Foreign Direct Investment Policy in the Lviv Region of Ukraine

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FOREIGN DIRECT INVESTMENT POLICY IN THE LVIV REGION OF UKRAINE

A REVIEW BY THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD)

TABLE OF CONTENTS

Tables

Boxes

CHAPTER 1. INTRODUCTION

This document is the report of the OECD review of Foreign Direct Investment (FDI) and Local Development in the Lviv Oblast (region) of Ukraine. This review is carried out in the framework of the joint initiative by the OECD and the European Commission on Improving the Conditions for Enterprise Development and the Investment Climate for Domestic and International Investors in Ukraine.

Purpose of the review

The objective of this review is to examine policies in the Lviv region for:

- Investment attraction, analysing which aspects of the local environment regional authorities/ agencies should build and market in order to attract more and better quality inward investment (*FDI attraction* – Chapter 2 of this report*)*.
- Assisting foreign investors with initial installation, monitoring their development in the region and helping them overcome problems as they arise in order to maximise retention and expansion opportunities (*FDI retention and aftercare*- Chapter 3 of this report*)*.
- Achieving the maximum long-term spin-off from inward investment attracted, for example through local supplier development, cluster building and creation of cross-border alliances by SMEs *(Long-term embedding*- Chapter 4 of this report).

Based on this analysis, the report provides policy recommendations (Chapter 5 of this report) to Lviv regional and local authorities and development agencies on how best to attract, retain and embed FDI and adapt innovations and model initiatives to local conditions. The innovative investment promotion approaches developed by CzechInvest, the Irish Development Agency and Scottish Enterprise are presented in Annexes II-V.

Review process

The main stages of the review include:

- Provision of a local diagnostic report on policies, operational arrangements, expenditures and impacts in the case study area (October 2004);
- One-week peer review visit to the case study area by an international panel of experts to interview local policy makers and other relevant people (November 2004);
- First draft of the expert panel and OECD secretariat comparisons of the case study area policies with policies in other areas (March 2005);
- Presentation of the draft report to the regional authorities and other partner organisations for comments at a regional seminar in Lviv (July 2005);
- Presentation of the final report to the national authorities at a meeting in Kiev (mid 2006).

FDI attraction, aftercare and embedding: definitions and principles

Before countries, regions or localities embark on special efforts to attract FDI, they should first decide how FDI should best serve their territory in order to formulate a coherent FDI attraction (as well as aftercare and embedding) strategy orienting and organising FDI promotion. Setting the overall policy vision is crucial in bringing all stakeholders from government, industry and society on board and creating unity of purpose and interest. Depending on the chosen strategy (attract FDI to foster export-oriented growth, target specific investors, target specific sectors such as ICT and pharmaceuticals, or favour a catch-all approach), FDI attraction strategies and structures to implement them may vary widely. It is therefore important that FDI policy strategies and structures are adapted to the conditions at local and regional level.

FDI attraction tools and activities

Governments use a wide variety of tools alone or in combination to attract foreign investment, such as:

- Investment promotion.
- Tax incentives and grants.
- Provision of industrial/ real estate.
- Creation of special economic zones (e.g. export processing zones).
- Provision of specific infrastructure.
- Cutting back red tape/ simplifying administrative procedures.
- Negotiation of bilateral tax, trade and investment treaties with potential investor countries.
- Creation of a favourable economic environment (repatriation of profits, access to imported components, political and economic stability, realistic exchange rates, economic growth).

The selection among these instruments to attract FDI should be a function of a territory's chosen investment strategy.

Investment promotion is needed to communicate a territory's competitive advantages and specific aspects of an FDI attraction policy. Promotional activities consist of providing information to potential investors creating an attractive image of a territory as an FDI destination and providing services to prospective investors.

The basic activities of investment promotion agencies include the following: Advertising, mailing, investment seminars, investment missions, participation in trade shows and exhibitions, distribution of literature, targeted direct marketing efforts, preparation of field visits by prospective investors, matching investors with local partners, handling the administrative background of firm locations (permits etc.), preparation of project proposals, conducting feasibility studies, and providing aftercare services.

Promotion is based on three variables: The product (the territory, the investment site or the sector/ industry cluster), the price (cost of locating and operating at the investment site) and promotion (the activities chosen to create a positive image of the territory/ investment site/ industry cluster).

FDI aftercare tools and activities

In the economic development field, aftercare can be defined as the provision of services offered by Investment Promotion Agencies (IPAs) or other specialised agencies aimed at facilitating new investment along with encouraging and, most importantly, anchoring incremental upgraded investment by existing investors.

However, while IPAs generally recognize the importance of reinvestment and aftercare services, few have adopted a systematic approach to that end. Some of the most successful agencies such as IDA Ireland, Scottish Enterprise, the Welsh Development Agency, the British investment promotion umbrella organisation Invest UK, CzechInvest, Singapore Development Board and many others prioritize aftercare. The scale of effort on aftercare activities should reflect the size of stock of FDI already in place in a region. In general, smaller scale efforts should be made in regions still at early stage of FDI development. On the other hand, aftercare can be very important, even in areas with a small existing FDI stock, if the investment climate features significant administrative barriers.

When reviewing the aftercare activities of some leading IPAs, we can identify the following major features:

- Monitoring foreign investors for problems or expansion opportunities.
- Recruitment and training assistance.
- Presenting case for new investment to corporate HQ.
- Information, incentives and support to adapt and expand premises.
- Minimise adverse effects of rationalisation.
- Improvement of local business environment (education, skills, communications, technology base etc.).

FDI embedding tools and activities

Policies to embed foreign investors overlap to some extent with policy for FDI aftercare. However, whereas the emphasis of aftercare tends to be mainly on facilitating retention and expansions of FDI, embedding emphasises achieving the maximum long-term benefits of FDI for the local/regional economic structure. The major preoccupation is to integrate foreign investors into local networks.

The following are the key features of long-term embedding policies:

- Local supplier development programmes.
- Support for joint research with local universities or firms.
- Provision of customised training programmes for foreign investors.
- Identifying local partners for joint ventures / strategic alliances.
- Cluster building initiatives.
- Labour mobility.
- Corporate spin-offs.

Whereas aftercare policies are directly connected to a successful FDI attraction or a potential reinvestment operation, long-term embedding policies are linked to a more general local/regional economic policy. These services aim not only at supporting re-investment, but also at increasing the value of the investment to the host country and region and at reducing the risk of closure.

Some of the most developed IPAs seek to integrate inward investors in supplier development and supply chain initiatives. Already a number of IPAs operate programmes to identify potential local supply sources for foreign investors, which otherwise may not be aware of their presence. Certain initiatives go further than this by encouraging inward investors to support supplier development by participating in supplier groups, best practice seminars and so on. Other embedding initiatives focus on encouraging collaborations between inward investors and local universities and colleges, to help improve the local skills base and local research and innovation capacity. There is a wide range of collaborations that inward investors could be encouraged to make, for example with universities, schools, local governments, chambers of commerce, enterprise agencies, trade associations, research and development associations, professional bodies, trade unions, the voluntary sector and other companies. It is important to identify where there is potential to increase the links between inward investors and other local firms and institutions in order to understand where best to concentrate embedding effort.

FDI and FDI policy in the Lviv Oblast: main issues and trends

FDI trends in Lviv

The Lviv Oblast has a very broad based economy ranging from agriculture through to food processing, mineral extraction (e.g. oil, gas and coal), construction, equipment manufacturing and tourism (e.g. culture and health resorts). Located at the cross-roads of trade and transportation, the region is also an important transit point for oil and gas pipelines from the former Soviet Union countries. Another attractive feature of Lviv for FDI is the availability of a well-trained labour force at considerably lower wage levels compared to its EU neighbours.

According to the Lviv Oblast State Administration FDI is defined as follows:

> "When foreign investment comprises not less than 10% of the authorised capital of the enterprise, such an enterprise is defined as an enterprise with foreign investment" (Invest in Lviv, 2004).

Broadly speaking this conforms to the definition of FDI developed by UNCTAD which has gained broad acceptance amongst policy makers and academics. However, it is unlikely that the 10% rule would provide a foreign investor with a controlling interest in all these cases – and the element of control is the main factor which differentiates foreign direct investment from foreign portfolio investment. Moreover, in the Ukrainian context the foreign investor may not always be a business, the foreign investor can often turn out to be an individual of relative high net worth. Thus, as a basis for collecting comprehensive and reliable data on FDI within Lviv Oblast, the above definition has limitations.

An analysis of foreign investment based on the information provided by the State Administration for the annual investment fair held in Lviv in 2004 reveals the following pattern:

- The amount of foreign investment in Lviv Oblast has been growing annually since 2001 and has demonstrated growth above the Ukrainian average in recent months.

- Lviv Oblast is currently ranked seventh according to its share of total foreign investment in Ukraine.
- In 2003 the leading countries which were the most important sources of foreign investment were: Poland (18%), Germany (13%), Hungary (11%), Switzerland (8%) and the United Kingdom (8%).
- When analysed by volume, these FDI projects appear well spread across a number of industries including: food and drink; clothing; commercial vehicles and car components; packaging, financial services; transport and communications; tourism and leisure; retail and natural resources. There is no obvious focus of sector strength.
- Foreign investments were modest in size, when analysed by value. The average investment value was only USD 4.3 million; eighteen projects had an investment value of USD 1 million or less; only four projects had an investment value of over USD 10 million.

Though growing year on year, foreign direct investment remains a relatively minor component of the economy of Lviv Oblast. The bulk of FDI which exists appears to be in small and medium sized business: much of this type of investment was present in the Yavoriv Special Economic Zone, with most of this investment being relatively young and immature. Most of the SME investment appears to take the form of joint ventures, predominantly oriented towards the domestic market in Ukraine.

Many of the larger foreign investments in Lviv are foreign acquisitions of established Ukrainian businesses, with nationally well-known brand names, which operate in traditional sectors such as food and drink. These businesses are also primarily oriented towards the domestic market.

The major investment projects can be grouped into three categories:

- Labour-seeking – These projects tend to be in labour-intensive and 100 percent export-oriented projects (e.g. FDI from Denmark in textiles and shoe-making, and FDI from Germany in auto electric parts). These projects are mostly green-field investments;
- Resource-seeking – These FDI projects seek to exploit natural and forest resources available in the region (e.g. FDI from Hungary into processing of brown coal tailings and FDI from Germany and Poland into woodworking). These projects cater to both domestic and export markets;
- Domestic market-seeking – These projects are mainly meant to cater to the domestic market in Ukraine and some neighbouring countries. These projects are mainly in the areas of equipment manufacturing (e.g. FDI from Hungary into automobile plant), food processing (FDI from Switzerland into confectionary production), production of construction materials (FDI from France into cement production) and trade and services sector (FDI from Canada into wholesale trade and transportation). These projects are realized mostly through mergers and acquisition of existing units by foreign investors.

Lviv FDI policy: general overview

While certain decisions are taken at the national level in order to attract investments into Lviv oblast (as well as other oblasts), these initiatives primarily originate at the oblast level. Indeed, central government policy is mainly focused on creating a favourable investment climate and attracting investments throughout Ukraine, and they leave it to regional and local authorities to convince the potential foreign or indigenous investor to invest in their particular oblast or city. In this regard, Lviv oblast enjoys slightly better investment conditions and opportunities than many other oblasts.

At the time of the OECD review visit (November 2004) the core of the Lviv Oblast investment promotion strategy relied on the two Special Economic Zones (SEZ) created in 1999 in Yavoriv and Truskavets regions. The SEZ, created by the Central authorities in response to the initiatives of Lviv Oblast and local municipal authorities, provided the following duty and tax concessions:

- Preferences in paying customs import duties and VAT (for goods of special destination) for a period of up to five years.
- 30% corporate tax reduction for a certain period.
- 100% exemption from duties for mandatory social security.
- 100% exemption for several years from duties for the State Innovation Fund.
- 100% exemption from land tax, diminishing rates of this tax by 50% or exemption from payments for land for a period of the pilot exploration.
- Exemption from the mandatory sale of foreign currency income.

While SEZ have certainly attracted some FDI, there are several examples where investors chose to bypass the benefits provided therein. The largest single strategic investor in Lviv oblast, Leoni Wiring Systems, chose to establish their green-field plant in Stryj rather than in a SEZ in order to avoid competition with other companies for (cheap) labour in a SEZ. Moreover, because of the company's reputation and size in Europe, and the prospective value of their investment in the assembly plant in Stryj, they were also able to secure from the central authorities simplified customs procedures for registering components and other materials being imported for assembly in their factory. In addition, they also secured from the central authorities special concessions on speedier reimbursement of VAT on exports of completed electronic kits. Both benefits were obtained through substantial lobbying by Lviv oblast and municipal authorities at the central government level.

When assessing the effectiveness of this investment promotion tool, it should be taken into consideration that the SEZ can produce undesirable displacement effects as they attract a substantial and disproportionate level of foreign and local investment at the expense of other parts of the region. Moreover, some of the customs privileges and tax benefits provided by these SEZ may negatively impact the central and regional budgets.

However, whatever the assessment of the Yavoriv and Truskavets SEZ impact is, the brusque decision of the new Government to cancel SEZ business benefits and tax and duty exemptions with immediate effect (as of April 2005) could have damaged the image of the country as investment destination. The case study of Holger Christiansen A/S company provided in Chapter 3 illustrates the effect of this unpredictable change: it entailed an immediate 30% increase of the company's operating costs and the cost of capital in the first full year of operation in Ukraine; plans to double the manufacturing capacity in the second half of 2005 and expand the workforce to 200 people had to be frozen.

The Lviv Oblast "Social and Economic Development Strategy 2015" spells out the commitment of regional authorities to create a stable environment for entrepreneurial development through supporting and encouraging foreign investment inflows. Notwithstanding the positive efforts at the oblast and municipal levels to attract investors and create a hospitable business environment, constraints abound. First and foremost, these are connected with complex, inconsistent and incomplete national legislation on business activities. Unclear and complicated normative legislation breeds corruption and bureaucracy which contribute to a negative investment image. The activities of numerous supervisory bodies are, regrettably, focused on inspections rather than support, which not only constrains business activity, but also detracts management from their business and impairs initiative.

A somewhat unique effort to attract investors into the oblast was launched at the "Economic Forum" held in 2004. This is an annual conference, launched in October 2001 with support from the central authorities, aimed at marketing western oblasts and attracting investors from the neighbouring countries. The municipality of Lviv launched a land auction where tracts of land were sold together with all approvals and certificates, on the condition that property would be developed as specified. Other initiatives to promote Lviv oblast include marketing brochures distributed through foreign trade missions and embassies, and web sites (www.invest.lviv.ua).

To benefit from its underlying strength as a destination for FDI, the Lviv Oblast needs to develop far more effective investment promotion to improve the image of the region, respond to insufficient brand awareness and lack of information on what the region has to offer. The competition for FDI is stiff among developing locations and Lviv's leading competitors for inward investment are developing increasingly focused investment promotion strategies.

Potential for cross-border co-operation in FDI

In recent years there has been a spurt in cross-border initiatives, particularly in OECD member countries. With an increase in the globalisation of products and services and reduced barriers to trade and investments, competition between regions and cities has become more intense. Within this framework, the border regions may face particular disadvantages, mainly due to their peripheral situation. The establishment of cross-border links is an effective policy response to meet these challenges. "It opens up new opportunities for growth, allows border regions to expand their industrial and service base as well as improves their exposure to international trade" (OECD, 2003, p. 30).

Cross-border co-operation can take many different forms, ranging from loose co-operation to integration. With respect to the 'integration' of regions, in terms of creating a new functional region with single market, there are more risks and difficulties, but at the same time it also offers greater rewards. The creation of a new cross-border region leads to a larger labour market and a more diversified supply of skills. Thus, it provides a superior comparative advantage to the new territory that could attract greater inflow of FDI per capita than before the integration. Integration also provides additional synergies. The intensity of such synergies will depend on the capacities of the parties to the agreement to co-operate and valorise their socio-economic complementarities. Cross-border regions that can ignite innovation potential will trigger a strong entrepreneurial growth (OECD, 2003, p. 30).

The potential for cross-border co-operation between Lviv Oblast and Poland has increased with the entry of Poland into the EU. Presently, about one-third of the total FDI inflows into the Lviv Oblast originated in Poland. With the foreign firms located in Poland expecting a rise in wage levels, some of them are likely to relocate some activities (e.g. labour-intensive activities) to the Lviv Oblast, as the German company Leoni did. Such relocation may evolve a division of labour between the two regions, further increasing cross-border trade and investment flows.

In spite of a great potential for cross-border co-operation, there may be several challenges to actually achieving it. Such challenges arise from the following:

- Both regions are relatively less developed compared to some other parts of Ukraine and Poland. As a result, they may compete for attracting foreign investments, particularly the FDI seeking low-cost locations.

- The European Union's legislation on 'Rules-of-Origin' to get duty-free access to EU markets may actually reduce the cross-border FDI and trade flows, as one region is within the Union and the other outside of it. This may also reduce the emergence of a division of labour between the two regions.

- With Poland's entry into the EU, Ukrainian citizens may face some visa- and work permit-related problems to enter Poland. This is likely to reduce the contact between the people and businessmen of the two regions.

CHAPTER 2. FDI ATTRACTION POLICIES

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Introduction

This chapter on FDI attraction draws upon information provided by the diagnostic report, desk research and interviews conducted in Lviv with local authorities and investors. The chapter will discuss the following aspects of FDI attraction:

1. Overall approach of authorities and agencies. In this section the key emphasis will be on the strategy used to attract FDI. The section will review the current FDI strategy in the Lviv Oblast highlighting achievements as well as weak points.

2. Aspects of the local business environment to be developed in order to attract high quality FDI. In this section we discuss proactive measures to enhance the dynamic economic determinants that play an important role not only in attracting FDI but also in maximising its benefits.

3. Organisation of specific policies. This section discusses the tools governments can use for their marketing strategies.

4. Conclusions and policy recommendations are provided at the end.

Overall approach of authorities and agencies in the Lviv Oblast to attracting of FDI

Some of the basic determinants of FDI such as geographic location, availability of natural resources and size of domestic market are largely outside the direct control of national policy. However, there is still much that governments can do to affect the locational decision of foreign investors. Once a government decides to attract FDI for economic development, the crucial starting point is to decide on the role of FDI and its contribution to the overall development of the economy.

The attraction of foreign investment requires the mobilisation of different interest groups across government and society. Unless government as a whole is convinced of and committed to an FDI policy, it is unlikely to maximise the opportunities for FDI or succeed with such policies in the longer term. Successful practices on the one hand build on the vision of what FDI can bring to economic development and effective buy-in from stakeholders and on the other hand are aligned to genuine market opportunities which the location can compete for.

Policy framework and strategy

Based on interviews conducted in the Lviv Oblast with local authorities, business organisations and major investors, two initial conclusions can be drawn:

1. The regional government demonstrates commitment to foreign investment and is willing to co-operate with the foreign business community; however, there is a lack of understanding of how the process might function.

2. The investment climate is changing in a positive direction; however, progress is slow due to the complex nature of many of these changes.

The Lviv Oblast has adopted an open door policy for foreign investors by removing most restrictions to FDI, though limitations remain in certain sectors. Two main national legislation acts, the Commercial Code and the Law "On the Regime of Foreign Investment" form the legislative framework for attracting FDI in the Lviv region. However, investors operating in Lviv claim that ineffective enforcement of laws at the regional level, combined with competing provisions among different legislations are significant impediments to doing business in the region.

The investment policy framework needs to address some fundamental obstacles to capital investment such as the unpredictability of legislation, land ownership and title, tax regulations, etc. The permits and regulatory procedures need to be transparent and handled efficiently and fairly. The comprehensive reform programme recently launched in Turkey provides insights on the array of issues which must be addressed in order to attract more FDI.

Box 1. Case study: Reform Programme for the Improvement of the Investment Climate in Turkey

Turkey's size, location and dynamic population should make it an ideal destination for foreign investment. However, foreign investment has been very low by international and even regional standards.

At the request of the Turkish government, the Foreign Investment Advisory Service (FIAS) conducted a study "Administrative Barriers in Turkey". As a result of the study, the Council of Ministers approved the framework of the "Reform Programme for the Improvement of the Investment Climate in Turkey". According to the recommendations of the reform programme, a Coordination Committee for the Improvement of Investment Climate has been established to advise the Council of Ministers on regulatory barriers in Turkey. The Committee has a joint structure uniting representatives from both private and public sectors and is chaired by the State Minister. Within the Committee, ten technical sub-committees have been set up, each with its own mandate on the following issues:

- Business start-ups.
- Employment.
- Sectoral licences.
- Investment locations.
- Taxes and financial stimulant.
- Customs and standards.
- Intellectual property rights.
- Small and medium enterprises.
- Investment promotion.
- FDI legislation.

Source: Based on Invest in Turkey, *http://www.investinginturkey.gov.tr/reform_prg.htm*

Regional authorities of the Lviv Oblast are committed to the continued development and improvement of the investment and business environment in the region. Recently, the Lviv Oblast State Administration embarked upon an ambitious "Social and Economic Development Strategy 2015" that spells out the Lviv region's long-term development policy, clearly identifying the private sector as the engine for economic development. The strategy has been recommended by a DFID (UK) funded project carried out with the involvement of both public and private sector stakeholders. One of the goals formulated by the strategy is to create a stable environment for entrepreneurial development through supporting and encouraging foreign investment inflows. Regional authorities plan to promulgate the strategy to social partners and investors as an indication of the priorities and tasks for regional development and as a demonstration of favourable conditions for business in the region.

For the strategy to act as a catalyst for regional development it should be:

1. Presented and explained to the public to avoid negative public opinion on investment that could harm the image of the region as an attractive investment location.

2. Supported by a continuous and predictable course of policy actions in order to demonstrate political and economic stability and commitment, which is an important factor for foreign investors especially for long-term large-scale investment projects.

3. Periodically be evaluated to ensure long-term success in attracting FDI and maximising its benefits. The active involvement of investors in that process and in the dialogue on necessary policy changes will lead to better policy development and implementation.

Objectives and targets

For an effective investment strategy, the government should determine clear and coherent objectives of the actual and expected benefits from FDI e.g. capital investment, increased tax revenues, exports, employment and skills, technology and innovation. When the objectives are set, the next step is to define what sectors, activities, countries and companies should be targeted, based on market opportunities and location competitive positioning.

Table 1. Objectives and targets for FDI attraction

	Objectives	***Targets***		
		Sectors	**Markets**	**Project type**
Lviv Regional State Administration	Sustainable economic development through FDI, job creation	Food processing, wood processing, transport equipment, textiles, construction, tourism, ICT, social infrastructure	Major trade partners	Not yet defined
Lviv City Council	Improvement of infrastructure	Tourism, infrastructure, utilities	Not yet defined	Construction

Interviews with regional and municipal authorities demonstrated that the approach to FDI attraction is largely reactive. Although a number of sectors were named as priorities for FDI attraction (see table 1), a clear methodology determining the choice of these sectors/markets in terms of their potential to attract investment and meet inward investment objectives has not been demonstrated.

