2.8
Total	36	100.0

Source: LNDC: Lesotho manufacturing portfolio (July 2005)

Table 5: Clothing manufacturing firms by sub-sector and number of employees: 2005

Industry sub-sector	Number of firms	%	Number of employees	%
Denim jeans / woven	8	19	14,754	37
Knitted garments	30	71	20,889	52
Denim fabric	1	1	950	2
Ancillary (embroidery; screen printing)	3	7	171	0
Estimated temporary workers			3,600	0
Total	42	100	40,364	100

Source: Bennett (2006)

A great proportion of clothing manufactures in Lesotho are TNC Cut-Make-Trim (CMT) firms (Salm et al, 2002). CMT, by definition, is a system under which a producer, as a subcontractor to a distributor (or another manufacturer) produces garments to the latter's precise specifications, while the fabric and designs are normally supplied by the distributor (Ndlela and Robinson, 1995). This is in contrast to Free On Board (FOB) firms where clothing manufactures must actually purchase the fabric and trims. Under an FOB arrangement, ownership of the raw materials for clothing belongs to the producer, not to the distributor. The government of Lesotho encourages firms to move away from CMT to FOB through its Duty Credit Certificate Scheme (DCC) – a facility that rewards firms that export. The DCC facility however is a temporary facility, and will expire in

²² LNDC data refers largely to those foreign-owned firms that the LNDC has had direct dealings with so the actual number of firms is slightly higher as reflected in the table that follows.

2009. Given the constraints within Lesotho's textile and clothing industry, the extent to which the DCC facility has actually encouraged local sub-contracting is limited.

Since the advent of Lesotho's eligibility to the AGOA in 2001, the clothing and textiles industry is the one sector that has grown and absorbed a significant part of the labour force (mostly women). It is estimated that 40 000 or almost half of the total labour force of Lesotho (84,000 in 2005) are in the ready-made garment sector (MFA Forum, 2005). As can be seen in Table 5, the bulk of the workers are employed in the knitted industry sub-sector (57%) and the denim jeans/woven garments sub sector (40%). Bennett (2006) points out that more people are actually employed in the clothing and textile industry than in the civil service. The Lesotho clothing and textile industry is therefore an important sector in terms of both export earnings and employment creation with an estimate annual wage bill for the sector of M550 million.

5.3 The role of public sector in supporting the development of Lesotho's garment industry

The principal government forces behind the development of the textile and clothing industry in Lesotho are the Lesotho National Development Corporation (LNDC), the Ministry of Trade and Industry, Cooperatives and Marketing (which we will refer to as the Ministry of Trade), and to a limited extent, the Basotho Enterprise Development Corporation (BEDCO). The Ministry of Trade and Industry has sought to align its business regulatory function with the needs of the textile and clothing sector and has been active in supporting initiatives to get the AGOA provisions extended. The focus of the LNDC has been more on negotiating the particular needs of TNC firms with respect to premises and a range of investment incentives.

While a measure of overlap is evident in the functions of these bodies, the Ministry of Trade is primarily responsible for industrial policy development through its FDI and domestic investment directorate. In particular, the Ministry would like to see a situation where local enterprises have some form of linkages with large business, though officials indicated that there was little indication of this occurring. According to the Ministry of Trade officials interviewed, the ownership structure of Lesotho-based TNCs (which largely consists of branch operations of Asian parent companies) as well as the lack of attention to these matters by powerful global retailers makes the establishment of any linkages extremely difficult.

The focus of the LNDC has been on negotiating the particular needs of TNC firms with respect to premises and a range of investment incentives. The LNDC administers the industrial estates and the investment process in cooperation with medium and large investors (with capital of at least 500,000Maloti) that want to invest in Lesotho. There are two divisions within the domestic investment promotion division of the LNDC – a local division and a foreign division. The local branch primarily focuses on support of domestic investment and expansion of existing facilities. Since late 2007, there have been some internal discussions in the LNDC on the option of exploring how linkages can be established between big (foreign) textiles and clothing firms

and the local private sector through, for example, the promotion of joint ventures.²³ However, there is nothing concrete that has come from this activity to date.

The Basotho Enterprise Development Corporation is for the most part responsible for driving the “establishment and development of Basotho-owned enterprises” of a micro and medium nature (Mthente, 2007). As with the LNDC, some plans for forging links with the TNCs are under consideration. However, as of yet this has not progressed beyond a research study to explore linkages between Basotho owned enterprises and the larger firms.