The Lviv Oblast must narrow down its investment promotion efforts to the few sectors where it offers a competitive advantage and which relate to growth sectors for foreign investment and complement local industry capabilities. Ideally, for each sector, target companies that are likely to generate mobile projects should be identified. This is especially important given the limited human and financial resources of investment promotion organisations.

At the same time, target source markets for investment as well as target foreign companies, need to be carefully monitored, tracked and prospected based on solid research. In terms of target markets, particular attention could be paid to attracting investment from nationals living abroad as experience shows that in many countries the diaspora has been a key source of foreign investment.

Following best practice, once each target sector has been agreed, the objectives for each sector should be defined in terms of the number of FDI projects the Lviv Oblast can realistically attract each year – ideally as part of a marketing plan. This will be determined by market size and the region's desired market share. Based on this number of projects, it is possible to estimate the associated capital investment and job creation.

For example, if the target is to attract two foreign projects in the food-processing sector in 2006 and the average size of a project in food processing in Eastern Europe is around USD 50 million, then in the food sector attracting USD 100 million FDI would be the target.

The below case of Victoria State demonstrates the effectiveness of targeted investment promotion strategy.

Box 2. Case study: Targeted investment promotion in Victoria State, Australia

The State of Victoria has established a dedicated department specifically tasked with attracting foreign investment. Victoria has a strong industrial and agricultural base and Melbourne is a major city offering access to large labour pools and advanced clusters. However, the State faces intense competition from New South Wales (especially Sydney), from lower cost States in Australia and from South East Asian countries. At the same time, Victoria faces an additional obstacle in attracting investment because of its distance from key overseas markets.

To address these obstacles, the State of Victoria has implemented various company targeting campaigns to develop the image of the State and build relationships with carefully targeted companies.

To enable effective targeting, the State first conducted a detailed competitive positioning exercise to benchmark itself against competitor regions across Australia and worldwide for more than ten target sectors. This allowed the State to identify sectors and specific project types where it is most competitive and to build customised sales arguments and business cases for investors.

This approach to company targeting adopted by the State is three-fold: (1) Targeting major companies in target sectors; (2) targeting high growth SME companies in target sectors; (3) targeting investment brokers (consultants, real estate companies, etc) who influence company location decisions. Following the best practice example of countries like Ireland and Singapore, sustained relationships are developed with target companies.

Organisation of FDI attraction policy

An effective FDI attraction strategy needs to be delivered by a dedicated body (agency) in close co-ordination with other economic development bodies. It is important that the body can operate as much as possible along private sector principles and free from political interference.

There are currently two organisations in the Lviv Oblast involved in FDI attraction: the Chief Foreign Relations, Foreign Economic Activity and Foreign Investment Department of the Lviv Oblast State Administration and the Department of Foreign Economic Activity and Tourism of the Lviv City Council. Both departments combine inward investment, trade and tourism functions. The departments have limited human resources and their activities are restricted to providing support to companies that have already decided to invest in the region/city. Proactive FDI promotion is not yet a primary objective. The services provided by the departments include consulting, information support, legal advice, site visits, and company meetings.

It is widely acknowledged by investors that the structure of investment promotion is ineffective and is associated with considerable bureaucracy. Currently, relevant responsibilities are scattered among ministerial departments on provincial (*oblast*) and municipal levels without clear separation of accountabilities and proper co-ordination. However, regional authorities have recognised the necessity for a more efficient institutional structure for FDI attraction and developed a plan to establish a "one-stop shop" agency with the involvement of non-governmental organisations, tax authorities and business consultancies. The need to train the new agency's management and personnel in how to respond to companies' inquiries has been emphasised.

When establishing an investment promotion body the regional government should make sure that it provides the newly established unit with the means to make a difference in attracting investment. In addition to a clear mandate, institutional set-up, vision and strategy, a well-structured and well-resourced body needs a certain minimum amount of qualified staff, tools, marketing budget, etc. and must be well connected with the public and private sectors. This unit needs to understand what investors are seeking, their view on the region as an investment location, the needs of their sector and company, the location's competitive advantages for attracting FDI and how it compares with other locations.

One of the key objectives of the investment promotion unit should be to serve as the first single point of contact for foreign investors. As was indicated by a number of foreign investors in the region the presence of such a body would definitely help the region to attract more FDI and facilitate the implementation of investment projects. For that reason the investment promotion unit should create strong visibility among existing and potential foreign investors and create awareness of its existence and the services it can provide. As soon as the unit is established it could be useful to become a member of the World Association of Investment Promotion Agencies (WAIPA) to have an opportunity to network with other agencies and international organisations. See Box 3 below for more information on WAIPA's mission and the benefits provided by membership to it.

Box 3. Case study: World Association of Investment Promotion Agencies (WAIPA)

In 1995, to facilitate the exchange of successful country experiences in promoting foreign investment, the United Nations Conference on Trade and Development (UNCTAD) launched a network of IPAs - the World Association of Investment Promotion Agencies (WAIPA). At present, WAIPA has 167 member agencies from all over the world. WAIPA acts as a forum for Investment Promotion Agencies (IPAs) to provide networking opportunities and facilitate the exchange of best practices in investment promotion. Membership is accessible to any organisation involved in promoting a location for investment for an annual fee of USD 2 000. IPAs benefit from the following services:

1. Publications:

   - Quarterly WAIPA newsletter.
   - Fortnightly WAIPA electronic news bulletin.
   - A selection of investment-related publications of WAIPA's Consultative Committee members.

2. Training: The training component of WAIPA's work consists of a series of regional training workshops and study tours. In 2003, WAIPA organised five training sessions for junior and senior IPA staff on strategic marketing; FDI and cluster creation; investor servicing and aftercare; and event management. All five sessions were organised with the help of the private sector. In addition, WAIPA offers the unique opportunity of enabling professionals of WAIPA member agencies to spend up to two weeks training at successful IPAs worldwide.

3. Networking: WAIPA's annual meetings offer cost-effective networking opportunities with corporate executives, and representatives of international and multilateral organisations. Additionally, WAIPA offers its members the showcasing facilities of its website. The website provides links to their homepages. Last but not least, WAIPA jointly represents its member IPAs at investment fairs and other international fora.

Source: Based on *www.waipa.org*

Aspects of the local business support environment to be developed in order to attract high quality FDI.

Domestic policies other than creating favourable macroeconomic and political environment that are aimed specifically at encouraging FDI inflows can play an important complementary role in FDI attraction. These policies are often referred to as 'product development' or supply-side measures aiming at enhancing the competitive advantage of the location.

Special Economic Zones

Special Economic Zones (SEZs) can be a powerful competitive advantage for FDI attraction especially for export-oriented investment. The success of SEZs very much depends on policies that go beyond incentives and are designed to create the infrastructure necessary to attract and up-grade FDI and enhance labour resources (see the case study of Aegean Free Zone in Izmir).

Box 4. Case study: Aegean Free Zone in Izmir (Turkey)

The growing Aegean Free Zone is strategically located at the gateway to the EU, the Middle East and northern Africa. The zone began operations in 1990 and now hosts some 360 companies that provide jobs to 12500 workers and generate more than USD 2.5 billion annually in international trade. Between 1992 and 2002, the free zone received 7% of the total FDI in Turkey.

US-owned, private sector company ESBAS (the Aegean Free Zone Development and Operating Company) is developing the zone's infrastructure, providing all utilities, leasing land parcels or buildings.

The zone provides a comprehensive range of services, starting with all basic utilities to ready-to-use factory buildings, open and covered warehousing facilities and rental business units for distributors and traders. ESBAS also offers a broad selection of supplementary services, such as equipment rental, stock control and labour recruitment. Unique selling points of the Zone are that it also provides full amenities for company employees and families, including Child Care Centre, Concert and Sports Hall, clinic, and NASA Space Centre. This has given the Zone a differentiating point to attract large amounts of FDI, even when Turkey as a whole has a weak reputation and very poor performance in the FDI market.

Over the years, high-quality infrastructure and services have attracted many major foreign manufacturing companies including Hugo Boss, Delphi Packard, Pulse Eldor and FTB.

In addition, the zone uses effective, strategic marketing tools. For example, it was recently awarded the "Best Website of a free zone or Export Processing Zone" award by the World Free Zone Convention for its visual impact, depth and clarity of information and user friendliness. The 2005 annual World Free Zone Convention conference will be hosted by the Zone in Izmir.

The Aegean Free Zone has become a model for developing countries and is now in demand for consulting services throughout Turkey, eastern Europe, and central Asia.

Source: Based on FDI Magazine and *www.esbas.com.tr*

As an initial requirement SEZs should provide services that meet key investor needs: site opportunities, immediate availability of property, good road and telecom infrastructures. Customs services should be streamlined and red tape kept to a minimum, possibly through one-stop shopping for permits and investment applications. A key factor for a successful SEZ is transparency in all facets of the investment conditions and efficiency in delivering by the zone management and the operating conditions after project implementation.

In 2004 there were two SEZs operating in the Lviv region: Truskavets and Yavoriv. Both zones have a special customs regime (also known as "regime of a special customs zone"). This regime proceeds from the fact that free zones by convention are located beyond the national customs territory. Structure and norms of the special regime of investment activity in the zones are very similar.

The scheme is typically restricted to companies who meet the criteria and make a minimum investment of USD 500K. Companies applying for benefits also have to pass competitive selection, sign an agreement with the authorised body and implement a coordinated investment project.

Both SEZs have special committees responsible for the functioning of the zones. Typical services provided by the zones' authorities include:

- Provision of land and industrial sites.
- Provision of infrastructure and utilities.
- Special customs services.

- Support for implementation of project.
- Presentation/visits for potential investors.

The summary of marketing strategies of Truskavets and Yavoriv SEZs are represented in Table 2.

Table 2. Marketing strategy of SEZs in the Lviv Oblast

	Overall strategy	***Geographical targets***	***Sector targets***	***Marketing tools***
Yavoriv SEZ	Job creation, expanding production base	Poland, Germany	Construction, wood processing, paper industry, food processing, carbohydrate extraction	Brochures, conferences, TV commercials, presentations to investors, Internet site, representation in Poland
Truskavets SEZ	Job creation, FDI attraction	Not yet defined	Tourism, recreation	Brochures, conferences

Infrastructure development

The government should pay particular attention to the provision of the essential infrastructure needed by industry such as utilities, road access and telecommunications. It is important to be aware that basic infrastructure requirements vary from industry to industry. The planning of the infrastructure must take into account the likely future needs of the industrial sectors being targeted by the investment strategy.

The government should seriously assess the potential involvement of the private sector in the provision of this infrastructure. Investment promotion organisations and business consultancies can be a proactive intermediary by interpreting investors' needs and by procuring various stakeholders for potential Private-Public Partnerships (PPPs) for the purposes of implementing a major infrastructure project, whereby the resources, strengths and capabilities of both sides are brought together. PPPs have proved to be successful in a number of countries across the world. Two examples of PPPs in Eastern Europe are described in Box 5 below.

Box 5. Slovenia and the Czech Republic

Slovenia

The city of Maribor in Slovenia has engaged in a Build Own Operate contract for a waste water plant with a consortium led by a French company, Lyonnaise des Eaux. Build Operate Transfer is the most familiar form of public-private partnership, whereby the project is developed by the private sector, which takes primary responsibility for funding, designing, building and operating it for a sufficient period of time to service and repay the debt raised for this purpose and earn a suitable return. Control of the project is then transferred back to the public sector (which retains formal ownership of the project assets throughout). The construction cost is to be financed in part with the European Bank for Reconstruction and Development.

Czech Republic

The sale of 27% of the Czech national telecom company, SPT Telecom, raised arguably the largest foreign investment in industry in the region. A consortium comprising the Dutch telecom and postal group, KPN, and Swiss Telecom acquired the stake through a capital increase of USD 1.45 billion. All of the proceeds are being used to finance SPT's modernisation plans. Whilst the consortium has management control, the Government kept a "golden share" that allowed it to veto certain strategic decisions. Although the financing process has been delayed by certain legal challenges, the new PPP structure is now very much in place and many of the planned changes are forging ahead.

Source: Based on UNCTAD, 1999.

Human resource development

One of the main areas where a location can boost a competitive advantage and therefore attract more and better quality FDI is in the area of human skills. This is a broad area affecting a wide spectrum of society and the role of investment promotion bodies should be primary as interpreters of investors' needs and future trends as well as initiators of actions to implement policies and programmes to meet those needs.

It is important to emphasise that skills acquisition and development are crucial to the competitive status of the economy. Numerous studies have revealed that investment in training brings benefits to society provided that the skills are used within the country or region concerned. Several IPAs, most notably IDA Ireland, try to anticipate the skills requirements of future investors in their target sectors and address these needs accordingly in their schools' curricula. The matching of the evolving needs of industry, particularly FDI, with outputs of training and educational programmes has to be done on a continuous basis. To achieve this match the government should bring together representatives of educational and training institutions, industry and business organisations. For bordering regions such as the Lviv region, it can be also useful to consider possible cross-border co-operation options with neighbouring regions to strengthen the skills base and to develop technology expertise. The case of the Upper Rhine area presents an instructive example of successful cross-border co-operation in the field of education (see Box 6).

Interviews with regional and municipal authorities in Lviv demonstrated that skilled labour force is recognised as one of the key competitive advantages of the region. However, no proactive actions have yet been undertaken to strengthen and enhance this advantage through educational and training programmes developed in line with overall industrial development and investment promotion strategy. On the other hand, the major private business consultancy, NewBiznet, that has hands on experience working with foreign investors, has realised the importance of skills development for its local and foreign clients and established a training department. This department organises and provides a wide range of training programmes for top and middle management in marketing, logistics, HR management, business planning, etc. In 2003 the number of participants of these training programmes reached 1200 people.

Box 6. Case study: The Upper Rhine Region and EUCOR university confederation

The Upper Rhine region is made up of the regions, cantons and departments between the Jura mountains on the Swiss-French border, the Vosges mountains in France and the Black Forest in Germany.

The Confederation of the Upper Rhine Region (EUCOR) established in 1989 became one of the first trans-frontier university confederations in Europe bringing together over 100 000 students and 10 000 academics and researchers. As an initial step towards co-operation, seven universities, participants of the projects from Germany, Switzerland and France, opened their courses to the students of all partner universities. It was estimated that around 150-200 undergraduate students per year obtain credits from other EUCOR universities.

In the teaching area, joint courses in different subjects have been introduced. One of the major success stories has been a joint course in biotechnology that allowed students to benefit from the different centres of excellence of Basel, Freiburg, Karlsruhe and Strasbourg universities.

EUCOR is also involved in university-industry links in the region. For example, the participating universities are partners of the BioValley initiative that brings together major pharmaceutical companies in the Upper Rhine area with regional universities and research institutes to promote commercial spin-offs.

Source: Conference Briefing Paper "Cross-Border Higher Education Cooperation in Ireland and Europe" by Andy Pollak and Bob Osborne.

Business facilitation services

Interviews with investors in the Lviv Oblast revealed that businesses suffer from frequent regulatory changes, contradictory interpretations and discriminatory implementation of existing legislation resulting from unclear separation of powers. In addition, investors pointed out that the entry and establishment stage is a costly process due to the large number of permits, licenses and approvals they have to obtain and the time it takes to collect all necessary signatures. One company confided that they needed 18 different documents just to open a company bank account.

Investment and business facilitation measures introduced by the government can significantly reduce the unnecessary costs of doing business by cutting down or eliminating corruption and improving administrative efficiency. Increased transparency of the administrative system and investment procedures makes it easier for foreign investors to predict costs for the realisation of investment projects. One method for regional authorities to combat regulatory inefficiencies and red tape is to develop so-called "investor road maps". These have been developed by the Foreign Investment Advisory Service (FIAS) as a tool for identifying and reducing the number and scope of procedural steps, regulatory requirements and administrative barriers that constitute the day-to-day interactions between government and businesses (FIAS 2001).

The departments in the Lviv Oblast State Administration and the Lviv City Council provide basic information and support services. However, investors often find the quality of these services unsatisfactory and turn instead to various private consultancies both local and foreign that provide investors with services ranging from consulting on investment climate issues to organising business training.

Foreign investors named corruption among the most significant issues that negatively impact on business in the Lviv region. To combat this problem the first task is to determine the nature of the grievances that commonly occur and whether there exist means for resolving those issues in a timely and equitable fashion. Secondly, it would be advantageous to establish a coordination body, an ombudsperson, to assist with the settlement of disputes. For investors, such a person could be called an Investment Mediator who deals with complaints before they turn into conflict that could damage the

reputation of the institution involved and the country as an investment destination. An example of an investment mediator is given in the box below.

Box 7. Case study: Office of the Investment Ombudsman in the Republic of Korea

In 1998, the Office of the Investment Ombudsman was established to resolve difficulties experienced by investors in the Republic of Korea and to enhance the overall business climate. The Ombudsman is appointed by the President of the country and is a member of the Foreign Investment Committee, which is composed of 12 ministers and 16 high-ranking provincial and metropolitan officials. From its inception in October 1999 to the end of 2001, the Office had received a total of 1084 grievance cases from foreign affiliates in the Republic of Korea, covering a variety of issues such as customs, construction, financial affairs, labour, taxation and investment procedures. Government agencies are required to respond to a request from the Ombudsman's office within seven days.

Source: Based on UNCTAD.

Organisation of specific policies to attract FDI

Governments have a wide array of tools to realise their FDI marketing strategy, ranging from financial incentives to marketing activities. The optimal mix of these tools depends on the kind of investment targets and resources available.

Market intelligence

Due to the complex and dynamic nature of FDI and the pace of change of economic determinants on regional, national and global levels, extensive use of market intelligence is an essential prerequisite for strategic planning and implementation of FDI policy. Regularly up-dated information on countries, sectors and companies helps the government to identify strategic targets and select policy options. Table 3 demonstrates the scope of issues market intelligence should cover.

Key aspects of FDI attraction strategy that are analysed with the help of market intelligence are:

- Competitive position – the strength of the location vis-à-vis its major competitors.
- FDI potential of the location - key sectors that have a potential to attract FDI.
- FDI targets – countries and companies that match locations' targets in particular sectors and technologies.

Leading investment promotion agencies often have a dedicated research unit that monitors and analyses FDI trends, regularly conducts the location's benchmarking analysis against its major competitors for FDI in each industry sector, and provides company targeting and tracking services. However, due to human resources, skills and financial resource constraints many agencies use outside consultants to conduct necessary research and to prospect companies on behalf of agencies. The below case study in Box 8 gives an overview of an FDI research and company targeting tool developed by OCO Consulting, a private consultancy with expertise in inward investment, export development and competitiveness.

Table 3. Three levels of market intelligence

Level	*Parameters of research*	*Sources of information*
Country	• Economic growth • Major industries • Exports • Key companies • Competitive advantages of key sectors	National statistics International organisations (UNCTAD, World Bank, OECD) Specialised press Ernst & Young European Investment Monitor
Industry	• Structure and trends • Employment • Turnover • Growth potential • Market share • Key companies • Degree of internationalisation	National statistics Industry associations Chambers of Commerce Specialised press Ernst & Young European Investment Monitor
Key investors (TNCs)	• Ownership • Decision-making structure • Key products/technologies • Growth • No of employees • Size (turnover) • Strategies (annual reports) • Existing international operations	Companies' reports Press releases Companies' web sites Diaspora Fairs/summit web-site Other IPAs' web-sites Ernst & Young European Investment Monitor

Box 8. Case study: LOCOmonitor™, an FDI database and company targeting tool

LOCOmonitor™ is a web-based market intelligence tool that tracks daily FDI projects done by companies worldwide. To date, over 13 000 companies in LOCOmonitor™ have recorded over 23 000 FDI projects. The database comprises only green-field establishments and major expansions; mergers & acquisitions, privatisation, equity investment and alliances are not included. Detailed information is captured on each FDI project, including the company name, origin country and city, amount of investment and jobs, sector, sub-sector, product and technology, business activity, location country, location city, motives, markets served and decision making contacts.

The data on FDI projects is collected from over 6000 sources searched daily including companies' press releases, Government web sites, newspapers, etc. LOCOmonitor™ also includes a database of IPAs and governments' actions to enhance the attractiveness of locations and to attract FDI.

Investment promotion agencies, regional development agencies, international organisations and multinational companies use LOCOmonitor™ for a number of strategic, organisational and implementation tasks including identification and profiling of growth markets, sectors and technologies, allocation of investment promotion resources, profiling and targeting companies and monitoring the investment promotion activities of competitor locations.

Source: www.locomonitor.com

Promotion and advertising

Besides clear strategic direction, successful FDI attraction requires effective marketing. The aim of marketing is to build the image of the location, which is a key foundation block in the process of FDI attraction. The role of marketing is primarily that of focusing investor interest on the location and overcoming negative perceptions rather than directly persuading companies to invest. Marketing techniques that can be chosen to raise the profile of a location include general PR campaigns (advertising in mass media), printed materials (brochures, newsletters, CD-ROMs, fact-sheets), participating in investment exhibitions, IPA conferences, investment/trade missions and web sites.

The main marketing tools and activities of the Lviv Oblast State Administration and the Lviv City Council are the following:

- A general brochure "Invest in Lviv Region" in Ukrainian and English containing information on the economic situation, the strengths of the location for investors with some testimonials from foreign companies, labour market data, and available infrastructure.
- Investment fair with participation of regional authorities, local companies, existing and potential investors.
- Business/industry seminars for potential investors in the eastern part of Poland.
- A web-site (*www.city-adm.lviv.ua*) with information on history of the city, investment opportunities and some useful contacts.
- Advertising of SEZs on national TV.
- Participation in the International Economic Forum.

However, despite these promotional efforts to create the image of the location, the region has not yet done enough to appear on the investors' map.

While evidence suggests that general PR campaigns are much weaker in producing investment leads than company-focused sector targeting (Wells and Wint, 1990), PR campaigns can still be important in correcting poor awareness or misconceptions about the area.

As for printed materials, instead of spending money on preparing glossy brochures abound with general information on the investment location, the focus should be on developing highly targeted business cases for specific target sectors with supporting data and promotional messages that build the business case for investment in the country/region. In preparing such material it is also important to understand major competitors of the location so that positioning can be based on clear differentiation. Rather than general brochures, fact-sheets providing concise sector-specific information and outlining the business case attract interest from companies and make more efficient use of limited investment promotion budgets.

Inward investment newsletters highlighting major policy changes, recent project wins, etc can be effectively used to keep investors up-dated on the investment climate in the location. They are an important technique in building sustained relationships with targeted investors.

Investment conferences/fairs are important tools to generate interest in the area and start networking with potential investors and the wider investment community. The most successful conferences/fairs are sector-specific and include presentations by satisfied investors. Conferences and trade shows require at least one month of preparation, to research the companies attending, set-up

meetings with potential investors and plan effectively for implementation of the campaign at the show. Most important of all is sustained follow-up of all contacts and lead generated at the show, and many IPAs use customer relations management (CRM) tools to facilitate the process.

The web-site is a powerful marketing tool that can contribute to awareness and brand image, provide information, gain market intelligence, and reduce costs and time in delivering marketing materials. The web-site is also a powerful tool for lead generation especially through a 'contact us' feature for potential investors. The web-site of the investment promotion agency for the Copenhagen region should be taken note of as it can be considered as a best practice example (see Box 9).

Box 9. Case study: Web site of Copenhagen Capacity

Copenhagen Capacity is the official inward investment agency of Greater Copenhagen, whose mission is to promote Copenhagen to potential corporate investors and to assist companies in establishing operations in Copenhagen. The web site of Copenhagen Capacity is an excellent example of effective use of the Internet for marketing purposes. The following features of the web site make it a best practice:

- A clear, logical and easy-to-use structure.
- Five foreign language options (English, Danish, French, Chinese and German).
- Registration to newsletter function.
- Weekly updated news reports, data and information on events.
- Sector and activity-specific options with tailored information on Biotechnology and IT & Telecom sectors, HQs, R&D centres and shared service centres.
- Clear arguments supported by reliable international data highlighting advantages of the location for particular sectors/activities.
- Benchmarking tool that allows on-line comparison of Copenhagen with other regions on a range of business issues.
- Database of available industrial sites and office space and interactive search tool, Copenhagen Location.
- Comprehensive information on labour costs and availability of labour skills and education.
- Well-structured contact information indicating contact person for each section e.g. IT & Telecom opportunities, Asia, marketing materials, etc.
- A "contact us" feature for potential investors to generate leads.

Source: based on *www.copcap.com*

Grants and incentives

Incentives can and do influence investment location decisions (Loewendahl, 2001). However, the approach to the role of incentives for FDI attraction varies significantly across countries. For example, whereas Denmark does not offer any incentives at all for foreign investors, the Industrial Development Agency in Ireland has the power to offer an incentive package to an investor before they have committed to invest. However, Ireland's incentive policy has shifted over time. Initially, incentives were awarded to any company that invested which created jobs or new capital investment. The IDA then adopted a more targeted approach from the 1980s, which allocated incentives to companies operating in target sectors, including international trade services and electronics. In the last few years, the incentives policy has again changed with a focus on attracting high quality investment. A simple formula is used; to be awarded incentives the average salary per job created has to be over a minimum level.

If the government decides to use incentives they should first ensure that they will be needed in order to attract high value investment projects. Secondly, the structure and nature of incentives need to be reviewed regularly in the context of evolving development objectives. However, categorical or retrospective changes to existing incentives may damage the image of the location as an investment destination.

Site and property provision

Availability of appropriate real estate that matches specific parameters of a project is one of the key investment location factors. Investors usually seek assistance from the local authorities in identifying an appropriate site/office. In addition to providing information and advice on the availability of real estate, governments are often involved in the development of the real estate market.

In the Lviv region, regional and municipal authorities help investors in finding appropriate industrial sites and offices. However, sometimes there is a mismatch between the supply and demand. For example, there are a number of historical buildings in the centre of Lviv, which are part of the city's cultural heritage, available for sale/rent but often needing serious refurbishment. As for industrial sites, companies wishing to invest in a green-field project face the problem of non-agricultural land ownership. In addition, investors pointed out the lack of information on available buildings and premises that can be leased or bought. In some cases poor coordination of executive authorities of different levels resulted in a situation when several tenants of the same premises turned up with contracts signed by different institutions.

Conclusions and recommended policy actions

The Lviv Oblast offers good opportunities for inward investors, not least because of its strategic geographic and economic position at the doorway of the European Union, quality of labour force, and strong industrial potential. However, to benefit from its underlying strength as a destination for FDI, the Lviv Oblast needs to develop far more effective investment promotion to respond to poor image and brand awareness and lack of information on what the region has to offer. The competition for FDI is stiff among developing locations and Lviv's leading competitors for inward investment are developing increasingly focused investment promotion strategies. *A detailed review of the strategy and organisation of investment promotion in the region is therefore recommended.*

Develop a coherent FDI attraction strategy

A coherent FDI strategy requires a clear vision of how FDI can contribute to the economic development of the region. It is therefore recommended that Lviv Oblast authorities develop an FDI policy, building on the general economic development strategy, but specific and focused on the FDI market opportunities and Lviv competitive positioning. This policy should formulate:

- Clear realistic objectives.
- Organisation roles and responsibilities.
- Tangible results and performance indicators.
- Feasible timeframe.
- Structured action plan.

To elaborate such a strategy the government of Lviv Oblast would have to engage in a dialogue with various stakeholders including local industry players, business associations e.g. European Business Association, Chamber of Commerce, industry associations, NewBiznet and other professional consultancies, NGOs, academics and investors.

Elaboration of a structured plan of policy actions based on a clear vision of objectives and targets combined with realistic estimation of necessary financial, technical and human resources is a prerequisite for effective FDI attraction. The proposed plan for development and implementation of FDI attraction strategy foresees four steps for the Lviv regional government (see Figure 1). While the first two steps lay the basic investment promotion blocks, the third step deals with the organisation of the FDI policy. Finally, the fourth step should build up on previous policy actions and ensure the implementation of investment promotion strategy.

Adopt a targeted approach to investment promotion

The experience of many OECD countries, including Ireland, the Netherlands, the UK, Australia and Canada has demonstrated that targeted approach to FDI attraction is by far the most cost-effective way of achieving strategic objectives for FDI policy. A targeted approach to FDI attraction mirrors the sales process of the private sector when selling their products or services.

Targets for FDI attraction should be identified with extensive use of market intelligence and analysis of the region's competitive position. *It is therefore recommended that the government of Lviv Oblast adopt a more targeted approach to FDI policy by narrowing down its inward investment promotion efforts.*

As a starting point the following suggestions can be considered. Based on the field research in Lviv, priority sectors for attracting inward investment into Lviv can include: (1) Food-processing; (2) transport equipment; (3) tourism & recreation activities; (4) wood-processing; and (5) paper industry.

The target markets depend on each sector, but could include the US (food), France and the UK (tourism) and Germany and Japan (transport equipment).

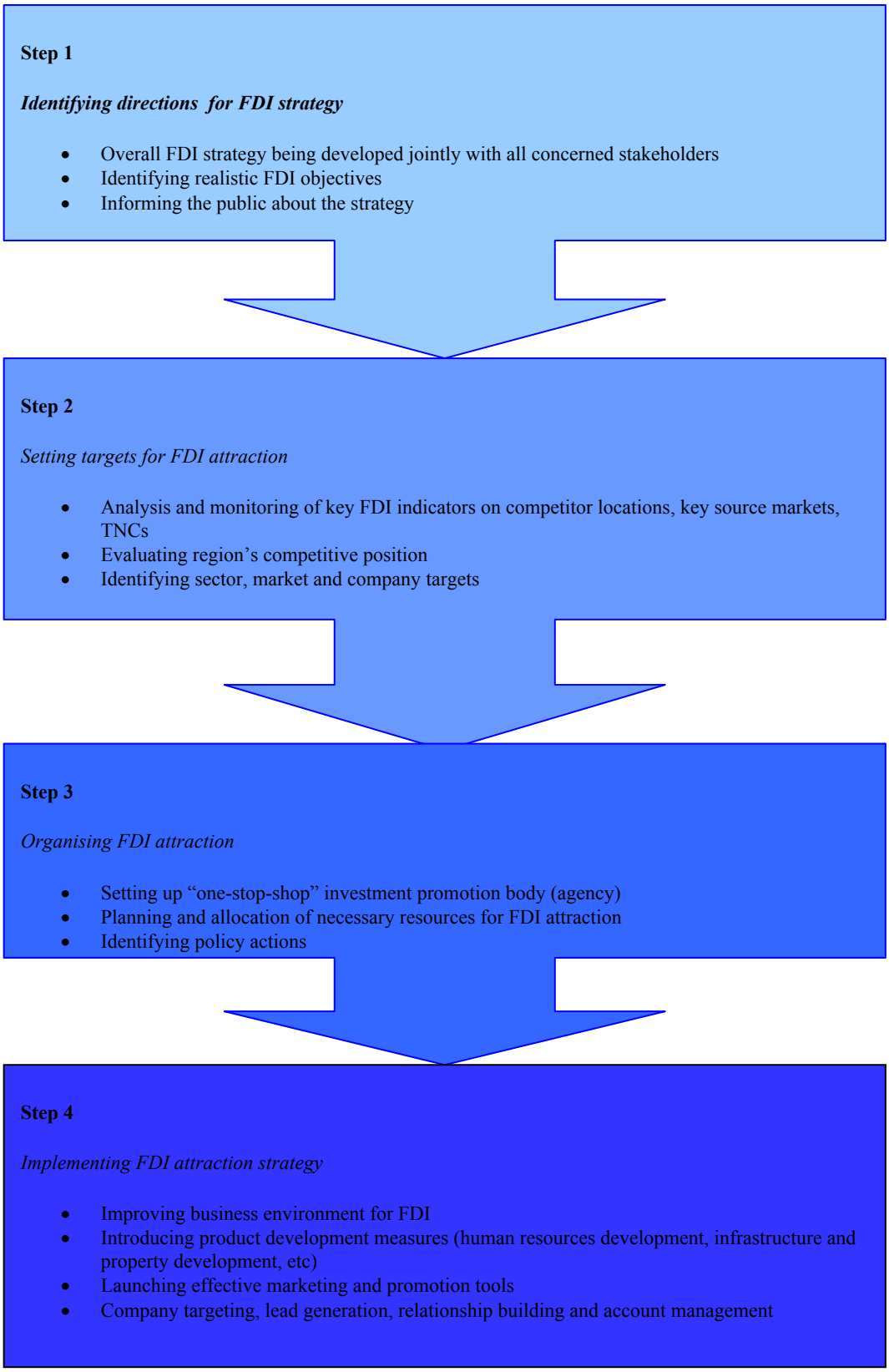
Some of the key investors in three main target sectors are given below. They could serve as a useful starting point for marketing the Lviv Oblast to foreign investors.

Set up an investment promotion body

Developing a well-structured and well-resourced investment promotion body is a condition sine qua non. It is recommended to replace the current complex system of investment promotion in the region with a single unit that will have the capacity to make and implement policy. The precise location and degree of autonomy of this body needs to be decided by local and national government in collaboration with their partners. It might be hosted within the Lviv Oblast State Administration, it might be an independent body or it might be a regional arm of the proposed national Ukrainian IPA.

Interviewed investors pointed out that authorities involved in investment promotion often lack understanding of the business environment. Since an investment promotion body operates in a highly commercial environment it is strongly recommended to employ private sector skills and experience ranging from international business, economics, marketing and industry expertise. Principles of private sector sales organisations should also be applied to the organisation of the agency in terms of its efficiency and flexibility.

Figure 1. Step-wise plan of investment promotion strategy



Food and Drink sector			
Major investors in Eastern Europe		Major investors globally (manufacturing only)	
Name of company	Country of origin	Name of company	Country of origin
Carlsberg	Denmark	Nestle	Switzerland
Danone	France	Coca-Cola	USA
Nestle	Switzerland	Carlsberg	Denmark
Cargill	USA	Cargill	USA
Heineken	Hungary	PepsiCo	USA
Phan Nam	Netherlands	San Miguel	Philippines
Nordzuker	Germany	Heineken	Netherlands
DuPont	USA	Danone	France
Mars	USA	Unilever	UK
Efes Beverage Holding	Turkey	Ajinomoto	Japan

Transport Equipment sector			
Major investors in Eastern Europe		Major investors globally (manufacturing only)	
Name of company	Country of origin	Name of company	Country of origin
Volkswagen	Germany	Toyota	Japan
General Motors	USA	General Motors	USA
Robert Bosch	Germany	Volkswagen	Germany
Denso	Japan	Honda	Japan
Toyota	Japan	DaimlerChrysler	Germany
Sumitomo Group	Japan	Ford	USA
Hyundai	South Korea	Hyundai	South Korea
PSA Peugeot-Citroen	France	PSA Peugeot-Citroen	France
Continental	Germany	Denso	Japan
LEONI	Germany	Bridgestone	Japan

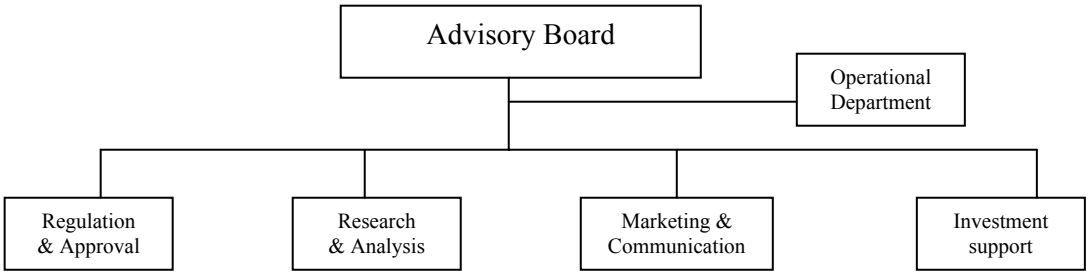
Tourism & Leisure sector			
Major investors in Eastern Europe		Major investors globally (manufacturing only)	
Name of company	Country of origin	Name of company	Country of origin
Carlson Companies	USA	Accor	France
Accor	France	Marriott Int	USA
Societe du Louvre	France	Hilton Hotels	UK
Holmes Place	UK	Carlson Companies	USA
Marriott Int	USA	Starwood Hotels & Resorts	USA
Sumitomo Group	Japan	Intercontinental Hotels	UK
ORCO Property Group	Luxembourg	Le Meridien Hotels & Resorts	UK
Anders Wilhelmsen Group	Norway	Sol Melia Hotels & Resorts	Spain
My Travel	UK	Hyatt Int	USA
The Media Centre	UK	RIU Hotels & Resorts	Spain

Source: LOCO*monitor*™, OCO Consulting.

It is also recommended to establish a dispute resolution unit (investor mediator) within the investment promotion body.

At a later stage and subject to the availability of financial and human resources, this body could develop into a fully-fledged investment promotion agency. Based on best practice examples, the structure of the investment promotion agency could consist of six departments (see Figure 2).

Figure 2. Organisational chart of an IPA



– **Advisory board** comprises representatives of local government, local industry, business associations and major investors. The board decides on overall strategy and policy actions to be taken to improve the attractiveness of the region.

- **Regulation and approval department** monitors and approves investment projects. A specifically appointed person (investor mediator) who processes companies' grievances and suggestions can also operate in the department. This would facilitate communication between investors and regional authorities.

- **Research and analysis department** monitors, collects and processes information and arranges informational support to all the agency's departments and clients.

- **Marketing & Communications department** is responsible for implementing the agency's communication strategy in cooperation with the media and other stakeholders comprising local authorities, professional organisations, etc. It is also responsible for improving the image of the region abroad through various marketing tools. In addition, the department coordinates the network of sales representations of the region abroad.

- **Investment support department** supports the needs of potential and existing investors. It provides information on procedures required to invest and operate in the region comprising investor hand-holding and sign-posting. It also arranges contacts between multinationals and local companies for possible JV opportunities.

- **Operational department** ensures effective operation of the agency. It includes HR, accounting and IT support.

Develop initiatives to improve attractiveness of the region

While economic and political stability as well as a healthy investment climate are absolute pre-conditions for attracting significant investment in the region, effective product development policies including enhancing technological and human infrastructures are essential to successfully compete for and benefit from inward investment in the medium and long term.

It is recommended that Lviv regional authorities conduct feasibility studies of product development projects that could improve the quality of the location. These measures include simplification/fast-tracking of all company registration and license procedures using a one stop shop approach.

Due to issues of land ownership and infrastructure weaknesses, establishing dedicated industrial sites, with infrastructure, services and even living accommodation and amenities would be attractive to inward investors and the expansion of existing investors. This strategy is being followed by other emerging markets.

To overcome the lack of financial and technological resources, the opportunities of cross-border alliances with neighbouring regions of Poland and Public-Private Partnerships should be considered to improve the quality of infrastructure.

The Lviv Oblast has been a popular recreational and tourist area for a long time now. Its Truskavets spa resort is well-known in the ex-Soviet Republics and in neighbouring countries. A niche strategy focused on tourism and recreation could attract investment and raise the profile of Lviv region, as well as generating service sector employment. The most important steps to take are to define key target markets (initially one or two key countries) and then work with specialist travel companies to develop package offers including flights, transfers, accommodation and beauty/health treatment programmes. Potential links between tourism and other business sectors could also be examined.

Develop and realise an effective PR campaign to improve the region's image

Interviewed investors were almost unanimous in the fact that the perception of Ukraine in general and the Lviv Oblast in particular, did not align with the reality. There are too many stereotypes that persist. *It is recommend therefore to launch an effective PR campaign to build a positive image of the region.* To achieve its target, direct marketing should transmit a clear message and be very focused on the sectors where the Lviv Oblast is well placed to compete. The utmost goal of the image development should be creation of an ideal picture of the region's strengths and opportunities designed to attract the interest of foreign investors. The recommended PR plan with its actions, aims and target groups is summarised in the table below.

Table 4. Marketing action plan

Actions	*Aims*	*Target groups*
Investment missions with "sales" presentation on key sectors	Networking with potential investors in key source countries	MNCs and export-oriented companies, diaspora
International investment exhibitions	Networking and exchange of experience	International organisations, investors, IPAs
Membership with WAIPA	Networking and exchange of experience	International organisations, IPAs, mass media
Investment conferences	Introducing location, updating on investment climate, informing on sectoral opportunities	Investors, media
CD-ROMs, sectoral brochures	Image-building, informing on sectoral opportunities	Potential investors, chambers of commerce, visiting delegations, embassies
Investment newsletters	Updating on investment climate, sectoral opportunities, highlighting recent successes	Potential/existing investors, diaspora, consultants and brokers, media

Since it is not easy to build an image of a small community, it is recommended to examine the feasibility of conducting a joint marketing campaign with neighbouring regions in Poland to get on the mental map of investors. Once the attention is attracted, the regions could use other techniques e.g. incentives, technological expertise or JV opportunities to get investment projects.

CHAPTER 3. FDI AFTERCARE POLICIES

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Purpose and Approach

Based largely on the information gathered during the OECD's review visit to Lviv in Ukraine in November 2004 augmented by desk research this chapter:

1. Re-considers the meaning and significance of investor aftercare, defines strategic aftercare, and highlights the public policy challenge and focus of strategic aftercare for economies in transition.

2. Assesses the general relevance of strategic aftercare to Ukraine; and its particular relevance for Lviv Oblast.

3. Presents two in-depth company case studies which identify key support issues for strategic foreign investors in Lviv Oblast, and enable the current support environment to be assessed.

4. Describes the aftercare models and approaches developed by CzechInvest; the Irish Development Agency; and Scottish Enterprise (Annexes II-V).

5. Sets out the main findings and recommendations based on the previous analysis for:

   – The development of strategic aftercare services in Lviv Oblast.

   – The scope which may exist for the development of new cross border initiatives on aftercare at oblast level.

The focus of the chapter is on practical policy recommendations relevant to Ukraine and the development of aftercare services in Lviv Oblast. The report is largely based on economic and strategic analysis of the relevant policy contexts and issues. The comparative component of the analysis draws upon international case studies and the relevant academic literature.

The Rationale, Challenge and Focus of Strategic Aftercare

The Rationale for Strategic Aftercare

The definition offered by the Multilateral Investment Guarantee Agency of the World Bank (2003) is as good a point of departure as any. The MIGA has stated that:

> "Aftercare is the general term covering the management of relationships with existing investors. In essence it is the investment promotion equivalent of customer care. As such it adheres to the old sales adage that it is almost nine times less costly to sell to an existing customer as it is to attract and successfully develop a new one."

Aftercare embraces a wide range of support activities. Typically, these activities are provided by Investment Promotion Agencies (IPAs) operating at the national level. Their aftercare activities help foreign firms to realise their initial investment plans and intentions (this is usually termed "post-investment" support); and, over time, to extend and deepen their direct investment activity in host countries (see for example Annex II, FDI Aftercare Learning Models: Ireland, A New Model for Aftercare).

Support can be of a strategic or operational nature, or take the form of information and advice of various kinds. Young and Hood (1994) provide a fuller classification of this type of activity in one of the few published papers which seek to address aftercare from an academic/policy viewpoint. The general presumption here is that markets on which such services can be directly transacted either do not exist or tend to operate in such an imperfect manner that some form of public sector intervention is needed.

In addition to the market failure argument, a range of other factors can be cited which give aftercare its growing meaning and significance for policy makers. Though the distinction can at times be hard to maintain, these factors tend to fall under one of two main headings namely: "Place Marketing Benefits" and/or "Economic Development Benefits. Annex I contains a summary of the former, whilst the main economic development benefits of strategic aftercare are listed below:

Short-term benefits

The UK experience of attracting and retaining FDI indicates that in general only two thirds of the jobs created and safeguarded at the time of announcement are realised. Well designed aftercare programmes providing immediate post-investment support can help investors realise more of their initial investment plans and intentions by helping to minimise delay.

Longer-term benefits

Indeed, aftercare programmes can be an important component of local economic development strategies which promote the continuous upgrade of existing investment and related factor conditions.

For example, this could occur where flag-ship investors are present and where over time the corporate parent devolves significant responsibility for product-related R&D to the local subsidiary (e.g. NCR in Scotland and Apple in Ireland) and /or this could also occur via the deployment of strategic supplier development programmes, as in the case of Ireland.

Both approaches promote innovation and provide scope for the adoption of more fully integrated approaches to local economic development - approaches which strengthen economies agglomeration and the centripetal forces of localisation which promote local clustering (see, for example, Young, Hood and Peters, 1994).

Wider policy benefits

A community of foreign investors can lobby for changes which will enhance local operations, create new synergies (e.g. in staff training) and lower cost and improve the reliability of public services and utilities. In this the IPAs aftercare programme represents a potentially important conduit for investor views and opinions to reach the top levels of Government. Such policy advocacy can play an especially important role in shaping government policy on how best to improve the local infrastructure and local factor conditions for business.