5.4 The approach to linkages in the garment sector and the experience of the IMTT

The Inter-Ministerial Task Team (IMTT) was set up in 2004, as a multi-stakeholder grouping, with the principal objective to address issues raised by foreign textile and clothing manufacturers operating in Lesotho (Government of Lesotho, 2004b). With its secretariat located in the Ministry of Trade, the IMTT members include Ministries of Employment and Labour, Finance and Development Planning, Home Affairs and Public Safety, Local Government, Natural Resources, Public Works and Transports, the Central Bank of Lesotho, the LNDC, utility companies and the private sector (Government of Lesotho, 2004b). The technical committee of the IMTT was set to address eight major challenges identified by the stakeholders. These related to: foreign exchange; visa issues; taxation; clearance procedures; AGOA; incentives; security; and infrastructure. The IMTT's initial concern was to enable the sustainable growth of the textile and clothing industry, in an environment of considerable uncertainty with regards to the future of the sector. The retention and expansion of garment-related FDI firms was seen to be the priority within this process. Consequently, it was revealed in the interviews that creating TNC-SME linkages was not considered as a major issue, and was never discussed in any of the IMTT meetings. According to two key government informants, the IMTT hardly met in 2007 and it was not clear whether it was still operational.

While the IMTT has lost some of its momentum, since its initial focus on supporting the development of the denim mill in 2005 and resolving some of the concerns of investing firms in subsequent activities, it remains a structure that has some potential to address issues when needed. The Government of Lesotho, according to officials interviewed, is in principle willing to support linkages in the textile and clothing industry and in other sectors. However, there was some concern that any process should not add to the obligations of investing firms as this might result in them deciding to relocate to an alternative country. Nevertheless, the bulk of the stakeholders, including some of the firms, agreed that there was a need to reinforce linkages between TNC and SMEs as well as among SMEs, not only in the textiles and clothing industry but also in other sectors like natural resources and government procurement.

²³ The domestic investment promotion division of the LNDC is the process of developing an enterprise development facility. The facility has as part of its components a credit guarantee facility, equity facilitation (that is, a possibility of initially sharing the risk and then a buy-out of the LNDC), and an intermediary loan facility earmarked for big institutions that can lend out to SMEs and business support consultancy.

Despite the general sense articulated by respondents that linkages were desirable, a number also expressed concerns over whether such a venture to create linkages could be viable. There was a common sentiment that Basotho owned enterprises did not have the capacity to produce for the foreign based affiliates, as they lacked the expertise to produce quality products. At the same time, there was no legislative requirement that compelled the TNCs to link with local enterprises for purposes of transferring technical know-how or any other expertise to local suppliers. Some doubted whether the textile and clothing industry should be earmarked for an all out linkages programme at all under circumstances where the dominant large retailers, branded manufacturers and marketers had not taken on board such commitments and in turn required them of their suppliers. According to one interviewee, it was after all of these global buyers “who control global production networks and stipulate supply specifications” (Mthente, 2007).

In the past, an effort was made through a DFID-funded project, initiated in 1998, where the government tried to establish a Garments Centre which was run by the Lesotho Manufacturers Association (LMA). One of the objectives of the garment centre was to improve productivity of Basotho owned enterprises – in part to raise their capacity as potential suppliers to exporting firms. However, it was reported by stakeholders that this effort did not receive total commitment from all the stakeholders, and therefore did not succeed. Other attempts to respond to broader industrial linkages have included the strengthening of the indigenous private sector through the Lesotho Chamber of Commerce and Industry (LCCI), supported in the Privatisation and Private Sector Development Program financed by the World Bank since 1995.

5.5 The scope for future linkage development in apparel and other sectors

Respondents interviewed for the study were asked whether a structure similar to the IMTT, or the IMTT itself, would be able to initiate and sustain a linkages initiative. Generally it was felt that a structure such as the IMTT would be a necessary, but not a sufficient condition for the support of linkages. In this regard most felt it was necessary that the support of the entities that local affiliates were contracted to was secured as well as the support of major buyers.