Developing this point further, acting on the opinions and perceptions of existing foreign investors is also important for government credibility in attracting and retaining FDI. Foreign investors, especially large blue-chip investors, have extensive international experience which often provides a solid comparative basis for analysis of the local business climate. The corollary to this for host countries is that government macro-analysis can also benefit from the aftercare relationship with managers in the local subsidiaries and regional HQs of leading investors. The international outlook and expertise of local subsidiary managers is a potentially useful source of intelligence on key trends and issues (within the corporation, its industry setting and, indeed, the wider global economy). This can help inform and shape government thinking on the nature of the strategic challenges and opportunities faced by the host economy and their implications for economic management and economic development: CzechInvest, for example, organise networking events to facilitate this type exchange.

The Policy Challenge and Focus of Strategic Aftercare

According to UNCTAD (2001), aftercare is now regarded as one of the core functions of IPAs in advanced economies, developing economies and economies in transition (see Chart 1). The apparent willingness to embrace aftercare requires qualification as it must be recognised that designing and implementing effective aftercare policies is intrinsically an extremely challenging economic development task. The scope of the challenge includes:

- Identifying which services are needed at different points along the investment cycle, who should receive them and exactly when.

- Deciding how best to deliver aftercare services raises important issues within and between different parts of the public sector regarding leadership, governance, co-ordination and control. For example, should control reside in one central body or be dispersed throughout a more federated structure operating under a shared national vision and strategy?

- Determining what level of resource is needed, where these resources should come from, what the role of the private sector should be, and whether such services should be free at the point of delivery?

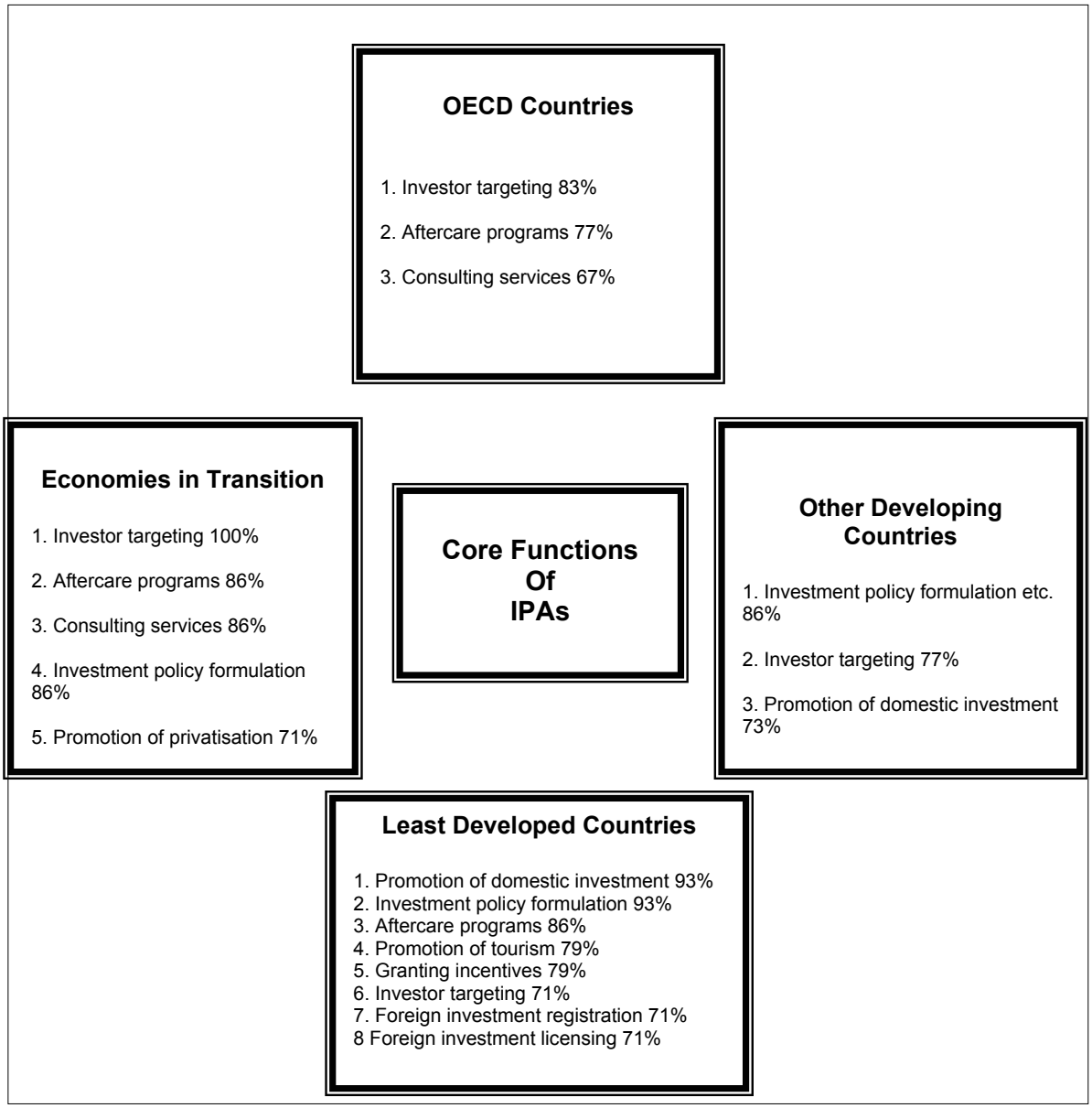
The challenge of aftercare is even greater in the case of economies in transition. In Ukraine, for example, the institutional landscape is slowly changing and developing: currently no single body has responsibility for economic development, and while the establishment of a national IPA has been announced, it remains unclear at the time of writing when this body will become fully operational and whether aftercare will form any part of its remit.

Furthermore, Ukraine's basic infrastructure has some major weaknesses: in particular, the rail gauge is narrower than that in Europe and international air links generally need to be significantly improved. In the case of the city of Lviv, basic business conditions can still be very difficult. For example, during the OECD's study tour to Lviv it was evident that water was subject to rationing and power supplies to industry were not always reliable. In this context, the provision of good aftercare support clearly becomes an even more demanding and challenging task.

Moreover, there is a dearth of good comparative research which has been published to help steer policy formulation on best practice in aftercare. Poorly conceived aftercare programmes run the risk of misallocating scarce public sector resources by supporting foreign investors whose needs from a policy perspective could/should be met through existing business services or business development programmes in the host-country. In such an instance this can lead to needless duplication of effort and

provide foreign investors with an unfair advantage over their indigenous counterparts, thereby exacerbating undesirable displacement effects in domestic markets (both product and factor).

Chart 1. Core Functions Of Investment Promotion Agencies (IPAs)



Source: UNCTAD Survey of Investment Promotion Agencies, 2000.

Note: The numbers in this chart represent the percentage of surveyed IPAs which handle the indicated tasks. Only functions undertaken by more than two thirds of the IPAs surveyed are taken into account here.

This raises the important issue of what the primary focus of aftercare should be for an economy in transition. The main contention of this paper is that the best aftercare policies are ultimately designed to bring the maximum net economic benefit to the host-country in the long run. This would be achieved by forging close relationships with the local subsidiaries of leading foreign investors

which can be levered to attract additional, higher quality direct investment. Accordingly, the policy goals for aftercare programmes should be consistent with government aims for overall economic development and good economic management. Long-term economic benefits should be maximised using the minimum amount of public-sector resources necessary, with wasted public resources being avoided wherever possible.

The most appropriate focus for aftercare follows logically from this position: this should be on types of strategic FDI which are mobile and contestable across national borders and whose economic impacts (direct, indirect and induced) are strongly additional and whose displacements effects are minimal. Relative to the domestic business stock and perhaps other types of FDI, strategic FDI should, *inter alia*, demonstrate a clear potential for the following features to develop and become increasingly dominant traits:

- High export intensity.
- High local content in the product/service produced.
- Low import intensity.
- High pay and productivity.
- Limited displacement effects in key local markets (both final and factor).
- Ability to promote, rather than constrain, host-country competition.
- The ability to support high value-adding functions.
- Ability to develop strong strategic linkages locally.
- High levels of innovation: introducing new products and opening up new host-country markets etc.

Strategic FDI will also tend to align well with priority industries and sectors identified by government. And strategic FDI will also help to stimulate the development and upgrade of a) key aspects of local infrastructure (e.g. promote the modernisation of transportation and telecommunications etc.) and b) key factor conditions (e.g. the formation and provision of key skills, the development of appropriate sites and property, specialised funding etc.).

The Relevance of Aftercare Policies to Ukraine and Lviv

The General Relevance to Ukraine

Ukraine is making some progress towards an open market economy, but it is generally acknowledged that to date progress has been slow. Ukraine aspires to, but has yet to achieve, membership of the World Trade Organisation – although, at the time of writing, it has completed 25 of the bilateral protocols necessary for accession, in particular, agreement with the United States has yet to be reached. Moreover, in May 2004, the European Commission concluded that Ukraine did not yet meet the criteria for market economy status, following an anti-dumping investigation and concerns over state interference in pricing[1].

1. This status was given to Ukraine in December 2005.

The European Bank for Reconstruction and Development provides a comprehensive analysis of the annual progress on market reforms in Ukraine in its Transition Report published in November 2004. The following represents a selection of comments and observations relevant to the present analysis:

- The penetration of foreign direct investment (FDI) has been substantial in the Central European and Baltic (CEB) economies in banking and insurance, telecommunications, water, power and transport following large programmes of privatisation and re-regulation. Structural reforms in Ukraine, however, continue to lag well behind the CEB and to date FDI penetration has been minimal.
- For example, between 1992 and 2003 the proceeds of privatisation of Ukrainian infrastructure amounted to USD 283 million (at 2000 prices) compared with USD 9.7 billion in Poland, USD 7.4 billion in Hungary and USD 5.8 billion in the Czech Republic. Much of this activity has been FDI driven.
- Energy distribution (partially privatised) and mobile telecommunications (wholly privatised) are the only areas where significant progress has been evident in Ukraine.
- In the CEB, foreign banks control the majority of banking assets in both the commercial and retail sectors. In Ukraine, few of the 150 or so banks are under foreign control. Many are small and poorly capitalised. Re-structuring of the sector is needed. And as the IMF has pointed out, this will entail much greater transparency on ownership than is currently the case in Ukraine.
- While the government has decided to accelerate the privatisation of a number of key state-owned industrial enterprises, the process has not always been open. For example, the terms surrounding the privatisation of Krivorizhstal, Ukraine's largest steel plant, effectively limited the tender to domestic interests and higher bids from foreign strategic buyers were rejected.
- Accession countries in the CEB started to reform immediately after independence. However, reforms only got underway in Ukraine in 1996 - once it had established a constitution. Indeed, it has taken until now for the pace of reform to gather serious momentum following the introduction of new Civil, Commercial and Customs codes in 2004.
- Most businesses in Ukraine regard the cumbersome regulatory framework, the unstable body of legislation, anti-competitive practices and widespread corruption as serious barriers to trade and investment. The unpredictable and onerous procedures for tax inspection and customs have been regularly highlighted by business and policy analysts as especially damaging. This was a recurring theme during interviews undertaken by the OECD study tour in November 2004 within Lviv Oblast, echoed by investors, local authorities, banks and business service providers alike.

The above highlights some of the adverse business conditions, structural difficulties and the limited opportunities which foreign investors currently face in Ukraine. These barriers have constrained the general development of Ukraine's FDI position and profile relative to the wider region. Based on UNCTAD definitions and methodology, the following key statistics help to illustrate this. These are taken from the latest World Investment Report for 2004.

- The cumulative position, reflected in stock values, shows that the stock of FDI in Ukraine was worth around USD 7 billion in 2003. This is significantly smaller than the equivalent stock position in the Czech Republic (USD 41 billion) and Poland (USD 52 billion).

- The stock value of FDI in Ukraine was 14.1% of GDP in 2003 compared with 48%, 24.9% and 23.7% respectively for the Czech Republic, Poland and Central and Eastern Europe as a whole. These figures reflect a fairly stable comparative position for the period since 2000.
- The flow of FDI in to the Ukrainian economy was worth USD 1.4billion in 2003; while these flows have trebled in strength over the five year period since 1999, they remain significantly weaker than the equivalent flows in to the Czech Republic and Poland.
- On UNCTAD's FDI Performance Index, Ukraine is ranked 98th in the world alongside Burkina Faso and Gabon.
- On UNCTAD's FDI Potential Index, Ukraine is ranked 94th in the world alongside Morocco and the Republic of Congo.
- On a forward-looking scale of economic risk, devised by World Markets Research Centre (WMRC), where one is the lowest and five is the highest, Ukraine currently scores 3.25 alongside Georgia and marginally ahead of the Kyrgyz Republic while Poland, Hungary and the Czech Republic score 2.25 (EBRD, 2004).

Thus, in the context of Eastern and Central Europe, the above evidence is consistent with Ukraine's position as a market for strategic FDI which has just reached emerging status. Moreover, while the Cabinet of Ministers has announced the intention to establish a national IPA for Ukraine, its core functions are not yet known and its organisation has yet to take shape and become operational.

In the absence of a) an installed base of strategic inward investors and b) a suitably empowered and resourced national IPA which is fully operational both internationally and at the oblast level, it would seem that strategic aftercare is a policy whose time has yet to come in Ukraine. In the next section, however, the relevance of the aftercare is tested for more fully at the "regional" (oblast) level within Ukraine.

The Specific Relevance to Lviv Oblast

Based on the definition of strategic aftercare developed in this paper, the acid test of "relevance" is straightforward: are there any strategic investors who have developed to the point where aftercare support is needed, located in Lviv Oblast? This question can not be answered directly from further analysis of official statistics, government reports etc. As such, the OECD visit to Lviv Oblast in November 2004 provided an excellent opportunity:

- To gather local information and intelligence on FDI trends and issues and to better establish the size and make-up of FDI in the oblast.
- To establish whether there were any strategic foreign investors in the oblast.
- To identify the key issues which any strategic foreign investors face in implementing their investment plans in the oblast.

Relevant intelligence was gathered via face-to-face interview and from related documentation provided by various host bodies (e.g. brochures, pamphlets and reports etc.).

The Lviv Oblast State Administration's view is:

> "When foreign investment comprises not less than 10% of the authorised capital of the enterprise, such an enterprise is defined as an enterprise with foreign investment" (Invest in Lviv, 2004).

Broadly speaking this conforms to the definition of FDI developed by UNCTAD which has gained broad acceptance amongst policy makers and academics. However, the view of the State Administration is also that the business activity of foreign investors will largely take the form of one of the following:

- A wholly-owned private company.
- A wholly-owned subsidiary, affiliate or representative office of the foreign investor.
- Equity and non-equity joint ventures with Ukrainian companies.
- Shares of foreign capital in a limited liability company structure.

It is unlikely that the 10% rule would provide a foreign investor with a controlling interest in all these cases – and the element of control is the main factor which differentiates foreign direct investment from foreign portfolio investment. Thus, as a basis for collecting comprehensive and reliable data on FDI within Lviv Oblast, the above definition has limitations. Moreover, in the Ukrainian context the foreign investor may not always be a business: as the OECD study team's visit to Truskavets Special Economic Zone (TSEZ) revealed, the foreign investor can often turn out to be an individual of relative high net worth.

The definitional difficulty and the problem this poses for interpreting FDI data produced by the State Administration is not one which can be readily adjusted for within the parameters of the present study. As such, this data has had to be relied upon as it is the only source which we have been able to identify which attempts to track the level and mix of foreign investment activity through time for Lviv Oblast. A recent analysis of foreign investment based on this data was included in a report prepared by the State Administration for the fourth annual investment fair which was held in Lviv in 2004. This reveals the following pattern:

- The amount of foreign investment in Lviv Oblast has been growing annually since 2001 and has demonstrated growth above the Ukrainian average in recent months.
- Lviv Oblast is currently ranked seventh according to its share of total foreign investment in Ukraine.
- In 2003 the leading countries which were the most important sources of foreign investment were: Poland (18%), Germany (13%), Hungary (11%), Switzerland (8%) and the United Kingdom (8%).

Included in the same report is a list, compiled by the State Administration, of 47 of the most important FDI projects for Lviv Oblast. Key features to note are as follows:

- When analysed by volume, these FDI projects appear well spread across a number of industries including: food and drink; clothing; commercial vehicles and car components; packaging, financial services; transport and communications; tourism and leisure; retail and natural resources. There is no obvious focus of sector strength.
- Foreign investments were modest in size, when analysed by value. The average investment value was only USD 4.3 million; eighteen projects had an investment value of USD 1 million or less; only four projects had an investment value of over USD 10 million – these were:

- **Lviv Automobile Plant**, which makes buses and automobile equipment for the Eastern European, has been acquired by Hungarian investors and has received USD 30.6 million.

- **Leoni Wiring Systems UA GmBH**, which produces cable harnesses for GM cars, is a recent green-field project which is wholly German owned, involving an investment of around EUR 30 million.

- **Svitoch** which manufactures confectionery for the domestic market in Ukraine has been acquired by a Swiss investor (Nestle) and has received investment worth USD 21.3 million.

- **Lviv Brewery** which makes beer and non-alcoholic drinks has been acquired by a Swedish investor (Baltic Beverages Holding AB) and has received USD 12.6 million.

Though growing year on year, foreign direct investment remains a relatively minor component of the economy of Lviv Oblast. The bulk of FDI which exists appears to be in small and medium sized business: much of this type of investment was present in the Yavoriv Special Economic Zone, with most of this investment being relatively young and immature. Most of the SME investment appears to take the form of joint ventures, predominantly oriented towards the domestic market in Ukraine. This type of FDI would formally be classified (see Dunning, 1998) as "market seeking", and single-country oriented. This type of investment would also be relatively immobile across national borders and therefore non-contestable in terms of cross-border competition. Under the definition adopted in this paper, this type of FDI would not require strategic aftercare support and is perhaps best supported by quality business development programmes which would normally be available to all businesses regardless of ownership.

Many of the larger foreign investments in Lviv are foreign acquisitions of established Ukrainian businesses, with nationally well-known brand names, which operate in traditional sectors such as food and drink. These businesses are also primarily oriented towards the domestic market. This type of FDI would also formally be classified as "market seeking", single-country oriented and relatively immobile and non-contestable. As such, this type of FDI would not require strategic support and, again, is perhaps best supported by quality business development programmes which would be available to all businesses regardless of ownership.

However, two recent foreign investors, which formed part of the OECD study tour itinerary, demonstrated a very different set of characteristics.

Leoni Wiring Systems

A large and relatively recent green-field investment, wholly German owned, operating in the intensely competitive automotive components sector. Its business is 100% import/export. Leoni's Ukrainian plant is a preferred supplier to a number of General Motor's car plants in Western Europe. This type of foreign investment is efficiency-seeking, oriented to western markets, and relatively mobile and contestable over time. These features make this type of investment somewhat more strategic in nature and Leoni would currently self-select as a key target for any strategic aftercare programme in Ukraine.

Holger Christiansen (HC)

Danish in origin, Holger Christiansen is a medium-sized company which re-conditions key components for the automotive sector. HC has established a new production unit on a green-field site on the Krakovets customs free port within the Yavoriv SEZ, on the Ukrainian/Polish border. The project is 100% import/export and oriented towards western markets. This type of investment is also efficiency seeking, multi-country oriented, and relatively mobile and contestable. These features make the project more strategic in nature and HC would self-select as a target company for any aftercare programme in Ukraine.

Their strategic nature, choice of location and recent arrival set both of these investment projects apart. Both these projects are very recent arrivals and represent a significant departure from the general FDI pattern to date. These companies may possibly represent the leading edge of future strategic investment in Ukraine. The experience of these investors as first-time entrants to Ukraine is especially valuable in the context of this analysis. Accordingly, a more detailed case-study approach has been adopted in the next section to identify and better understand the key issues which have emerged for these companies where strategic aftercare support may have a continuing role to play.

CASE STUDY 1

Holger Christiansen A/S[2]

Founded in 1963, Holger Christiansen A/S (HC) is a mid-sized company employing around 650 people which supplies re-conditioned components (starter motors, ignitions, alternators, compressors etc.) to the automotive industry. Although Danish headquartered, HC is now 100% owned by Hella AG, the large diversified automotive component supplier which is German-owned and headquartered.

The first production unit for remanufacture was established in Esbierg in 1976. Since then HC has developed from a small regional company into an important parts supplier in Europe with a developing position in North America. HC now has sales subsidiaries in the United Kingdom, Germany, Holland, Sweden, France and the United States, and production subsidiaries in Germany, Slovakia and Ukraine. It is clear from Chart 2 that most of the company's international growth occurred in the last decade. The extent of HC's international development is reflected in the fact that 46% of the space owned by the company is now devoted to remanufacturing and warehousing in its overseas subsidiaries.

The Core Competence of the Business

Parts remanufacture is a growing business in which leading automotive manufacturers such as Fiat are now interested. However, the business which HC has built up has largely been based on the smaller retail end of the automotive industry (e.g. independent garages and small auto-shops) where HC has successfully pursued a "new for old" parts policy. The core competences which underpin HC's success include:

Sourcing Expertise

A comprehensive range of parts and components is needed for the remanufacture of starters and alternators. This is especially difficult to achieve due to parts proliferation. However, HC has built up considerable experience and expertise in parts sourcing over the years, and this has enabled the company to manage the parts proliferation challenge in a strategic and pro-active manner.

Remanufacture

The HC production process fully remanufactures all key components such as starters and alternators etc., from the inside out. HC has developed unique tooling which is specially adapted for the purpose of component disassembly and reassembly – without damaging still useful components. Consequently, the remanufacturing process is both labour intensive and highly skilled. All wearing parts are replaced and all other components are thoroughly cleaned, tested, repaired or replaced. Extensive quality control measures are in place throughout the process, using the best test equipment available, with a 100% end-of-line inspection.

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2. The author is grateful to Anders Johansen of J&L Consulting (www.j-l.com.ua) and Bo Jorgensen of Holger Christiansen Production, Ukraine (bmjua@sol.dk) for their input and advice without which this case study could not have been prepared. The views expressed remain those of the author.

Remanufacturing Expansion in Central and Eastern Europe

When remanufacturing volumes first rose above 500 units a month, HC acquired a competitor in the east of Germany to provide additional capacity. An additional new plant was then established in Slovakia in 1999 to service further sales growth and to take advantage of lower labour costs. (This is run by a separate daughter company and employs around 160 people.) Continued growth in demand, a near competitor establishing in Hungary, and its strategy of keeping a step-ahead of the competition were among the key factors which led HG to consider further expansion. The least-cost logic of HC's overall business strategy opened up the possibility of HC's first-time entry to an Eastern European country which bordered the EU.