In planning for TNC-SME linkages programme, it was also stated that the Government of Lesotho could look beyond its borders and think regionally. The survival of Lesotho’s textile and clothing industry in the post-2012 period may lie in regional integration and the ability of Lesotho to gain a measure of market-share in the SADC region, and particularly in South Africa. A number of South African owned business have actually set up in Lesotho with the aim of supplying into the Southern African market in the textile and clothing sector as well as in other sectors. South African firms appeared to be more comfortable with exploring the idea of local linkages with Basotho firms and with exporting firms.

Lesotho could therefore look into the potential of a SADC-wide textile and garment sector TNC-SME linkage programme. As a small country Lesotho, alone may not offer a big enough basket of supplying enterprises

for a meaningful linkage programme, but SADC as whole could present better prospects. Proximity to regional buyers, smaller production runs, and a good knowledge on local demand and preferences may provide Basotho-owned enterprises with a better scope to develop their business and supply capacity than is presently possible under the current orientation towards the United States market.

Some industry experts suggested that an important first step would be to identify buyers that may want to source product from Lesotho or Southern Africa, as well as inventory of production capacity in Lesotho and in the region (for example listing embroidery suppliers and providing information as to their production capacity, technology and contact details). A regional linkage programme could therefore start with an inventory of SMEs, including design houses and sourcing agents, as well as an assessment on infrastructure, trade logistics and environmental impact. A regionally driven linkages programme would also need to consciously address issues related to costs, lead times, quality, and dissemination of buyer/agent related information and clustering. The focus should also be on improving local and regional competitiveness so that manufacturers are able to meet the health and safety standards of the clothing brands” (Interview with Commark, 2007). There was also scope to build on nascent linkages with the sector in fields such as transport, business services and equipment supply and repair.

With a view to improving the supply capacity of local SMEs, the Smart Partnership office under the Prime Minister’s office, whose function is to encourage greater collaboration between the public and private sector for wealth creation and economic growth, could also be encouraged to play a role. The newly initiated Millennium Challenge Account project is one attempt that tries to create an enabling business environment for private sector development. The MCA initiative is designed on the basis of the aforementioned government documents. Within the MCA project one of the key elements is the support of local entrepreneurs through private sector capacity building and investment.

Initiatives such as that by the Basotho Enterprises Development Corporation (BEDCO) to link local entrepreneurs with the foreign owned garment manufacturers could also be considered for possible support. The programme, should it be implemented, intends to select the top 10 SMEs that meet the screening criteria, such as the availability of at least 60 sewing machines. Selected SMEs would subsequently be attached to TNCs. Industry mentors to assist with factory level operations.²⁴ The mentors would develop and run a 6-month training programme after which the readiness of respective enterprises will be confirmed and attempts to secure contracts made. The long term vision, according to BEDCO staff, is the creation of a SME garment manufacturing cluster which will enable various small enterprises to work together on an order from larger firms. While the specific approach of the BEDCO to this activity was questioned by some, the fact that it was seeking to play a role in facilitating linkages of one sort or another suggests that it could play a role in future. Stakeholders pointed out that apart from a lack of direct interest from larger firms there were challenges that would be encountered around finance for small firms (World Bank, 2007) and the institutional capacity of an entity such as BEDCO.

²⁴ Salm *et al* (2002) strongly recommend the setting up of an industry managed training centre.

As regards the domestic regulatory framework, the majority of respondents identified that there was no mandatory local-content requirement. Traditionally, exporting firms had sourced their inputs from outside Lesotho. Given a general concern that such mandatory local-content requirements would detract from Lesotho's ability to attract FDI some suggested an incentive programme of sorts as an alternative. Such incentives could also help raise the local content of a range of other investment fields such as tourism and infrastructure development. The government has already abolished corporate manufacturing tax for companies that export their produce outside the SACU region in an effort to sustain competitiveness of the investment location. It was the view of the LTEA that the government could extend this incentive in some way to support greater linkage activity.

In conclusion, the government of Lesotho sees itself as having to try and balance a range of objectives associated with attracting and maintaining FDI. At the time of this study growing the absolute level of FDI, expanding exports and increasing employment were the chief concerns. However, there were indications that the Lesotho government is cautiously considering its options for supporting linkage activities but the signals from policymakers have not translated into any significant action yet. The survival of the Lesotho garment manufacturing industry, post-2012 lies in regional integration and the ability of Lesotho to gain a foothold in the SADC market and particularly in the South African market. Proximity to regional buyers, smaller production runs and better relationships with regionally based related and supporting industries could allow scope for more Basotho owned enterprises to supply into this market than is presently possible with the dominant exports to the US market. A regionally driven linkages programme would also need to consciously address issues related to costs, lead times, quality, and dissemination of buyer/agent related information and clustering.