The Investment Project

The investment project associated with this next stage in HC's East European expansion comprised a new production unit for remanufacturing. This would involve the import and re-export of reconditioned components such as starters, alternators etc. for customers in the EU market. As such, HC required a new facility which it wanted to build on a wholly-owned two hectare green-field site. Moreover, the site had to be in a location which offered a good pool of engineering skills and good access to EU markets.

Pre-investment: Site Options and Project Feasibility

Early on in the site selection process HC were directed to Lviv Oblast in Ukraine through the Danish Embassy in Poland: the Embassy was aware of an earlier wave of investment by Danish textile companies which began to establish in Lviv Oblast in 1999.

HC twice visited Lviv Oblast on a fact-finding mission between December 2002 and January 2003. Local consultants (German and Danish ex pats.) were used to identify site options. Based on advice from senior officials in Lviv Oblast, the Danish consultant identified Yavoriv Special Economic Zone (YSEZ)[3] as a possible location.

A site visit was arranged for HC at short notice. HC were sufficiently convinced by what they saw to proceed with a full pre-investment feasibility to better understand the many associated risks and uncertainties. Local consultants were again used to assist in this. Between March 2003 and May 2003, local consultants worked with HC to test the practicalities of the HC business model against the features associated with a site in YSEZ.

The first problem was Customs-related and represented a potential deal breaker. "Active Processing" was the general policy operating in Ukraine and within YSEZ relevant to the re-export operations of HC. This policy requires imports to Ukraine to be processed and re-exported within 90 days. However, HC's remanufacturing process needs a minimum of six months to turn around a single container of used starters and a single container of related parts. In failing the 90 day rule, HC would become liable for duty of between 5-20% and VAT of 20% on the cost of imports and another 20% VAT on the price of re-exports.[4] If the processing time-frame were to be changed for HC, high-level

3. In common with other Special Economic Areas in Ukraine, the YSEZ offer new businesses investing over USD 500 000 tax advantages on their initial start-up costs and costs of operation. For example: for the period to 2020, corporation tax is zero rated; duty and VAT is zero rated on equipment and parts needed for production; and land tax is zero.

4. Under "Active processing" within the 90 day period, the original VAT element paid on imports is in theory fully refunded. However, businesses can not rely on when this refund will actually be paid by

approval would also be needed from the State Customs Service of Ukraine which is the relevant central authorities. Moreover, this procedure could be protracted and carries no guarantee of success from an investor perspective.

The local Danish consultant briefed the Vice Chairman of the Lviv Oblast directly on the emerging problems. The Vice Chairman suggested that the Krakovets Autoport which was located on the Polish border (but within the YSEZ) might represent a possible solution. Krakovets Autoport was a "customs free area" located on the main trans-European corridor. It had 74 hectares of land but no major investors as yet. However, in terms of regulatory approval HC would not only need to register as an investor and member of the YSEZ, but HC would also need to achieve Special Custom Regime status. The relevant approval process involved upward referral to the central customs authorities with no guarantee of success for the company. Moreover, as the first company on the free area the legal difficulties attached to the approval process were strictly unknown.

Taking the above risks and uncertainties fully into account, HC took the decision to go forward with the project on 5th July 2003.

Investor Support: Key Issues

The key investor-support issues which emerged after the decision to locate on the Krakovets Autoport are listed below in descending order of importance:

Special Custom Regime Status

Given the nature of HC's business (i.e. 100% re-export), achieving "customs free" status was fundamental to the success of HC's preferred business model for operating in Ukraine. Such status however required the approval of the customs authorities in Kiev.

Approval is conferred once the regulatory requirements, defined in a 12 point by-law, had been met. This by-law prescribed various features and requirements which HC's new facility would need to fulfil. On security, for example, this included installing appropriate fencing and building a security gatehouse. To meet the regulatory requirement a customs infrastructure was also needed. This included the creation within the facility of a separate sectioned area for goods inspection and dedicated space for the use of customs officials. Aspects of the by-law, however, were less clearly defined and legal meanings and interpretations had to be established for the first time – thereby adding to the length of time of the process and raising the level of risk and uncertainty.

Tariff Structure Classification

HC faced another fundamental problem with Customs Officials. This concerned the classification of HC's reconditioned components within Ukraine's tariff structure: no appropriate product/activity classification existed. Furthermore, to change the classification required the initiation of another procedure involving upward referral to central customs authorities where again a successful outcome could not be guaranteed from an investor perspective. Timescales were again uncertain and could not be planned for.

Tax Authorities in Ukraine: we understand that over USD 1 billion of back-dated VAT refunds are currently overdue to businesses in Ukraine.

Land Acquisition

As noted above, HC wished to establish a new production facility on a wholly-owned two hectare site. However, according to Ukrainian Law for a foreign investor to own land, a building must already exist on the land. To allow the construction of a new building to begin meant that initially HC had to lease land from Krakovets Autoport.

In turn this required formal approval for a change in land use. However, the absence of an official land register in Ukraine means that the approval process for such changes are subject to a multi-stage decision making process involving local stakeholders (Krakovets Autoport, YESZ Development and Management Board, Yavoriv Regional State Administration) the local community (Krakovets Village Council) and the relevant central authorities including the State Property Fund. This process has no pre-determined timescale attached to it and can also be risky and uncertain from the investor perspective. However, it allowed HC to proceed with its plans.

SEZ Registration

The registration process for YSEZ membership ultimately required approval by the Ministry of Economics in Kiev. A key part of the regulatory requirement involved the preparation of a detailed business plan setting out the company's investment plans, the related level of investment, the jobs to be created, the wage levels to be paid and the value that would be added. The process also required HC to sign a commitment to deliver these benefits.

HC's new facility was formally opened in September 2004. The start-up process including initial fact finding took 19 months. The facility currently employed around 50 people in early November 2004. This is expected to rise to around 200 over the next six months or so.

Investor Support Mechanisms

Once the decision to invest had been taken, local private sector consultants played an important role in helping HC manage the regulatory issues which had to be addressed. In addition to understanding the local business culture, private sector consultants also provided business advice, legal advice and introduced HC to key local contacts, especially in the public sector. HC were especially fortunate as the main local consultants that were used, also happened to be Danish, thus ensuring effective communication at all times.

The help and support from the Vice-Chairman of the Lviv Oblast was also a key factor which enabled HC to overcome several major regulatory hurdles which could have undermined the investment project which HC envisaged.

Future Issues

At the time of interview, most of the operational side of the project associated with HC initial investment had still to be rolled out. There is, accordingly, an immediate aftercare need around the bedding down of the initial project to ensure that project roll-out is fully efficient and kept on schedule. This is important in order to ensure that the planned number of jobs associated with HC's investment are fully realised.

The consistency and transparency of the Ukrainian regulatory environment are likely to remain key areas where future improvement is needed. HC has formal and informal channels which allow it to express its views to government. However, the effectiveness of these channels should be regularly reviewed in the light of experience, as existing channels may need to be further enhanced or new channels found and developed.

Local authorities within Lviv Oblast need to appreciate fully the type of business which HC represents. HC has sister plants elsewhere in Central Europe and where follow-on investment is mobile and contestable, future expansion may not be guaranteed. Accordingly, local authorities should be alert to the operational and strategic needs of HC going forward to ensure that HC operations in Lviv Oblast are well supported and fully competitive and therefore able to attract follow-on investment.

Case Study After-Word

This note was prepared following OECD's return visit to Lviv in July 2005. This was a brief visit to feedback the main findings from our study tour in November 2004. During this visit we were briefed by Holger Christiansen (HC) on recent policy changes which impacted directly on the company's investment plans and intentions for the company's business in the Ukraine. This note summarises the main points which emerged from the meeting.

Following an announcement by the new Government in 2005 year's Budget, the business benefits of establishing on a Customs Free Area within a Special Economic Zone were unexpectedly cancelled with immediate effect (1st April, 2005). The Government's reasoning for this included:

- the urgent need to achieve a better balanced national Budget in fiscal year 2005/2006;
- ending criminal activity which had based itself in SEZ's in eastern Ukraine; and
- the negative displacement effects which SEZ's have had on investment at Rayon level elsewhere in the Ukraine.

Tax and duty exemptions on imported capital equipment which constitute part of business equity and showing as capital assets on the balance sheet of any new investor were similarly withdrawn.

This change effectively undermined the basis of HC's decision to establish operations in the Ukraine as the substantial benefits which accompanied "Customs Free" and "SEZ" status were guaranteed under the previous Government and had been fully factored into HC's business plan. This had the immediate effect of adding 30% to the company's operating costs and the cost of capital in the first full year of operation in the Ukraine.

At the time of the Government announcement, HC was carrying 2 months inventory which has since been processed. This also forced HC to immediately cancel the import of all future planned shipments. In July the 80 staff employed by HC had to be sent home on three weeks paid leave. Plans to double the manufacturing capacity in the second half of 2005 and expand the workforce to 200 people were shelved.

Chart 2. Holger Christiansen - Dateline of Overseas Expansion

Sales Units

In 1985 the company's first foreign subsidiary was established in Nottingham, England, under the name Holger Christiansen UK Ltd.

On 1st January 1990 the subsidiary in Siegen, Germany, opened under the name

Holger Christiansen Deutschland GmbH.

On 1st January 1994 the subsidiary in Etten-Leur, Holland, opened under the name

Holger Christiansen Benelux B.V.

On 1st October 1994 the subsidiary in Örebro, Sweden, opened under the name

Holger Christiansen Sverige AB.

On 1st October 1998 the subsidiary in Olivet, France, opened under the name of

Holger Christiansen France SARL.

On 5th September 2001, Holger Christiansen Italia S.r.l opened in San Lazzaro di Savena/Bologna, Italy. 2001

On 1st September 2002 the subsidiary in Atlanta, USA opened under the name

Holger Christiansen North America Inc.

Production Units

On 1st January 1991, the production company Holger Christiansen Production GmbH in Rothenfels, Germany was taken over.

On 1st March 2000, the production company Holger Christiansen Production, Slovakia s.r.o. opened in Senec, Slovakia.

In September 2002, a site of 20 000 m² incl. buildings of 4 500 m² was acquired in Bernolakova, Slovakia and Holger Christiansen Production, Slovakia s.r.o. moved to this location.

On 1st October 2003, construction of the plant began in Ukraine under the name Holger Christiansen Production Ukraine 2003. The plant was formally opened in September 2004.

Source: Company Web Site.

The company advised the Deputy Minister in the Ministry of Economics of the difficulties directly. Two months after their approach, HC received a response from the Deputy Minister informing HC that he was unable to help in this instance. Up to July no other help has been forthcoming from the public sector. The company, with the help of local consultants, has had to take the initiative. This has involved revisiting the existing Ukrainian legislation to identify possible temporary solutions which will allow HC to re-start its business.

In July 2005, two basic options were being explored:

a) Altering the HC business model to take better direct advantage of the existing rules on "Active Processing". Rather than reconditioning, this could, for example, involve the importation of used components for re-assembly into starters – this option would leave parts of HC manufacturing capacity underutilised and would also require new approvals from the Customs Authority. However, if approval can be achieved at the local level under the delegated power and authority which exists on import contacts of up to $500,000 this could provide a way forward. If however, local officials feel unable to decide on whether such approval can be given, the matter is likely to be referred to central authorities and the Ministry of Economics for an "expert ruling" which could take up to 2 months – a timescale which will place the project in jeopardy.

- Moreover, under Active Processing rules, VAT is collected then refunded to businesses. A major worry and concern of using the AP model in the current political climate is the uncertainty as whether, when and how much VAT will be refunded. It is understood that because of other spending commitments and priorities, the Government has little or no money to repay VAT to business.

b) Obtaining a temporary decree/ruling from the Customs Authority under the current "Repair Regime" legislation. Under the "Repair Regime" a single product code is used for the purposes of determining the appropriate tariff rate which would otherwise be applied. This would enable HC to import used starters for remanufacture but not the spare components which HC also needs for its original business model to be optimised. Under that model spare parts comprise 50-60% by value of HC imports and 80% of the import duty paid.

Our understanding is that Leoni has also been greatly affected by the unexpected changes announced by the Government. For example, Leoni is paying around $2 million a month extra in VAT, a sum which was not allowed for in its original cash flow projections for its new investment at Stryj due to the unexpected nature of the Government changes.

CASE STUDY 2

Leoni AG[5]

Leoni AG is one of world's largest and longest established manufacturers of wire, cable and wiring systems. During the 1990's Leoni transformed itself from a mid-sized German company into a large international business with global reach: as at September 2004, Leoni employed 28 177 people in over 60 facilities and subsidiaries in 22 countries.

In the year 2000, sales reached EUR 1 billion for the first time and sales have subsequently maintained this level despite market turbulence. The automotive industry accounts for around 75% of Leoni's group sales and Germany is the single largest market accounting for around 47% of group sales in 2003.

The present corporate structure was introduced in 1999 and comprises three separate business divisions: Wire (730 employees), Cable (4643 employees) and Wiring Systems (22 664 employees). Each business division respectively accounted for 7%, 41% and 52% of external group sales in 2003. In particular, the Wiring Division is dependent on a relatively small number of key customers including: General Motors, Daimler Chrysler, Porche, BMW and Rover. The new plant at Stryj in the Lviv Oblast of Ukraine is part of the Wiring Systems Division.

The key basic inputs to Leoni's business supply chain include copper, insulation materials, fibreglass and plastics. A second major group of materials, used in the Wiring Systems Division, includes plastic castings and metal contacts used in connection systems.

Staff numbers grew by 40% in the year to 30th September 2004. This is largely due to the rapid build up of staff to support the scale-up of production at the Wiring Systems Division facilities in Ukraine, Slovakia, Romania, Poland (see below) and Egypt. The proportion of Leoni staff employed outside of Germany is now over 90%.

Leoni's Central and Eastern European Growth Strategy

Strong dependence on the automotive industry has shaped Leoni's overall growth strategy. Reliance on a relatively small number of important car manufacturers (whose production and assembly lines operate on a just-in-time basis) means that of necessity Leoni must work very closely with these key customers. Accordingly, Leoni's aim is to achieve long-term growth by constantly reducing costs and delivery times and improving quality in line with customer requirements.

To help meet these aims and in order to maintain close relationships, Leoni involves key customers in its location strategy and site selection. This is formally recognised as part of the company philosophy and approach (see, for example, Location Risks, Leoni Annual Report 2003, Pg. 26).

In large part this philosophy also accounts for Leoni's entry in to Central and Eastern Europe – a process which started in 1992 and continues vigorously today. Two main phases of investment are evident. The first phase started in the early 1990s and was largely driven by the expansion and upgrade of Leoni's cable and wire businesses and focused on new locations in Central Europe: eight new manufacturing have been established in Hungary, Poland and Slovakia (see Chart 3).

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5. The author is grateful to Ralf Singmann of Leoni Bordnetz-Systeme (www.leoni.com) for the input and advice provided without which this case study could not have been prepared. The views expressed remain those of the author.

The second phase of investment which continues today is primarily focused on Eastern Europe and the next wave of countries which are likely to accede to EU membership. The key locations are in countries which border the recently expanded EU. Much of this investment is being driven by the need to expand the production capacity of Leoni's Wiring Systems Division in response to the needs of key customers in the automotive industry.

Key milestones associated with this phase of investment include:

- The laying of the foundation stone for Leoni's new wiring systems plant in Stryj, Ukraine (2002).
- The laying of a foundation stone for a new wiring systems plant in Bistrita, Romania (2002).
- A new dedicated Systems and Tools Unit[6] was established within the Wiring Systems Division in 2002.
- The formal opening of Leoni's wiring systems plant in Stryj, Ukraine – the biggest manufacturing project in Leoni's history (2003).
- The start of construction work on a second wiring systems plant in Ilava, Slovakia (2003).
- The opening of second wiring systems plant in Bistrita, Romania (2003). This plant was set up in record time.
- The ground-breaking ceremony in Mukachevo[7] for a second wiring systems plant in Ukraine (2004).

Cable harnessing is the primary activity undertaken in these facilities. After the engine, gears and drive shaft, cable harnesses are the components which add most value to cars and commercial vehicles. The cable harnessing undertaken by Leoni's Wiring Systems Division is typically carried out by 2000 to 3000 people in production facilities of 30 000 to 40 000 square metres floor space – and can involve an investment of up to EUR 40 million.

In particular, much of Leoni's recent rapid expansion in Eastern Europe is tied to the new model launches of leading automotive manufacturers. This includes the creation of additional cable harnessing capacity in Stryj (Ukraine), at Bistrita and Arad (Romania) and at Ilava (Slovakia) for the new Opel Astra and Zafira (General Motors), the new Mercedes A-Class (Diamler Chrysler) and the new BMW 1 Series. Although these facilities appear to undertake similar functions and activities, each has a distinct product/customer focus: the facilities at Stryj, for example, are dedicated to the production of cable harnesses for GM's new Opel Astra and Zafira.

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6. The purpose of this unit is to enhance the co-ordination of activities between Leoni's cable harnessing facilities and their suppliers (both inside and outside of Leoni). This unit brought together the previously separate functions of procurement, materials management and logistics.

7. Leoni's recent decision to establish a new facility at Mukachevo in the Ushgorod Oblast is independent of the strategic decision to establish at Stryj. This decision has been driven by price pressure from Leoni's customers. The location decision in favour of Mukacheyo was dictated largely by the short distance to Leoni's Hungarian plant which Mukachevo will support and the presence of too many near competitors in Romania.

Leoni's Investment in Lviv Oblast

Following ground work undertaken in 2001, Leoni's Wiring Systems Division announced on the 30th January 2002, its intention to invest EUR 40 million in a new cable harnessing facility which would be built at Stryj in Lviv Oblast in Ukraine. When complete this investment is expected to create over 4000 jobs: this will make Leoni the largest foreign direct investor in Ukraine to date. Work on the new location with its production area of 35 000 square metres and office space of 10 000 square metres was completed by mid-2003 - on schedule. As at November 2004, there were 2030 people employed directly on-site.

The Stryj facility makes cable harnesses for GM's new Opel Astra and Zafira. An initial production run was set up in rented halls in the first six months of 2002 to allow recruitment and training to get underway. Mass production of the Astra started in 2004. When the plant is finally completed, the production run is expected to reach 42 000 cable sets per day.

The Stryj operations are 100% import/export. Given the just-in-time philosophy of its key customers, transport and logistics was a key criterion in choosing the Stryj site which is close to Ukraine's western border with Poland and near to a trunk road: the manufactured parts need to be delivered to Opel's final assembly points in Western Europe (Eisenach, Bochum, Antwerp and Ellesmere Port). Ukraine as a whole also offered an attractive wage structure, a qualified labour force and - with particular respect to the designated site in Stryj - strong support from local government and the municipal authorities.

Investor Support: Key Issues

This section highlights the key investor support issues which Leoni faced after the Stryj investment decision had been taken. These emerged during initial face-to-face interview and subsequent e-mail exchanges with senior management at Leoni who were directly involved in the Stryj start-up. These issues are presented in rank order of importance from most important to important from the investing company perspective:

Customs and Excise

Given that Leoni's operations at Stryj are 100% import/export, customs regulations have a major bearing on the viability of the basic business model. Leoni wished to identify a legal and proper solution for its operations which would be "customs free". Initially, Leoni explored the possibility of a bonded warehouse being established but discovered that Ukrainian regulations prohibit active processing in such circumstances.

The solution which emerged is adapted to the needs of the customs authorities and based on the model of a raw materials business operation. This model is apparently widely used by the authorities for processing companies which export from Ukraine. The approval process took two years. During this time Leoni paid full VAT and duty on all its operations. According to Leoni, customs and excise regulations are the main obstacles to further sustainable growth.

Tax and Social Security

Leoni obtained no tax relief on their new Stryj operations. However, the inconsistent application of specific tax rules was identified as an issue which materially affected the efficient day-to-day running of the business. Furthermore, the relevant paper work and documentation was also highlighted as being inadequate and often opaque. Bureaucrats tend to penalise any mistakes which may have been made in the completion of documentation in their judgement, by charging higher fees.

Recruitment and Training

Local advertising was sufficient to attract the required number and level of skills at the operative level: cable harnessing is intelligent piece-work and the skill mix is analogous to that needed in textiles. Leoni's needs have largely been met from the pre-existing pool of textile workers which exists in the north west of Lviv Oblast. The lack of suitable consultants has meant that there has been relatively little use of outside trainers to support the company's training of first-line supervisors.

Building and Land Approvals

This was a much more extended process for Leoni. It was managed primarily through an office of Lviv-based construction contractors. This enabled the plans of Leoni's architect to be cast according to Ukrainian standards. Leoni initially leased then purchased the land for the new production facility at Stryj. The land and building regulatory procedures required 23 approvals from the different authorities involved. There were particular difficulties encountered in relation to power supply. However, none of these procedures caused the investment schedule to be delayed.

Anti-competitive Practices

Leoni encountered this when work tenders were put out locally and there were only one or two responses, when more might have been expected. This has given rise to the suspicion of price fixing amongst local sub-contract and service providers

Business Registration

This was the first regulatory process to be undertaken once Leoni had taken the Stryj investment decision. Application was made in February 2002 and it took ten days to successfully complete.

Investor Support Mechanisms

Leoni had very little comment to offer on private-sector support mechanisms. Where these exist, they are mostly unable to support a large investor such as Leoni because they lack the competence and expertise or are under developed. More often than not the type of support needed is simply non-existent. The only positive examples cited by Leoni were the support received from Lviv-based consultants regarding building and land approvals, and training.

The personal interest which the President of Ukraine took in this project ensured that the bureaucracy acted with integrity and in an appropriate manner. The strongest direct support, however, came from the Vice-Chairman of the Lviv Oblast and the Head of the Stryj Ryan. Indeed, the former headed up a project group within government to mobilise the necessary co-operation and support from public-sector service providers and to facilitate necessary meetings and discussions with the relevant central authorities in Kiev. The involvement of the Vice-Chairman of the Lviv Oblast, for example,

was integral to securing the necessary central approval for Leoni to operate under procedures which are "customs free".

The Future Need for Strategic Aftercare

The presence of subsidiary plants of similar size, age and function in different East European countries, the use of well-established standard working practices and procedures across similar plant subsidiaries; and the systematic generation of cross-border and cross-divisional flow of key management information via the new Systems and Tools Unit implies that Leoni will have a greatly enhanced capacity to generate reliable plant performance metrics for comparative purposes.

The more intense inter-plant competition which could result could further enhance Leoni's system for prioritising and allocating capital for strategic investment in its manufacturing subsidiaries. Such a development will reinforce the need for pro-active aftercare policies by the countries and regions in which these subsidiaries are located including Stryj in Ukraine.