It is also important to note that investors in Lesotho's garment and apparel sector have generated linkages in a wide range of services that were previously provided on only a limited basis by local firms. These services range from accommodation provision, legal and business administration services, transportation, waste services, and a variety of other activities. These have not been the result of any particular set of interventions but could also form an important and relevant basis for exploration in future initiatives in that they have a genuine market foundation.

6. Lessons learned from the linkage experiences in the South Africa, Mozambique and Lesotho case studies

A core message from the analysis of the three case studies is that linkage activity between TNCs and local firms requires active facilitation processes and the support of a range of institutional parties. While it is true that in some cases these linkages developed of their own accord, several TNC representatives indicated that widening the net of beneficiaries of such linkages required some carefully conceived, planned and executed interventions. In a context such as Lesotho, where there was limited policy focus on linkage creation and interest by most apparel investors in developing relationships with the narrow band of local SMEs, evidence of observed linkage activity was deemed, by all role players interviewed, to be very limited. The Mozambique and South Africa cases, on the other hand, demonstrated growth in linkage activity arising from targeted interventions that emphasised collaboration between various role players to optimise the potential “window of opportunity” from major FDI thrusts by TNCs.

Firm dynamics are also important to the process of stakeholder collaboration. In the case of South Africa and Mozambique, the presence of lead TNC firms facilitated the establishment of stakeholder forums and channels for regular dialogue between the TNCs, government and local SMEs. In the case of Lesotho, the clothing and textile industry is characterised by a large number of firms with decision-making capacity based overseas. Moreover, in the South African and Mozambican case studies, the lead firms were able to identify an advantage to procuring inputs and services from local supply chains. In Lesotho, firm managers indicated that there is relatively limited scope for engaging with local SMEs for either services or procurement, and that this is in large part due to the nature of global sourcing practices.

The context in which TNCs invest in host countries is also important to the promotion of linkages and, as is demonstrated in the summary matrix which follows, the circumstances in all three cases differed markedly. Under these conditions any reading of the lessons and their potential applicability to other circumstances would need some significant interrogation in relation to the specificities of the country: its level of economic activity, the density and capabilities of local firms, levels of trust between major role players and many other factors. A major capital investment by a single major global player such as BHP Billiton in the Mozal project introduces very different dynamics in the host country, some of which are conducive to the exploitation of local linkage activities. The South African case on the other hand suggests that even where firms effectively participating in global value chains face major obstacles; these can be overcome by a confluence of government policy, TNC strategic intent and facilitated inter-firm collaborative learning.

Drawing from the case studies it is clear that a number of factors deserve some attention should host countries seek to encourage greater levels of local linkages in the process of securing investment. In particular the Mozambican and South African experiences suggest the considerable benefit that can accrue, in terms of domestic firm opportunities, from carefully framed linkages support policies and programmes that accompany foreign-direct investment oriented frameworks. This absence of explicit linkages policy and programmes appears to substantially reduce prospects of converting gains in increased foreign direct investment into deeper productive gains as demonstrated in the Lesotho case.

The cases of more successful linkages programmes suggest that it is imperative that initiatives undertaken to support linkages are generated through some form of compact involving the specific TNCs, local firms and host country governments or their specific agencies. The involvement of all parties in the conceptualisation, design and implementation ensures that activities respond to the varied needs of the stakeholders and has the added potential of unlocking resource commitments from TNCs and other entities. The introduction of discussions of linkage processes at the outset of TNC investment decision making processes is important to secure early commitment and offers the potential to mobilise linkages in the establishment phases of major investments which can be reworked to meet future operating requirements once a plant is up and running. Respondents in the Lesotho case suggested that where more powerful global value chain operators are one step removed from investment (such as in the production of garments for global retailers) the involvement of such stakeholders could offer an important source of leverage with out-sourced intermediaries.

Furthermore, it is demonstrated in the cases that encouraging forms of inter-firm networking amongst prospective host country suppliers provides a solid platform for programmes and critically allows for a more effective learning and upgrading dynamic to be encouraged. Even suppliers that have little in common in terms of their processes or products can learn a great deal from one another when faced with challenges such as those related to meeting supply qualification requirements of a TNC.