Chart 3. Leoni Expansion in Central Europe 1992-2002

• New wiring harness facilities established: – in Hungary (Leoni Hungaria, Eger,1992) – in Slovakia (Leoni Autokabel Slovakia, Trencin, 1993); – and in Poland (Leoni Autokabel Polska, Ostrzeszow, 1995) and
• New cable production and mobile-phone car-kit assembly operations established: – in Slovakia (Leoni Slovakia, Nova Dubnica, 1992; and Leoni Cable Slovakia spol. s.r.o, Stará Turá (Slovakia), 2000); – in Poland (Leoni Kabeltechnik Polska, Torzym, 1993); and – in Hungary (LKH, Leonische Kabelwerke Kft. Htavan, Hungary, 1997).
• New wiring production in Poland (Leoni Draht Polska Sp. z o. o., Kobierzyce and Leoni Kabel Polska Sp. z o. o., Kobierzyce, 2000).
• A new, state-of-the-art wire and cable plant was opened in Wierzbice, Poland in 2002.

Source: Company Web Site.

Main findings and recommendations

The Significance of Strategic Aftercare

There are many reasons "in principle" why aftercare policies can be expected to play an increasingly important role in the economic development of Lviv Oblast of Ukraine: in the main these are derived from the economic development benefits and place marketing benefits associated with aftercare and the anticipated growth trend in foreign direct investment.

It is the main contention of this report, however, that if the net economic benefit is to be maximised over the long run, then from inception the policy focus in Lviv Oblast should be on the provision of aftercare services which are targeted on the needs of "strategic foreign investors" where the related flows of direct investment are most likely to be mobile and contestable across national borders.

"Strategic foreign investors" are defined by a number of traits which enhance the contribution to local economic development. For example, relative to the existing business base (domestic and foreign owned), strategic foreign investors have (or have the demonstrated potential to develop) a number of important traits which contribute to economic development. These include some/all of the following:

- High export intensity.
- High local content in the product/service produced.
- Low import intensity.
- High pay and productivity.
- Limited displacement effects in key local markets (both final and factor).
- Ability to promote, rather than constrain, host-country competition.
- The ability to support high value-adding functions.
- Ability to develop strong strategic linkages locally.
- High levels of innovation: introducing new products and opening up new host-country markets etc.

Strategic FDI will also tend to align well with priority industries and sectors identified by government. And strategic FDI will also help to stimulate the development and upgrade of a) key aspects of local infrastructure (e.g. promote the modernisation of transportation and telecommunications etc.); b) key factor conditions (e.g. the formation and provision of key skills, the development of appropriate sites and property, specialised funding etc.); and c) capacity building amongst key local institutions.

But Is Strategic Aftercare Relevant in the Ukraine/Lviv Oblast Context?

In the context of Eastern and Central Europe, the evidence presented in this report (e.g. on the progress of market reform, the size and make-up of FDI stocks, the strength of FDI flows, the relative attraction of Ukraine as a host location etc.), indicates that as a market for strategic FDI Ukraine is just emerging.

Moreover, while the Cabinet of Ministers has announced the intention to establish a national IPA for Ukraine, its core functions are not yet known and its organisation has yet to take shape and become operational.

Thus, in the absence of a) an installed base of strategic inward investors and b) a suitably empowered and resourced national IPA which is fully operational both internationally and at the oblast level, "strategic aftercare" in Ukraine is a national policy whose greatest relevance and potential still lies in the future.

Though growing on a year on year basis, FDI remains a relatively minor component of the Lviv Oblast economy and the FDI position there is broadly typical of Ukraine as a whole. The bulk of FDI which exists is in small and medium-sized joint ventures and a few larger acquisitions – the latter often involve established Ukrainian businesses in traditional sectors such as food and drink, textiles etc.

A key characteristic to note, however, is that both types of FDI are largely oriented towards the domestic market in Ukraine. As such, this type of FDI is formally classified (see Dunning, 1998) as "market seeking" and single-country oriented. Such investment tends to be relatively immobile and non-contestable across national borders. Thus, under the definition and criteria used in this report, these types of FDI would not be regarded as strategic and are best supported by quality business development programmes - which would normally be available to all businesses regardless of ownership.

Developing the above point, we note from the OECD study tour that a number of organisations already have an important role in business service provision and that a number of models and approaches have begun to emerge in Lviv Oblast. The current network of service providers includes a number of banks (e.g. Kredyt Bank, *www.kredytbank.com.ua*), business consultants, embassies and consular activity, and other intermediaries (e.g. The European Business Association, (*www.eba.com.ua*); Lviv Development Project, (*www.ldp.lviv.ua*) and NewBizNet (*www.bsc.lviv.ua*) etc.).

In the absence of a well defined national policy and approach, Lviv Oblast State Administration also has a potentially key role to play in promoting the development of comprehensive business services which are of high quality and easily accessed on a regional basis.

Such a development will enhance the attractiveness of Lviv Oblast as a business location and strengthen its regional competitive advantage. Specifically, the oblast authorities can help promote the development and exchange of best practice, monitor service quality, highlight where wasteful duplication of services exists, and promote a service pricing policy which is fully competitive and transparent.

However, the OECD study tour helped identify two recent foreign investors, **Leoni Wiring Systems** and **Holger Christiansen (HC),** where the local investment demonstrated a significantly different set of characteristics from the general FDI pattern evident to date in Lviv Oblast: both projects are relatively recent arrivals; both are well above average in terms of the size of investment; both serve the European automotive market; both operations are 100% import/export; and both subsidiaries have sister operations in other countries which could compete for new investment within the company. For Ukraine and for Lviv Oblast these projects are "strategic green-field investments" which may well represent the leading edge of a new investment trend and the shape of things to come.

These investment projects, and the presence of a significant but unspecified number of Danish textile companies which we believe are also export oriented, means that a starting point now exists for the development of an investor aftercare approach in Lviv Oblast which is customer focused and truly strategic.

What are the Key Lessons from the Czech, Irish and Scottish Experience[8]?

Czech Republic

As a Central European economy in transition the experience of the Czech Republic (CR) is especially instructive for Ukraine and Lviv. The CR demonstrates the progress that is possible and the type of steps which need to be taken. Today the CR has reached a stage of development which well meets the conditions for the development of strategic aftercare services:

- A large installed base of foreign investors has grown in the CR and this includes a number of large strategic investments.
- With over ten years experience, CzechInvest, is now recognised as one of Europe's most successful IPAs.
- CzechInvest is itself now more deeply engaged in the process of becoming a more fully integrated economic development body with national level responsibilities.

The professional approach of CzechInvest to investor aftercare is reflected in a number of operational strengths including the establishment of a dedicated aftercare unit, well defined overall aims, a well defined customer base, a targeted approach, a pro-active company visit programme, close linkage between the aftercare unit and the Marketing Department in CzechInvest, and the use of a performance measurement system which links activities to outputs. Moreover, building aftercare around the existing scheme of national financial incentives lends coherence to the Czech approach to aftercare. Investors also appreciate the "can do" attitude of CzechInvest, its responsiveness and its flexibility. This contrasts with investor experience of other central government bodies in the CR. As such CR can help shape the challenging process of changing bureaucratic cultures which can appear at times to be excessively rigid, inflexible and difficult to work with from an investor perspective.

However, aftercare services in the CR remain an enabler of FDI, not a driver: survey evidence indicates that in most cases foreign investors feel they would expand without CI aftercare services as other more important factors are involved. Moreover, the significantly lower performance weighting within aftercare of "structural issues" and "expansion activity" compared with "client hand-holding" also suggests that aftercare policies focused on long-term economic development have yet to emerge.

Ireland

The organisational structures which support the Irish model of economic development exhibit a high degree of co-ordination and integration within and between the key public sector bodies concerned at the national level. The work of the IDA lies at the heart of this effort.

Perhaps the most pronounced features of the IDA are: its strategic approach, integrated service delivery and its flexibility: the IDA is constantly moving its focus and direction in response to a) the economic development challenges and needs which Ireland faces b) the changing nature of foreign direct investment globally; and c) the changing needs and structures of global business.

These features are fully reflected in the IDA's approach to aftercare which has assumed an increasingly high priority in IDA thinking over the years. Perhaps the most interesting aspect of the IDA approach is the eight-stage model of foreign subsidiary development which has been adopted. Each stage provides a customer-led focus for the delivery of a comprehensive range of strategic

8. See Annexe II for the full description of Irish, Scottish and Czech FDI aftercare experience.

aftercare services which are tailored to the development needs of local subsidiaries. The IDA recognises, however, that this model is only a characterisation and that there are also many exogenous factors which can influence subsidiary development paths.

That said, the IDA view is that most foreign subsidiaries can be positioned within this framework and that in many cases it will be possible to pro-actively manage a transition from one stage to the next. This model is also seen as a useful learning tool to help introduce the concept of local subsidiary development to managers in overseas corporations from an economic development perspective. It also helps the IDA executives and Board agree what represents a valuable outcome from this development process. From the parent corporation perspective, each stage represents a greater ability of the foreign subsidiary to add to the global company's value base.

The strength of the IDA's approach, however, needs qualified on at least two accounts. First, trade promotion and export support is a responsibility of the IDA's sister body, Enterprise Ireland. Thus, an important aspect of the outward international business development of the local subsidiaries of foreign investors, (many of which are highly export oriented), does not formally come under the aegis of the IDA. In this sense the IDA approach is neither seamless nor fully integrated. Secondly, the general applicability of the model of subsidiary development and the robustness of its empirical underpinnings perhaps needs more rigorous testing in the light of other non-Irish evidence on the prevalence of significant subsidiary upgrading in host economies (see, for example, Peters E. 2000).

Scotland

As an administrative region within the United Kingdom, albeit with considerable devolved powers, Scotland has one of the largest, most active and successful investment promotion networks in Europe. As such, the Scottish model has particular relevance for Lviv Oblast. The pursuit of pro-active aftercare policies have been an important component of Scotland's success: this has allowed close long-term relationships to be forged with strategically able managers in the Scottish subsidiaries of leading foreign investors. Strategic aftercare, with its greater focus on leveraging asset-augmenting investment has also contributed significantly to the enhancement of the innovative capacity and capability of the Scottish economy.

The evolution of aftercare support in Scotland holds a number of practical lessons. These include:

- The importance of segmenting the client base in order to identify the key local subsidiaries and subsidiary managers which offer the best prospects of leveraging the greatest long-term economic benefits; this also enables scarce resources to be focused and tailored to need.

- The strategic importance of developing and maintaining close relationships with each subsidiary manager.

- The significant challenge of establishing new working practices and leveraging resources for aftercare within Locate in Scotland (LiS) Glasgow and on a network-wide basis – when additional resources are scarce.

- If the desired level of flexibility is not achieved, the adoption of smart working models, such as matrix management on a functional basis, can not in itself guarantee productivity gains and win-win outcomes.

- Enhanced understanding how leading foreign investors can help other businesses to scale (via supply-chain development and/or technology transfer, for example), and open up significant export opportunities.

A key challenge in Scotland has been securing wider-ownership of aftercare throughout the Scottish Enterprise (SE) network. Progressive embedding within the SE network and fuller integration with business development activities has ensured that aftercare support is now much more of a shared responsibility across the SE network, rather than the narrow responsibility of dedicated aftercare staff in a single specialist unit. The next step in this progression is expected in the near future when the present aftercare responsibilities of Scottish Trade International (STI) will be fully integrated into enhanced Scottish Development International (SDI) sector teams[9].

Preparing for Strategic Aftercare in Lviv Oblast

In this section we define an aftercare entry point for Lviv Oblast based on the main models of aftercare identified by Young and Hood (1994). This research identified four main models of aftercare which were used to explore the implications for investor targeting, the time-frame and focus, the type of service provision and the pros and cons of each approach. Taken together, these models provide a framework where thinking on aftercare can be developed on a more formal and systematic basis.

These models are:

Model 1 - The Company Friend:

This is a minimalist approach, providing limited operational support, trouble shooting, and help with regulatory compliance. Support tends also to focus on large or high profile investors mainly over the first two years after start-up.

Model 2 - Project-based Aftercare:

This approach does not attempt to be fully comprehensive. Aftercare resources are directed to specific operational aspects of subsidiary activity such as supplier development or training and recruitment, manufacturing services, R&D etc. Timescales reflect the requirement of the specific project/initiative.

Model 3 - The Aftercare Team:

Here a dedicated resource provides a "single door" for aftercare. The approach tries to provide more comprehensive support to as many foreign investors as resources will allow and is concerned with long-run outcomes. The aftercare team could be organised generally by investor geography or more specifically by sectoral specialisation, large and small firm specialisations or a distinction between strategic and operational issues. With broad spans of responsibility, team size usually becomes an issue of careful deliberation as does the related matter of co-operation and possible integration with other related public sector activities.

9. These teams will provide support to Scottish-based businesses (regardless of ownership) on all aspects of their international development. This will encompass both trade and investment promotion and support, and as such, represents a fully integrated approach to international business development. The model is most probably a first of its kind.

Model 4 - An Integrated Approach:

This approach sees aftercare as a key component of a comprehensive plan for economic development focused on levering strategic economic benefits over the long run. The approach demands a high level of co-ordination within and between the different public sector bodies involved in economic development. Responsibility for investor aftercare becomes shared and more deeply embedded in the wider enterprise network as the relevant activities become more fully integrated across organisational and divisional boundaries.

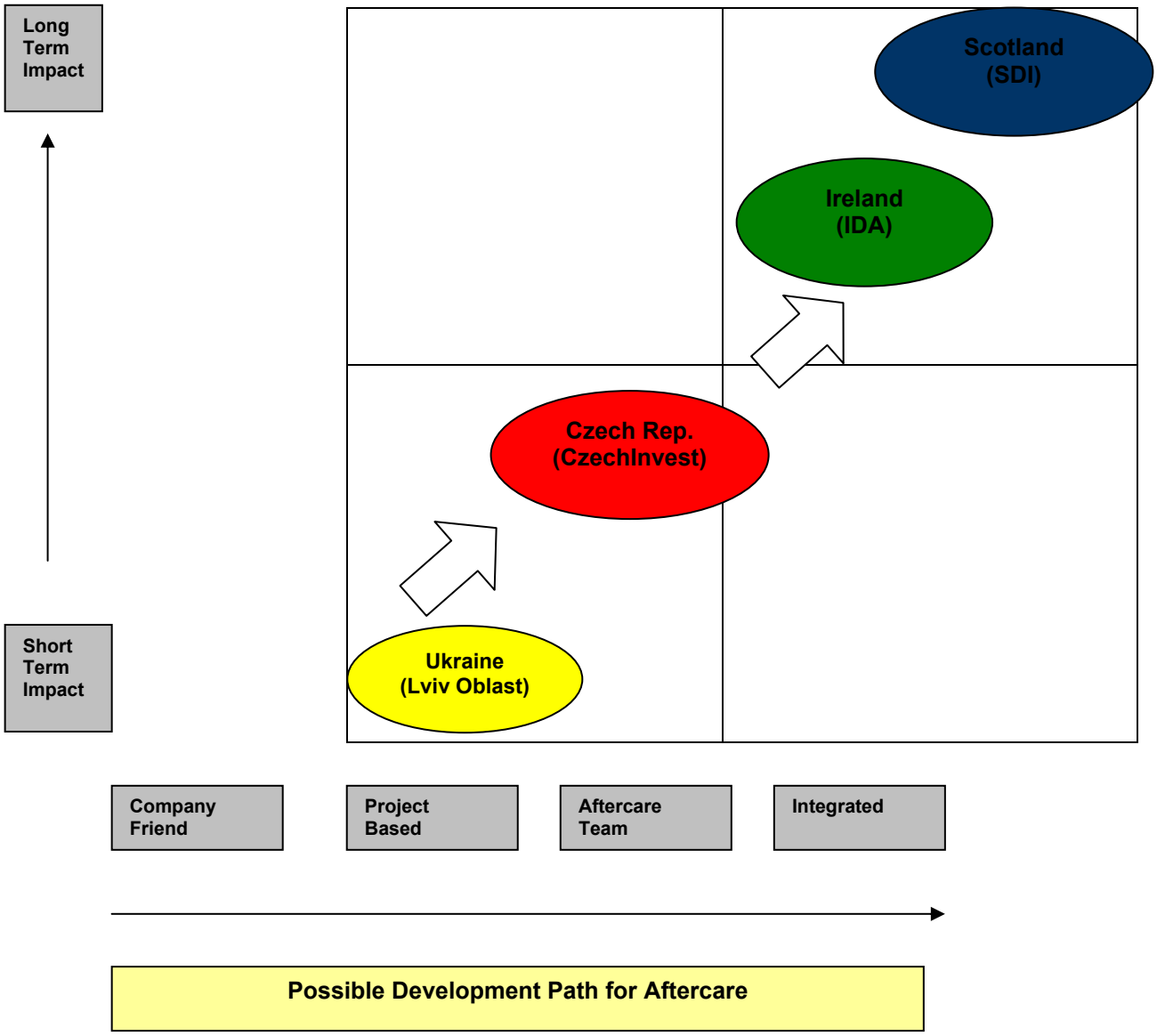
All four models represent discrete approaches. However, looked at differently, they could also represent a progression along a spectrum of aftercare support. For example:

- Model 1, the start of the spectrum, represents a basic approach to aftercare which is partial and selective and focused primarily on relatively short-term benefits.

- Model 4, the top of the spectrum, represents an advanced, comprehensive and fully integrated approach to aftercare, focused on levering strategic economic benefits over the long run.

With Lviv Oblast in mind, it is also interesting to note that substantial parts of Models 1 and 2 can be implemented at regional level (and below) without reference to, or dependence on, a national framework. Moreover, both these models represent options which are the least costly (and least resource intensive). Based on this framework (and the case-study evidence reviewed previously), Chart 4 portrays the stage of development on the aftercare spectrum which the Czech Republic, Ireland and Scotland have reached. It also indicates the likely entry point for Lviv Oblast.

CHART 4. Development of Strategic Aftercare and Economic Impact



Next Steps for Lviv Oblast

Most of the lessons gleaned from the country aftercare case studies relate to a future when the FDI policy context in Ukraine is more fully developed and Ukraine has a larger stock of strategic investors. In preparing for that future, there are, however, steps which the State Administration should consider taking now. These are set out below.

The New Investment Promotion Agency (IPA)

The Lviv Oblast State Administration needs to be fully informed of the plans to roll out the new IPA for Ukraine and to understand:

- The timescale for organisational development.
- Whether aftercare will feature as part of the IPA's responsibility.
- How the IPA will relate to the regions of Ukraine etc.
- Whether new resources and capabilities will be made available for aftercare at the regional level.
- The implications for existing foreign investors in Lviv Oblast.

A Pioneering Role for Lviv Oblast

In the meantime, if there is any delay in the role out of the IPA, a policy vacuum could result. In these circumstances, the Lviv Oblast authorities could/should consider taking positive steps to begin the formal process of introducing good aftercare working practices. In turn, the emerging modus operandi could be used as an exemplar for other regions and contribute to the policy thinking of the new national IPA.

In this context the Lviv Oblast State Administration should also seek out more detailed guidance regarding protocols for establishing and promoting best practice in investor aftercare services. This would give practical guidance on such issues as: how to set up a modern investor database and customer relations management (CRM) system, how to target existing foreign investors and how to set up and undertake aftercare visit programmes. This advice is readily available form a number of para-statal organisations such as the *Multilateral Investment Guarantee Agency (MIGA)*[10] The MIGA provides a range of relevant services including advice on best aftercare practice and some of this is available at *www.fdipromotion.com*.

A Preferred Model of Aftercare for Lviv Oblast

We recommend that Lviv Oblast adopt a strategic aftercare approach focused on key foreign investors. Moreover, this approach should be based primarily on the "Company Friend" model, suitably modified and adapted to the local operating environment. We recommend that the function

10. The Multilateral Investment Guarantee Agency (MIGA)was created in 1988 as a member of the World Bank Group to promote foreign direct investment into emerging economies to improve lives and reduce poverty. MIGA fulfils this mandate and contributes to development by providing political risk insurance (guarantees) to investors and lenders, and by helping developing countries attract and retain private investment.

responsible for adopting and rolling out this model could/should be located within the Lviv Oblast State Administration. The staff time devoted to support will reflect the size of the target group of investors and the amount of time and effort required to forge and maintain close relationships with key subsidiary managers. Staff should have excellent troubleshooting skills within government and a deep understanding of the needs of international investors. The staff should report directly to the most senior official within the State Administration with the greatest business nous, the best advocacy skills and top-level contacts in the Ukrainian Government.

Key Aftercare Issues to be Addressed

The type of issues which could provide the focus of a company-friend aftercare scheme would include those highlighted as key concerns by existing strategic investors such as Holger Christiansen and Leoni. Accordingly, the consistency and transparency of the application of Ukrainian regulations are likely to remain key concerns going forward where significant improvement is needed from a strategic investor perspective. In this context, the State Administration in Lviv Oblast could act as an additional channel enabling the views of strategic investors to reach the right people in top government at the right time. More specific operational concerns relate to issues such as:

- Customs and Excise.
- Tax and Social Security.
- Building and Land Approvals.
- Anti-competitive Practices.
- Improvements in Transport, Telecommunications and Utilities.

Given the relatively recent arrival of these strategic investors, there is also an immediate aftercare need surrounding the bedding down of the initial projects to ensure that full project roll-out is achieved efficiently and to schedule. This is especially important if the planned number of jobs associated with these investments is to be fully realised. Consideration should also be given to targeting the stock of Danish textile in order to better understand their present needs and to explore their future concerns, so that an appropriate aftercare response can be tailored.

The State Administration of Lviv Oblast needs also to appreciate the type of business that strategic investment represents. Subsidiaries such as Leoni and HC have sister plants elsewhere in Central Europe. As a result, follow-on investment can be highly mobile and contestable across borders, and future expansion may not follow automatically. Accordingly, the State Administration should attempt to forge close on-going ties with these investors. This will help the authorities to be aware of the operational and strategic needs of these subsidiaries going forward and to try to help ensure that their Lviv operations are well supported and fully competitive, and in a strong position to attract follow-on investment.

Moving to the Next Level of Aftercare Support

The above points provide the State Administration with a ready-made rationale for longer-term planning with a view to adopting an approach which more closely resembles the "Project-based Aftercare" approach of Model 2. In the absence of private sector providers, the ability of the local authority to intervene and to give positive support under this model will be limited by its statutory powers. It may be more feasible, for example, to provide support around issues such as recruiting and training skills from the local labour market but less feasible to intervene on issues such as international supplier development.

Scope for Developing Cross-border Aftercare Initiatives

In the context of this report, the scope for developing cross-border aftercare initiatives should be carefully assessed against the needs of strategic investors and the transmission mechanisms and processes which enable their contribution to local economic development to be maximised as quickly as possible.