The following lessons summary matrix should not be seen simply as a checklist of success factors but also understood within the unique circumstances of each country and influenced heavily by the dynamics of the sectors concerned, both domestically and globally.

Linkage lessons summary matrix by case study country

Country and case	Case study FDI information	Linkages profile	Role of government with respect to linkages	Role of FDI companies with respect to linkages	Role of host country SMEs with respect to linkages	Role of ODA and multi-lateral organisations	Lessons
Lesotho: Textiles and apparel	Rapid post 2000 growth of AGOA-export related garment investment (primarily firms from Taiwan and China) in a context with a very limited manufacturing tradition.	Very limited, generally ad hoc arrangements with high level of failure in few examples cited.	Key priority for public sector and public agencies is job creation. Government has not emphasised the issue of linkages and has no programmes in this field. Some efforts being considered by Basotho Enterprise Development Corporation and Lesotho National Development Corporation.	Tight margins, headquarters based overseas and the tentative nature of the TNC presence (AGOA dependent) has resulted in few significant linkage efforts that stakeholders are aware of. However, linkages have emerged through growing demand for services such as transport, business and legal services, accommodation and others.	Most enterprises in this field are informal or micro-businesses with little experience of contractual supply relationships at scale. Some host country SMEs have emerged in business services (tax, legal and accounting), packaging and transport.	Focus areas have included investment climate issues largely related to regulatory matters (eg World Bank), institutional capacity development around trade (DFID, ITIC, original framing of AGOA (US government and USAID, decent work and enterprise competitiveness (ILO), business development for local enterprises (DFID), infrastructure and capacity (MCA).	<p>Baseline circumstances matter: a limited presence of active local SMEs and lack of manufacturing for export culture means there is not much to work with in terms of productive capacity.</p> <p>Government priorities are relevant – if government is not significantly interested it is unlikely to see significant programmes emerge or pilots succeed.</p> <p>Lead FDI firms must set an example and take initiative or programmes will have little chance of getting off the ground.</p> <p>A coherent support framework for SME development is important to help move beyond necessary conditions (existence of FDI and a supportive environment) to generate sufficient conditions (eg finance).</p> <p>Sectors are important: The particular pattern of garment investment (local branches of vertically integrated Asian production facilities) and end market issues (scale of orders and lack of access to buyers) does not necessarily support local linkage formation.</p> <p>Culture and language can create obstacles and need specific attention despite being viewed as “soft issues”.</p> <p>Limited government capacity requires focus on core issues that might be undermined by a broadening of the development agenda to issues such as linkages.</p>

TNC FDI FIRMS AND DOMESTIC SME LINKAGES: REFLECTING ON THREE SADC CASE STUDIES

Country and case	Case study FDI information	Linkages profile	Role of government with respect to linkages	Role of FDI companies with respect to linkages	Role of host country SMEs with respect to linkages	Role of ODA and multi-lateral organisations	Lessons
Mozambique: Mozal aluminium smelter	Largest ever capital investment in export-focused aluminium smelter. Investment decision influenced by supportive investment environment, infrastructure, cost of energy and proximity to major SA smelter facilities of BHP Billiton.	Growing services and manufactured goods supplies sourced from locally-based (but not always indigenous) firms selected to participate in linkages programme.	A priority focus area for government agency (CPI) and supported by a high level of political endorsement. Government depends heavily on programme delivery by private partners.	Mozal initiated business linkage activities initially around plant set-up and subsequently around operations. Commitment of senior management, staff and resources supported by experience of BHP plants in Richards Bay (South Africa).	Existing SMEs in manufacturing and services sectors displayed eagerness to participate in programme	Significant multi-lateral presence in country with strong focus on improving private sector conditions and encouraging FDI (World Bank and IFC). Considerable number of independent reviews of projects (eg IDRC)	<p>The scale of investment and the existence of a singular dominant project gets attention and creates ongoing opportunities at scale as well as political requirement to show local impact from special offer arrangements to TNCs.</p> <p>Evidence of a track record of supplier development elsewhere by the TNC (in other FDI projects) and a commitment to take risks and use own resources to drive a project was deemed to be important. For example Billiton's involvement as a trainer and certifier ensures product and processes meet customer standards.</p> <p>Supplier requirements aligned with capabilities beyond the country – in the region (eg South Africa)</p> <p>Timing can be important with projects occurring at a time of increasing margins and growing output volumes lending themselves more to local linkage formation to allow improved market turnaround times.</p> <p>Measurement of impact has been important to secure commitment of various role players to expanding the project and involving other TNCs.</p> <p>The creation of networking forums such as that with financial institutions ensures that other factors impacting on SMEs are attended to through appropriate channels.</p>

TNC FDI FIRMS AND DOMESTIC SME LINKAGES: REFLECTING ON THREE SADC CASE STUDIES

Country and case	Case study FDI information	Linkages profile	Role of government with respect to linkages	Role of FDI companies with respect to linkages	Role of host country SMEs with respect to linkages	Role of ODA and multi-lateral organisations	Lessons
South Africa: Toyota and the benchmarking club	Decision by TMC Japan to acquire majority assets of TSA (having operated under licence as a purely SA-market focused firm) in 1997 and to develop SA Toyota plant as major production facility for European market supply.	Growing value and volume of sourcing from domestic suppliers but reduced number of total firms with increased GVC integration pressures and “tiering” of supplier relationship through core global sourcing partners.	Government policy framework (Motor Industry Development Programme) seeks to combine FDI attraction and local sourcing opportunities. National policy related to Broad Based Black Economic Empowerment place pressure on all sectors to increase sourcing from emerging enterprises and existing black owned businesses. Notable support from local government in encouraging localised inter-firm collaboration around an agenda set by firms.	TSA had a track record as a company operating in a protected domestic market of seeking long term relationships with local suppliers. TMC saw the relatively high proportion of existing local suppliers as an advantage for market access to the European market.	Local SMEs and those linked to TNC suppliers committed to collaborate on a programme to upgrade their manufacturing processes through benchmarking and other forms of collaborative learning.	No significant involvement apart from initial research support from firm collaboration from DFID.	<p>A clear, predictable and supportive government macro-policy framework (sector specific, trade and investment) allows for FDI firms to make decisions on longer term local sourcing commitments.</p> <p>Active participation and leadership from a network of relatively sophisticated firms provides a solid base for local collaborative action.</p> <p>A TNC strategy that prioritises a certain level of strategic local sourcing supported by a history of relationships and technical support enhances trust.</p> <p>A preparedness of government at all levels of recognise the importance of firm-related competitiveness matters as being at the heart of a process is essential to ensure positive impacts are felt in the firms in the early stages and on an ongoing basis.</p> <p>Independent facilitators with a reputation amongst role players can be essential in overcoming mistrust.</p>

7. Concluding remarks: creating TNC FDI and domestic SME linkages

Many SADC countries have in recent years experienced a sustained higher level of FDI. This has been closely associated with high levels of global demand – and the related higher prices – of commodities that had for many years previously suffered from weak or very erratic demand. To a large degree the investment associated with the extraction and export, and in some cases the limited processing, of these commodities has involved significant FDI by established and emerging Transnational Corporations. The scale of these projects and the related requirements on the host countries - in policy and infrastructure terms to respond to the TNC needs - has not always seen attention to the possibilities that might exist in trying to secure direct benefits to domestic businesses from the investment process and subsequent operations. Even in South Africa where there has been considerable ongoing experience among policymakers and firms interacting over FDI, opportunities an explicit focus on linkages has not always been guaranteed.

The case studies demonstrate that, whether it be at a national policy level (in Mozambique) or through a combination of sensitive national policy frameworks and robust local inter-firm networking (in the case of South Africa's automotive sector) possibilities do exist to carve out opportunities for linkages that have the potential to deepen gains from FDI. The absence of such intent, from both government and TNC investors, as in the case of Lesotho, can limit opportunity for linkages to be developed – beyond the indirect, although admittedly important, gains from linkages in related and supporting industries such as transport and business services. Furthermore, both the Mozambique and Lesotho cases suggest that regional market links within SADC can provide some important opportunities for realising linkages benefits in a context where the individual countries might not have the density and depth of enterprises and markets that might be deemed important. Linkage experience with TNCs and local SMEs in a number of SADC countries, including but not limited to the case studies discussed in this article, provide a solid basis for informing such future explorations.

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