Given the international orientation of strategic investors the scope of cross-border initiatives embraces a potentially wide range of initiatives which would also enhance local business conditions more generally. These might include initiatives designed to:

- Improve border-crossing infrastructure.
- Enhance the roads and roads maintenance and services of key commercial arteries which cross main borders.
- Improve international air and rail links.
- Simplify and speed up customs control procedures.
- Remove unnecessary barriers to the movement of goods and people.

From the strategic investor perspective, initiatives such as these would help improve businesses efficiency and may enhance the attractiveness of the local subsidiary for re-investment by the corporate parent. These initiatives might also allow the local subsidiary to take advantage of skills in adjacent cross-border labour markets when local skills shortages exist. The local subsidiary might also be encouraged to send more staff on advanced training courses and seminars abroad. The latter would be especially important where local training is not available or inadequate as this would stimulate and promote the more rapid formation of key local skills by another means. Local authorities in adjacent border regions with similar economic structures but with different aftercare approaches could also seek out new and innovative ways to network more closely and exchange on best aftercare practice as part of the creation of a cross-border learning region.

While the powers of local authorities to co-operate on relevant cross-border issues has recently been strengthened by the adoption of the Law of Ukraine "On Transborder Co-operation", many of the most important cross-border issues for strategic investors lie out with the scope of local authorities and require co-operation on cross-border issues at national level. That said, local authorities in Lviv Oblast should try to maximise on the opportunity that exists for cross-border co-operation at regional level which schemes such as the EU's TASIS Programme provide (through its new neighbourhood programmes, for example).

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Main Links

Berman Group *www.bermangroup.cz*

CSES *www.cses.co.uk*

EBA *www.eba.com.ua*

EBRD *www.ebrd.com*

IDA *www.idaireland.com*

J&L Consulting *www.j-l.com.ua*

Leoni Bordnetz-Systeme *www.leoni.com*

Lviv Development Project *www.ldp.lviv.ua*

Lviv State Administration *www.loda.gov.ua*

MIGA *www.fdipromotion.com*.

NewBizNet *www.bsc.lviv.ua*

Scottish Enterprise *www.scotent.co.uk*

SDI *www.scottishdevelopmentinternational.com*

UNCTAD *www.unctad.org*

CHAPTER 4. FDI EMBEDDING POLICIES

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Introduction

Regional governments worldwide are increasingly seeking to attract foreign direct investment (FDI) as an integral component of their core development activities. They are making extensive use of marketing, promotion and investment incentives to influence foreign investors' location decisions. FDI can potentially lead to many local development benefits. In addition to the new jobs and out put that will be generated in the foreign affiliates, there could be multiplier effects resulting from local procurement of materials and services and local spending of wages and salaries and a series of other benefits including technology transfer, upgrading the efficiency of local suppliers, competitors and customers, contributions to local infrastructure and improved labour force skills (Potter, Moore and Spires, 2002, 2003).

Under certain circumstances, FDI could also have negative effects on the host's economy in the form of crowding-out the domestic competition or exploiting local natural resources without concern for the environment. The purely low-wage labour-seeking FDI (e.g. 100% export-oriented projects) is likely to move to other locations when the wage costs increase with the economic development in due course of time.

Therefore, it becomes imperative for a national or regional government to decide what type of FDI it wants to attract and what kind of benefits it wants to derive from such FDI. Much larger benefits of FDI occur in the long-term when it is embedded into the host country's economy. Such benefits include spin-off effects (e.g. emergence of internationally competitive supplier industry) and spill-over effects (e.g. technology diffusion into a wider economy through trained personnel and demonstration effect on local companies to upgrade their technologies to compete with foreign companies).

Embedding of FDI into a host country's economy largely depends on market-forces such as the presence of a competitive supplier industry and institutions with a significant knowledge-base (e.g. universities and national research institutes). However, the embedding of FDI is not an automatic process. Often, either due to the weak supplier network, shortage of skilled personnel, weak support institutions or simply due to the 'inertia' on the part of the foreign investor, such long-term embedding does not take place. Given such uncertainty, government policies, both at the national and regional levels, have an important role to play in deriving larger benefits through FDI by motivating foreign investors to integrate their activities into the local economy. Policies also have an important role to play in minimising the negative effects of FDI.

For instance, one of the efforts to better embed foreign investors involves attracting higher quality investment by targeting activities that are more knowledge-intensive and have a greater local managerial autonomy. Such FDI is likely to have greater local spin-offs than traditional types of operations, which focus on domestic market. The other aspect is to develop programs to better integrate FDI into regional networks of firms and institutions. This could be done in two ways: First, efforts could be made to increase the scale of local linkages of foreign affiliates, both by encouraging foreign affiliates to increase their local linkages by making them aware of the opportunities to do so and also by working with local firms and institutions to bring them up to the standards required by foreign affiliates. Second, efforts could be made to strengthen and deepen the nature of the relationships between foreign affiliates and local firms and institutions, for instance, by encouraging tutoring of local suppliers by foreign affiliates (Potter, Moore and Spires, 2002, 2003).

Based on the practices of leading regional development agencies in various OECD countries, some of the key features of policies for embedding FDI could be as follows (see Potter, Moore and Spires, 2002, 2003, p. 7).

- Local supplier development programs.
- Support for joint research with local universities or firms.
- Provision of customized training programs for foreign investors.
- Identifying local partners for joint ventures/strategic alliances.
- Cluster building initiatives.
- Labour mobility.
- Corporate spin-outs.

This chapter analyzes the regional policies and programs of Lviv regional government (within the framework of national policy) to promote embedding of FDI into the local economy. It draws policy recommendations for the regional and national governments, based on international best practices for better embedding of FDI in the Lviv Oblast in particular and Ukraine in general.

Promoting Embedding of FDI – A Review of National and Regional Policies

Ukrainian investment policies basically do not distinguish between local and foreign investments. They apply the principle of *national treatment* and seek to attract and promote investments from both domestic and foreign sources.

Ukrainian policies with respect to FDI, including embedding aspects, can be grouped into two categories:

1. National legislation – normative and legislative acts or separate provisions which regulate all types of economic activity, including investments. This legislation is applied to both residents and non-residents.

2. Specialised or Sectoral legislation – normative and legislative acts or separate provisions that regulate activities connected with foreign investments.

The general principles and concepts defining and regulating foreign investments, investment activities and foreign enterprises are specified in the Commercial Code of Ukraine. The new Commercial Code, adopted in 2003 defines and regulates enterprises, economic activities and other

aspects of commercial activities. However, there are contradictions between the new Commercial Code and the new Civil Code. Some elements of Ukrainian Company Law contradict the Commercial and Civil Codes.

In addition to provisions of the Commercial and Civil Codes, the specialised legislation, the Law of Ukraine on the 'Regime of Foreign Investment', provides foreign investors with guarantees against expropriation of their assets and permits repatriation of earnings after payment of all taxes. A few additional benefits such as the duty free import of 'in kind' assets (equipment, licenses, etc) as initial contribution to the start-up capital of an enterprise are provided in this law.

In late 2001, the government of Ukraine approved the *Programme for Development of Investment Activity for 2002-2010*. The Programme encompasses all types of investments, including foreign investments. The long-term programme will be implemented in two phases.

In the first phase (2002-2004), the main focus was on liberalisation of entrepreneurship activity; creation of an optimal legislative environment; harmonisation of national legislation with European and world legislation; ensuring political stability and consolidating some governmental authorities; stimulating domestic consumption; stimulating investment in new equipment and technologies; reducing the tax burden, etc.

During the second phase (2005-2010), it is planned to continue to restructure the economy and improve efficiencies by applying new technology and equipment, introducing effective utilisation of energy and material resources, introducing pollution abatement equipment and improving environmental standards, stimulating exports of scientific and high technology products with high level of processing, stimulating development of stock market and capital market instruments, including fostering growth of financial service institutions such as investment and insurance companies, pension funds, etc.

An analysis of the Ukrainian approach suggests that the government's focus is more on legislative aspects rather than policy and strategic issues of attracting and reaping the full potential of FDI inflows. It is not evident whether the national policy has clear objectives for FDI and strategies for optimal utilisation of FDI inflows for national development. Neither the long-term programme on investment nor the legislation covering investments make any explicit reference to long-term embedding of FDI as an objective. Neither the long-term programme nor the investment legislation provide any incentives (other than certain duty-free benefits and guarantees related to expropriation of assets and repatriation of profits) to foreign investors nor impose any performance requirements on them towards achieving embedding of FDI into the local economy. The policy also does not make any reference to the development of supplier networks and institutions that can support FDI projects. Part of the problem lies in the approach to attracting FDI.

The government does not seem to follow a targeted promotion of FDI in areas of relative comparative advantage. Up until early 2005 the core strategy of the government to attract and retain investments, including FDI, relied on the establishment of S*pecial Economic Zones* (SEZs) that provide duty and tax concessions. However, without strong linkages to the areas of national/regional competitive advantage, SEZs may lead to investment diversion from other locations within the country. Locations outside the SEZs may be deprived of potential investment inflows.

The policy of the national government focuses on creating a favourable investment climate and attracting investments into the country as a whole. It is the responsibility of the regional and local authorities to induce the potential investor to invest in their particular oblast or city. Lviv Oblast

because of its geographical position and endowment of natural resources provides relatively better investment opportunities and conditions than many other oblasts.

With the support of the UK Department for International Development (DFID), the Lviv regional authorities have prepared the *Social and Economic Development Strategy up to 2015*. The ultimate goal of the strategy "is to improve the well-being of the population of Lviv Region. The Strategy recognises the fundamental importance of economic development as a principal prerequisite for growth in the personal incomes of those in work and the payment of social benefits to economically inactive categories of people".

To achieve the ultimate goal, the strategic goals are directed "at supporting entrepreneurial initiative, activity and creativity among the people of the region. To achieve this we will create favourable conditions for personal advancement and for the development of private enterprise. This will transform the Lviv Oblast into an even more attractive place to live, a place supportive of competitive economic activity and personal development".

According to the Development Strategy Report, the attractiveness of the Lviv Oblast for investors includes:

- Significant proportion of modern industries in the regional economy and growth in the number of innovative companies.
- Acceleration in the rate of privatisation.
- Intensification of interconnections between science and production.
- Advanced financial services market.
- Highly educated and professionally qualified work-force, cost of labour.
- Rich resource potential.
- Development of a network of scientific research and higher educational establishments with strengthened scientific potential.

The Strategy is formulated into four development goals:

1. 'Lviv Oblast as a region of stable economic and entrepreneurial development' – "Achievement of this objective will help simplify procedures of incorporation and operation of Ukrainian and foreign companies, improve market infrastructure and develop human capital". Among the actions envisaged to meet this goal is to 'enhance cooperation between authorities and business support institutions (creating local business incubators; setting up mutual aid funds and societies, etc.);

2. 'Ukraine as gateway to the European Union' – "Regional authorities will maximise the opportunities connected with the region's proximity to the border and will expand foreign economic cooperation";

3. 'Lviv Oblast as a region with a skilled workforce and innovative potential' – "Objective is to support and enhance the development of human potential and promote the innovative potential of local companies. Local authorities will introduce policies aimed at improving education, supporting science development, and promoting contacts between the scientific research sector and local business";

4. ‘Lviv Oblast as a region with a clean and attractive natural environment, with flourishing culture, tourism and recreation’ – “Objective is to improve the environment and to use the cultural heritage, tourism and recreation potential of the region to enhance the standard of living of the regional people”.

As could be analysed from the Development Strategy, investment, both indigenous and foreign, forms a critical element of the strategy. There is no special treatment of FDI. The focus is more on attracting investment. The strategy does not have any explicit actions to be taken to embed FDI or for that matter even local investment into the local economy to reap the optimal benefit from investments. Such positive actions that are absent in the strategy are the creation of special status for enterprises that establish linkages with the local economy through local supplier development or research co-operation with the local research institutes/universities. However, goals one and three of the Strategy can foster embedding of investments into the local economy in an indirect way. Experience from other countries suggests that the presence of innovative local companies and research institutes and reserves of highly educated personnel tend to attract FDI in higher value added activities that utilise the local innovation system through establishment of long-term relationships.

The regional development strategy aims at improvement of the industrial production structure by defining priority industrial lines for the region and the branches which need technological modernisation and support from the state. But, it does not spell out the mechanism (e.g. special incentives) through which investments can be directed to identified priority areas. The only concession provided is that technology projects do not require a minimum level of investments to be located in the special economic zone to enjoy the benefits provided. The definition of what constitutes a ‘technology project’ is not clear (e.g. type of innovation or value addition) and may be prone to misuse.

At the time of writing, the core of the investment strategy of Lviv Oblast relied on the two Special Economic Zones (SEZs) created by the national authorities in the region, acting upon the initiatives of the Lviv Oblast and local municipal authorities. However, as mentioned earlier, the SEZs may have the effect of *investment diversion* from the other regions of the oblast rather than *investment creation*.

The law on Yavoriv SEZ was adopted in January 1999 and the privilege is granted up to January 2020. The Area combines the functions of the complex industrial area, free customs area and the science-based technological park. All types of business are permitted on the Yavoriv SEZ unless otherwise prohibited by Ukrainian legislation. The SEZ’s subjects are juridical and private persons, branch offices, subsidiaries, divisions and departments, which are located in the SEZ and which realise investment projects with an estimated budget of not less than USD 500 000. However, for the technology park projects there is no requirement of minimum level of investment.

YSEZ was formed for the following purposes:

- To create work activities and job replacement provision for the personnel who lost their jobs with the reduction in production activities of Yavoriv State Ore Mining Chemical and Processing Enterprise.
- To solve ecological problems of the Yavoriv region by means of renewal of lands damaged by the activity of the Yavoriv State Ore Mining Chemical and Processing Enterprise.
- To deliver high-quality competitive goods and services for the internal and external markets which will be produced in the YSEZ.
- To develop and implement advanced technologies.

- To develop an expeditionary transport warehouse and service business on the territory of Krakovets custom motor transport port.

Among the comparative advantages of YSEZ are the following:

- The advantageous geographical location. YSEZ is located on the Ukrainian-Polish frontier near the motorway and railway crossing. A trans-European Transport Corridor crosses it from the West to the East.
- The Krakovets Autoport (free customs area).
- Rich deposits of mineral resources and power base – mineral oil, gas, brimstones, limestone, clay, gypsum and rare minerals.
- Availability of medicinal mineral water of Naftusia and Borzhomi classes, hydrogen sulphide.
- Advanced woodworking industry, wood and timber reserves.
- Scientific and technological park.
- Developed infrastructure, adequate power supply sources to meet industrial demand.

The priority sectors for the park are: industrial technologies, particularly in the chemical industry; production of equipment and machinery; precision instrument manufacturing; control-measuring devices and apparatus; electronics and optical electronics; development and use of modern materials; information technologies; energy production and energy-saving technologies; non-waste and resource saving technologies; computer technologies and telecommunications; means of communication and transport; agricultural and industrial complex; medicine and healthcare, and biological technologies.

Truskavets SEZ was established in 2000 at the foothills of the Carpathian Mountains, where there are several resorts, sanatoria and recreation zones. The main purpose of establishing the SEZ is to stimulate the development of tourism and recreation.

The most common forms of entry-mode for foreign investors are:

- Private company, belonging to the investor.
- Representative office, subsidiary or affiliate of the foreign company in Ukraine.
- Agreement on common activity (when a Ukrainian company has foreign capital for particular projects).
- A foreign investors purchase of some open joint stock company's shares.
- Limited liability with a share of foreign capital in the authorised capital.

In those cases, when the foreign investment comprises not less than 10% of the authorised capital of the enterprise, such an enterprise is defined as an *enterprise with foreign investment*. An enterprise with 100% foreign investment is considered as a *foreign enterprise*. A foreign enterprise is a unitary or corporate enterprise, established in accordance with the legislation of Ukraine, acting only on the basis of the property of foreigners or foreign legal entities, or is an existing enterprise purchased by the abovementioned entities.

There are no requirements as to minimum and maximum levels of foreign investments.

Embedding of FDI in the Lviv Oblast – An Empirical Analysis

Over 50% of the FDI inflow into Lviv Oblast was invested in the food industry, financial activities, transport and trade and agriculture. Over half of all foreign investments in Lviv Oblast came from six countries – the USA, Canada, the UK, Sweden and Germany. With the expansion of the EU to include Poland, cross-border investments picked up momentum. In 2002 and 2003 one-third of all FDI in Lviv Oblast came from Poland. The volume of Polish investments on 1st April 2004 amounted to USD 58.8 million.

Among the most important projects with foreign investments are the following:

- 'Svitoch', a confectionary producing company, in which Nestle of Switzerland invested USD 21.3 million.
- 'Lviv Brewery', a beer and non-alcoholic drinks producing company, in which Baltic Beverages Holding of Sweden invested USD12.6 million.
- 'Lviv Automobile Plant', a company manufacturing buses and automobile equipment, in which Dankar KFT and Farma Market KFT of Hungary invested USD 30.6 million.
- 'Leoni Wiring Systems', a company producing cable networks for motorcars, in which a green-field investment of EUR 30 million was made by Bordnetz Holding of Germany.
- 'Holger Christiansen Production Ukraine', an electrical equipment reconditioning company, in which a green-field investment of USD 1.8 million was made by Holger Christiansen Company of Denmark.
- 'Webasto-Electron Ltd.', an automobile parts manufacturing company, in which a green-field investment of USD 1.4 million was made by Webasto Thermosystems International of Germany.
- 'Krono-Lviv', a woodworking company, in which Krono-Invest of Poland invested USD 9.9 million.
- 'Stryilisoproduct' a woodworking company, in which Leistenfabrik Arnold Deppe and Co. of Germany invested USD 1.5 million.
- 'Svitanok', a wood manufacturing company, in which Western Enterprise Fund of the USA invested USD 1.3 million.
- 'Danish Textile', a clothes manufacturing company, in which PVN Holding of Denmark invested USD 2.3 million.
- 'Kredyt Bank (Ukraina)', banking, in which Kredyt Bank of Poland invested USD 21.3 million and the European Bank of Reconstruction and Development invested USD 8.2 million.
- 'Intertrans', a transportation company, in which ZUKK Trading Limited of Cyprus invested USD 7.0 million.
- 'Ukrainska Hvylya Ltd.', a communications services company, in which Hatwave Hellenic American Telecom of Cyprus invested USD 5.8 million.
- 'Lviv-Petroleum Ltd.', a fuel and lubricant materials realisation company, in which Holnord Trade of the Netherlands invested USD 1.8 million.

- ‘System Consulting Ukraine Ltd’, a company processing brown coal tailings, in which System Consulting of Hungary invested USD 3.3 million.
- ‘Europa Oil and Gas Ukraine’, a company involved in exploration and extraction of natural resources, in which Europe Oil & Gas Ltd. of UK invested USD 1.1 million.
- ‘Ukr-Pak Ltd.’, a packaging producing company, in which Ken-Pack and Pol-Am-Pak of Poland invested USD 5.2 million.
- ‘Dunapak-Ukraina Ltd.’, a company producing cardboard and paper packaging, in which Dunapak Papers & Packaging Ltd. of Hungary invested USD 3.2 million.

A detailed study and analysis of some of the investment projects will provide an indication of the degree of integration of FDI into the regional economy and the methods through which such embedding takes place.

Kredyt Bank (Ukraina)

Kredyt Bank (Ukraina) was formed in 2001, when the West Ukrainian Commercial Bank (WUCB), established in October 1991, was formally acquired by the Kredyt Bank of Poland. It is one of the successful FDI projects from all angles. Earlier in 1998, when the WUCB faced some financial problems, the Polish Kredyt Bank and the European Bank of Reconstruction and Development (EBRD) invested in WUCB. Presently, the total foreign investment in the bank amounts to about EUR 30 million. The Ukrainian capital amounts to only 5.1% of the total capital invested in the bank. The investment by EBRD helps the Kredyt Bank in getting foreign inter-bank loans. Among its services, the bank provides export-import credits, investment credits and letters of credit.

Presently the bank is well integrated into the local economy (see Box 10 below). In addition to the much needed capital, in terms of direct benefits, the FDI brought in new technologies, new organisational methods, a new approach to business and new banking services. The bank introduced new services such as hire purchase, mortgages and insurance services for import-export business. The bank also set up 16 centres to service micro-financing and plans to expand this business. It has set up 33 new branches across Ukraine, including six in Lviv Oblast, to service the retail business. It is in the process of expanding its electronic banking system.

Box 10. Kredyt Bank's Centre for Promotion of Foreign Investments Attraction, Small and Medium Business Development

By far the most significant aspect of FDI into Kredyt Bank was the creation of the 'Centre for Promotion of Foreign Investments Attraction, Small and Medium Business Development' in the Lviv Oblast by the bank in July 2003. Among the main directions of the Centre's activity are:

- Analysis and practical assistance in increase of investment and financial appeal of the clients for potential investors and business partners.
- Consultations on the issues of small and medium business development, investments attraction and financial consulting.
- Consultations and practical assistance in preparation and execution of the business-plans of investment projects and business plans for the development of small and medium businesses (consultations and assistance are provided with the help of the business partners of the bank – investment, consulting, leasing, insurance, auditors and legal firms, CCIs and higher educational establishments).
- Help in investors' search and helping the investors to carry out the investment.
- Promoting the realisation of the Programme of small business lending.
- Training and seminars on the issues of investment attraction, small and medium business development (including participation of the representatives and clients of the foreign banks and managers and officers of the Chamber of Commerce and Industry, higher educational establishments, consulting, investment, audit, leasing and law firms – business partners of the Centre as well as representatives of the Consulates of foreign countries).
- Creation and maintenance of the database for investment projects and business-plans for the subjects and small and medium business.

The creation of the Centre seems to have been motivated by the Parent company's expertise in this area. The Polish Bank occupies leading positions in the market of mortgage lending, small and medium business, and banking services for the individual. The investment by EBRD may also have played a role in establishing the Centre. The bank did not receive any incentives either from the regional or national government to establish the Centre. However, the bank collaborates with the local authorities in the organisation of investment seminars, exhibitions and in supporting the manufacturing units in the SEZs. The Centre organised an Investor Bazar in which investors from 16 countries participated.

Source: Kredyt Bank (Ukraina).

The bank provides regular training to its staff to update their skills and banking knowledge. It has its own training centre, where specialists from other parts of Europe give training. In addition, the parent company Kredyt Bank (Poland) provides training in Warsaw. The staff are also nominated for training programmes conducted by the Central Bank of Ukraine as well as other institutes in Canada and the USA.

In terms of local procurement, the bank does not procure much given the nature of its business. However, the bank has links with some local software companies for procurement of specific software such as risk analysis, on tender basis. It is also working with a local software company that is linked to Oracle on a system called 'Profile to make International Payments'. The bank collaborated with some universities in conducting some training programmes and conferences.

Svitoch-Nestle

The origin of Svitoch dates back to 1882 as a sweet manufacturer. In 1910 it started manufacturing confectionary. It was in 1962 that the company acquired its name Svitoch. In the privatisation that followed the collapse of the Soviet Union, the employees of the company became owners. In 1996, it became a closed joint stock company, but was experiencing acute financial problems. In 1998 shareholders capital was reorganised and with the investment from Nestle a partnership was formed in 1999.

Nestle has been operating in Ukraine since 1994, through a representative office and import of some products. Nestle's competitor Kraft Jacobs entered the Ukrainian market by acquiring some local companies and started competing with Nestle aggressively. So when Nestle also started looking for acquisitions, Svitoch presented an opportunity, with its well-established brand name. Since 1998, Nestle invested about USD 41 million. The company presently makes 40 000 tons of confectionary annually and employs more than 1500 people. Subsequently, Nestle also acquired a ketchup manufacturing company in the region.

In addition to the capital inflows needed to save the company, Nestle's participation brought new production technologies and management skills. In 2002, Svitoch was awarded first priority level for good manufacturing practice and quality standards. Svitoch also benefits from being a part of Nestle's global corporate network. For instance, Svitoch's local staff is provided regular training in other units of Nestle worldwide.

In terms of new management methods, Svitoch's production demands in terms of hygiene, cleanliness, workers' safety and production control are higher than those set by the Ukrainian legislation. Its financial control systems are also higher than Ukrainian standards.

Svitoch procures about 70% of its raw materials through Ukrainian suppliers and the rest through imports. Five years ago the figures were 30% local procurement and 70% imports. Svitoch undertook efforts to develop suppliers' network in Ukraine. It constantly monitors quality and advises suppliers on quality upgrading. One of its suppliers Blitz Pack, which is associated with Samara of Russia, became a global supplier by supplying to other companies globally. Machinery for the production line of some chocolates was procured from a Ukrainian company, Petrovisky.

Svitoch carries out adaptation of its parent's product range to suit local taste, but does not carry out any new product-related R&D. For substantial R&D requirements it depends on Nestle's global R&D network. Prior to acquisition by Nestle, Svitoch had an in-house R&D department. Svitoch does not collaborate with any local universities for its R&D requirement. According to the company, the local research institutes do not specialise in the areas of interest to the company. However, if any university has an interesting idea, Svitoch is open to co-operation.

There are instances of some employees leaving Svitoch to set up their own companies (spin-offs). Nestle supports such spin-off firms by placing procurement orders on them.

Leoni Wiring Systems

Leoni is a green-field investment by a German company. It manufactures electrical wiring systems for automobiles. Leoni also has a manufacturing plant in Poland, across the border from the Lviv Oblast. After the entry of Poland into the European Union, the company expected an increase in the wage costs in Poland and relocated production of some product ranges to Ukraine. Its investment amounts to about USD 30 million and employs 2030 staff, which will soon increase to 2500.

Leoni started looking for an alternative site for manufacturing in 2001. Romania, Bulgaria and Ukraine were considered as they form the border to the now extended EU. On the advice of the Representative of the German Chamber of Commerce, Lviv Oblast was considered and the project was presented to the local authorities who gave the company strong support. Due to the huge employment potential, the national authorities were also highly supportive by removing all bureaucratic hurdles.

Leoni is a 100% import-export company and so does not procure locally any inputs for the products manufactured by it. But, it procures support services locally. For instance, construction services, welding devices, clothes for workers, etc., are procured locally. The company finds a lack of competition among local suppliers. When it floats tenders, often, only one or two companies respond. This lack of competition adversely affects price, quality and timely delivery of service.

Leoni provides regular training to its staff and is also training local managers to reduce dependence on expatriate managers.

Although Leoni did not create any strong linkages with the local economy through development of supplier networks, it has long term plans for Ukraine. One of its companies that manufactures cables, both for in-house use and supply to others, is planning to relocate some of its manufacturing activities to the Lviv Oblast. Leoni being a high-profile investor, some of its competitors from Germany, USA and Japan, have visited the plant and have expressed their own plans to invest in the region. With such investments, there is a possibility for the emergence of a dynamic cluster in the region.

Lvivska Brewery

Lvivska Brewery is a beer and non-alcoholic drinks producing company, in which Baltic Beverages Holding of Sweden has invested USD12.6 million.

Along with the investment, BBH has brought into the company new technologies, standards and management techniques. This package has enabled Lvivska to increase production, introduce new products and even to aim at export markets. In 2003, for the first time the company reached a sales volume of 10.83 decilitres of beer. With this the company consolidated its market position in Ukraine and started on plans to expand its brand name Lvivska into international markets. Work on structuring an Integrated System of Quality and Environment Management according to the requirements of standards ISO 9001:2000 and ISO 14001:1996 has been launched at the company. Towards achieving these standards, it has brought in modern production equipment and control systems. It has also widened its product range.

The company also won the awards, Investor of the Year 2003 and Employer of the Year 2003. Its sub-brand 1715 is included in the State list ‘100 Best Goods of Ukraine’.

Lvivska Brewery provides regular training to its staff. By 2003, 47% of its total employees of 194 people had acquired additional professional qualifications through various training programmes and seminars in Ukraine and abroad. Some employees were sent to the Scandinavian Brewing School (Denmark) and Orkla Brand School (Norway) to improve their qualifications. During the last five years, one person per year was sent to Copenhagen University to study technical issues for six months. Similarly three chemists per year were sent to Stockholm University for training. As a routine process, all the managers receive one week’s training each year at a foreign company. All the employees of the company have had an opportunity to master the knowledge of the English language through the company’s project ‘English 50/50’.

Lvivska concentrates on brewing in Lviv. Its local procurement includes cleaning and transport (loading and distribution) and all the malt used as raw material. Its main raw material, hops, is not grown in sufficient enough quantities to meet the company's need. The company develops long-term co-operation with local suppliers. It provides financial and technical support to farmers. Financial support for future crops of barley and technical support through farmer visits to the company and its overseas brewery operations.

The company has close co-operation with the Department of Brewing Industries in Lviv Polytechnic University. It holds round table discussions with the university and the company has an open door policy for both staff and students. It collaborates with the Veterinary Academy at the university on waste. The brewery and university also collaborate on ecology and chemistry. But, the university does not give any consultancy as it does not have an advanced level of expertise on these issues. The Ukrainian Brewing Trade Association provides some consultancy to the company on technical and process related matters. Lvivska also collaborated with a local laboratory on a bottle design.

The company also has a project called 'For Students from Lvivska', which has become popular with young people. As part of this project seven winners from among the students of National University – Lvivska Polytechnika – have been awarded grants from the company and were provided with the opportunity to carry out their practical work at Lvivska under the supervision of the company's experts.

Webasto-Electron Ltd.

Webasto is an automobile parts manufacturing company, in which a green-field investment of USD 1.4 million was made by Webasto Thermosystems International of Germany. It produces conditioning systems for cars and buses.

Webasto procures 80% of its requirements locally. The company procures from suppliers using the ISO 9001 standard. Webasto helped its local suppliers in meeting this standard through financial and technical support.

Webasto's workers were provided training in Germany.

Webasto does not have any research collaboration with local universities. However, there is a three-way agreement between Lviv Polytechnic University, Webasto Germany and Webasto Ukraine on joint training. The university provides trained employees on logistics and international business systems.

Assessment

In the analysis of integration of FDI into the economy of Lviv Oblast, it may be kept under consideration that much of the FDI inflow into the region is of recent origin (about five to six years). Foreign firms normally need and do take time to identify the potential and establish strong linkages with the host economy. However, sometimes, foreign firms because of their existing linkages (e.g. supplier networks) or simply due to *inertia* may be too slow or completely fail to utilise the potential in a host country. In such cases, host country policies could stimulate or speed up the process of embedding FDI into the local economy.

FDI into the Lviv Oblast can be categorised as follows: i) Projects that seek access to natural resources, e.g. wood, oil & gas and minerals; ii) Projects that seek low-cost advantages, e.g. low labour and energy costs (100% export-oriented projects); iii) Projects that want to cater to the domestic market in Ukraine, e.g. food processing and beverages; iv) Projects that serve the domestic market and also have potential to earn foreign exchange, e.g. trade, banking and tourism services, and health resorts.

Out of these FDI projects, categories iii) and iv) seem to be relatively well embedded into the region's economy, with fairly strong local procurement activities and links to local universities and authorities. Part of the reason for this could be that these are mainly acquisitions of existing companies that already had strong linkages with the local economy. But, FDI would help the quality of such supplier networks. This is evident in the cases of Lvivska Breweries, Svitoch-Nestle (category iii) and the Kredyt Bank (category iv). The category ii) projects, mainly in the textile, leather goods and electrical systems (Leoni) are by nature the type of investments that are *cost-sensitive*. They usually execute only the labour-intensive part of (e.g. assembly) activities in host countries. They tend to have their fixed global suppliers and are therefore slow to see the potential for supplier networks in the host country. With respect to the category i) type of investments, it was clear from the observations in the study tour that strong linkages have not been established in this category in relation to its potential.

There are a number of actors involved in FDI-related activities. They include local and national governments, local and foreign investors/firms, local and foreign banks, Consulates of the foreign governments, foreign aid agencies, local universities/research institutes and non-governmental organisations, such as the European Business Association, Chambers of Commerce and Industry and Business Support Centre - NewBiznet. All the actors are focused on activities related to attracting investment and in facilitating its establishment. Practically no actor is involved with activities related to long-term embedding of FDI.

From the policy perspective the main weakness lies in the *absence of a clear FDI policy*. The region has a development strategy, but it does not envisage the role to be played by FDI in such a development strategy. The developmental objectives for which FDI is sought are not clear. Apart from bringing in much needed capital and creating employment, given a conducive environment FDI can help in building an internationally competitive local research and productive capacities. Such long-term benefit occurs through establishment of linkages with the local economy (local firms and universities) and diffusion of new technologies and managerial know-how into the wider economy.

Even the Special Economic Zones are designed with the main objective of creating employment, rather than on issues of value addition, technology development and diffusion. The incorporation of the idea of technology parks also seems to be just as an addendum rather than a well-articulated strategy. As a result they failed to create dynamic clusters that generate externalities and agglomeration effects. There are also several cases where foreign investors decided to locate outside the SEZ, even at the cost of forgoing the benefits offered by the SEZs. For instance, the largest single strategic investor in Lviv Oblast, the Leoni Wiring Systems chose to establish its green-field plant in Stryj rather than in the SEZ for reasons of not wanting to compete with other firms in SEZ for the labour force (low-cost).

An analysis of the government policy reflects three aspects: 1) the government wants to play a minimal role in matters of investments and business activity in general; 2) the government does not want to distinguish between domestic investment and foreign investment. It wants to promote all investments; 3) although, the regional authorities want to attract investments in certain areas, they do not have clear strategy to redirect FDI into those areas. While all these are very good intentions, for an economy in transition to catch up with more advanced countries, selective policies can help in

speeding up the process and in building up a stronger economic base. Therefore, it may be important to clearly specify the *complementary roles* to be played by domestic and foreign investments in economic development.

Policy Recommendations

First, the government (both regional and national governments) should *envisage an FDI policy* with clear objectives and its role in the regional development plans. In deciding on the objectives, sectors and specific areas in which the region possesses relative comparative advantages should be considered. Presently, the government is too pre-occupied with changing the legislation, rules and regulation rather than on policy aspects. In this regard the Czech Republic's experience in promoting FDI, discussed in Box 11, and that of Estonia, discussed in Box 12, may be useful.

Box 11. FDI Promotion and Embedding in the Czech Republic

One of the strategic goals of the CzechInvest, the investment promotion agency of the Czech Republic, is to support the supplier network in the country and link it to foreign affiliates. It is a strategic method of inducing foreign companies to locate in the Czech Republic, as the presence of a strong supplier network creates an attractive environment for foreign investors. The CzechInvest launched a Supplier Development Programme in 1999 to improve links between local suppliers of components and services and foreign affiliates in the country. The programme has three objectives: to promote modern industrial technology, to heed environmental protection considerations and to raise qualifications of the local labour force. In January 2001, the programme introduced a new sub-programme called 'Twinning Programme', which was co-funded by the EU and the Czech government. This two-year sub-programme focuses on the electronics and electro-technical industry.

The Supplier Development Programme has *three* elements:

- *Collection and distribution of information* regarding the products and capabilities of potential local component suppliers, assistance to foreign affiliates in contacting these potential suppliers.

- *Matchmaking*, which has three phases. Firstly, 'Meet-the-Buyer' events between foreign investors and potential local suppliers. These events focus on identifying the type of components and services that foreign investors are considering sourcing. Secondly, 'seminars and exhibitions', organised with and for the local suppliers and foreign affiliates. Thirdly, the 'matchmaking programme' takes the form of concrete proposals to potential foreign investors, indicating potential supplier network in the Czech Republic.

- *Upgrading of selected Czech suppliers*. Since 2000, the CzechInvest has organised upgrading programmes for selected local suppliers that meet defined criteria in high-technology industries, such as electronics and for selected engineering firms supplying a wide range of industries (e.g. producers of machine spare parts, plastic form and packaging). The selected firms prepare an upgrading plan that is tailored to their individual capacities and requirements. Progress is monitored with quantitative performance benchmarks, comparing the local companies with their competitors from the EU. The upgrading activities include consultancy and training support in areas such as the utilisation of technology, general management operations, ISO certification and organisational change. Training is also provided in a wide range of areas, including finance, management, quality assurance and marketing.

Source: UNCTAD (2001), p. 189.

Box 12. Estonia's FDI Strategy

The Estonian Investment Agency is a part of the Foreign Investment and Export Service of 'Enterprise Estonia'. Estonia's FDI strategy seems to be based on three aspects: 1) select target sectors on the basis of Estonia's competitive advantages; 2) attract FDI in targeted sectors by providing investor services; and 3) promote domestic firms in the new technology areas and upgrade the capabilities of the existing firms.

Enterprise Estonia supports international business by creating an environment that allows foreign investors to make the right investment decisions, find suppliers and partners in Estonia, and to trade profitably with Estonian companies. Its business services include:

1) Provision of information on subcontractors through its detailed database of Estonian companies.

2) Support for relocation and expansion of foreign enterprises -

a) Investor Services - among others, general and industry specific information on investment opportunities and how to establish a company in Estonia; contacts with the public and private sector; help in finding joint venture partners; and assistance in finding industrial property.

b) Support for Infrastructure Development - projects supported include, the construction and repair of arterial roads, power and communication networks. The projects must be directly related to the development and expansion of the company and must create new jobs. The large firms can be granted up to 50 percent of the eligible expenses and the small and medium firms up to 65 per cent.

c) Support for Employee Training - all companies established in Estonia can apply for financial support for the employee training for: improving the qualifications of employees; professional training of new employees in the case of expansion of business activities of a company; and acquisition of new specialties and skills in the case of modernization of production activities. Depending on the size and location of company, the nature of training, up to 80 percent of the cost of training can be granted.

d) Support for Research and Development - provides grants of up to 25 percent of the product development costs and up to 50 percent of applied research costs related to a project. In addition, Enterprise Estonia assists investors in appraising project ideas and in preparing the development projects, including consultation and risk management evaluation.

Estonia's FDI strategy is based on targeted investment promotion in three broad sectors (*incidentally all these sectors are also important for Lviv*):

a) Manufacturing - with special focus on - Machine building and Automotive supplies; Electronics and Plastic components; and Wood Processing (pulp and paper, particle-boards for construction and furniture).

b) Services & Logistics - Shared service centres; Tourism; and Industrial real estate.

c) Innovative Products - Information and communication technology (ICT); Biotechnology; and Material technologies.

An analysis of sectoral reports prepared by Enterprise Estonia suggests that in the targeted industries, Estonia possesses some key factors of comparative advantage. They include availability of human resources with special skills, local raw materials, presence of domestic firms that have the capability to be subcontractors or component suppliers to foreign firms affiliates/firms, and specialized research institutes (e.g. Estonian Biocentre) and universities with research programs in the fields related to targeted industries and sub-sectors, and the active presence of industry associations. In other words, Estonia seems to have well developed innovation systems in the targeted sectors/industries. Such a system not only attracts high value added FDI, but also facilitates embedding of FDI into the local economy.

Estonia's FDI strategy is complemented by domestic SME support measures and programmes run by Enterprise Estonia including: Start-up Program; Training Programme; Marketing and Product Development Programme for Travel Trade; R&D Financing Programme; Innovation Awareness Programme; Consulting Programme; Business Infrastructure Programme; Joint Stands at International Trade Shows; The Green Key Programme and Competence Centre Programme.

For instance, the general objective of Competence Centre Programme is to improve the competitiveness of enterprises through strategic co-operation between science and industry sectors in Estonia. So, Enterprise Estonia supports the establishment of small R&D institutions or the competence centres. These centres are established and operated jointly by a number of enterprises and universities. The focus of these centres is on applied research, which is needed for the product development by the firms. Among the competence centres financed by up to February 2004 are: Competence Centre of Electronics, Info and Communication Technologies; Competence Centre of Food and Fermentation Technologies; Competence Centre of Healthy Dairy Products; Estonian Nanotechnologies Competence Centre; and Competence Centre for Cancer Research.

In addition, Estonia also has 10 industrial parks, including science parks and free zones, which will help in the formation of dynamic clusters.

Source: Based on Estonia Investment Promotion Agency and Enterprise Estonia; www.investinestonia.com; www.eas.ee.

The Czech Republic and Estonia are not the only countries that are focusing on attracting FDI and promoting linkages between FDI and the local economy. Several other countries are also increasingly making efforts on long-term embedding of FDI through promotion of local supplier networks. For instance, the Polish Information and Foreign Investment Agency (PAlilZ)'s main goals are to increase the inflow of FDI into Poland, create a positive image of Poland in the world and support exports by promoting Polish brands of products and services. As part of its mission PAlilZ provides the following services to investors: access to information regarding economic-legal investment environment; assistance in finding suitable partners, suppliers and investment locations; advice during each phase of the investment process (www.paiz.gov.pl).

Similarly, Ireland focuses on increasing the capability of domestic firms to absorb foreign technology. It becomes important that embedding policies work on strengthening the capacity of domestic firms as well as on influencing the conduct of foreign firms (Potter, Moore and Spires, 2002, 2003). The efforts of Shannon Development, Ireland, described in Box 13 may be useful.

Box 13. Shannon Development Ireland - 'Supply Network Shannon'

Irish industrialization was mainly dependent on the attraction of FDI for many years. But, since the beginning of the 1980s, the policy has shifted towards promoting the domestic sector. This shift reflected concerns about weak linkages between the foreign affiliates and local firms and that Ireland was becoming a 'dual economy'. To address these concerns, at the regional level, Shannon Development established the 'Supply Networks Shannon'. Shannon Development is the economic development agency for an underdeveloped rural area in Ireland. Shannon Development operates a large export zone (Shannon Free Zone) and a technology park, which have helped in attracting substantial FDI inflows.

Key components of the Supply Network Shannon initiative, which is aimed at increasing linkages between foreign affiliates and local subcontracting firms, are:

- Publication of a supplier directory to encourage local sourcing. It provides profiles of supplier companies and copies are circulated to regional, national and international buyers.
- "A Supply Network website with information on network events and member contact details by company and sector listings.
- Support for business clusters. Companies are encouraged to group together in order to benefit from consultancy work on group strengths and weaknesses and the development of projects on common issues such as production, waste, team-working, procurement, quality management and finance."

Source: Potter, Moore and Spires, 2002, 2003. pp. 9.

Second, once the objectives are clear, while encouraging other FDI, the region should also aim at *targeted approach to FDI attraction*. This would involve promoting the region to targeted investors and presenting them with the specific competitive advantages of the region (e.g. the region was home to electronics and chemical industries during the Soviet Union times). FDI in such areas of strength can foster its long-term embedding more quickly.

Third, in selected cases, the government (particularly the regional government) can stipulate *performance requirements* on the foreign investors in order to receive specified incentives. For instance, at the time of writing, every investor in SEZs is eligible to receive all the incentives available, provided they meet the minimum capital requirements. Receipt of incentives does not depend on value addition or establishment of linkages. A system can be created, where an investor can receive additional incentives by undertaking higher value added activities. An investor can also be given additional incentives for the development of local supplier networks or helping in upgrading local small and medium enterprises. Some of the performance requirements that are trade-related (e.g. local content requirements) are directly prohibited under the World Trade Organisation and bi-lateral investment agreements[11]. But still several others (e.g. performance of R&D, training of local staff, etc.) are permitted under international agreements, if they are linked to any incentives (voluntary requirement) and not a compulsory requirement (mandatory) on a foreign investor. The competition for FDI among countries, may limit the policy space for a particular country to stipulate such requirements. However, they can be implemented relatively easily on FDI that is seeking access to a country's natural resources or domestic market.

Fourth, with the emerging knowledge-based economy, a new territorial development paradigm is emerging in which regional growth processes are increasingly driven by innovation. Innovation in the new economy is seen as the output of a collective effort, rather than that of individual firms or universities (Cooke and Morgan, 1998; Storper, 1997). One of the most effective ways of achieving collective learning is through inter-firm alliances and networking between firms and institutions. Therefore, this may become a key focus for public policy. Foreign affiliates can play a key role in collective learning processes, particularly through the diffusion of new production processes and technologies to their supplier networks, and by forming collaborations with local universities (Potter, Moore and Spires, 2002, 2003).

Some governments are providing incentives to firms (both foreign affiliates and domestic firms) for establishing R&D co-operation with other firms or research institutes. For instance, since 1991, Brazil has been offering fiscal incentives to information technology companies that invest at least 5 per cent of local sales in R&D and 46 per cent of such expenditure was on projects carried out jointly with Brazilian universities or research centres. Several companies (including affiliates of foreign firms like Ericsson, NEC and Compaq) have availed themselves of these incentives. Based on this incentive, Motorola even established a Brazilian Centre for Semiconductor Component Development, as a global research centre in collaboration with local universities (Galina, 2001).

Fifth, the government should actively *promote entrepreneurship and SME development*. One of the critical reasons for the failure of FDI to establish linkages with the local economy is the absence or the weakness of the supplier industry in the host country. Most often either there are no suppliers of such components or where they exist the quality of those products does not match foreign investor's requirement. Promotion of entrepreneurship helps in expanding the product range of the local industrial base. SME development helps in technology upgrading of the local firms, improving the

11. Ukraine is not a Member of the WTO and hence it could still use the local content requirement, at least on the domestic-market and/or natural resource-seeking FDI.

efficiency and quality. As the case of Singapore in Box 14 shows, the governments can also enlist the foreign investors as partners in this task.

Box 14. Local Industry Upgrading Programme of Singapore

The Economic Development Board (EDB) of Singapore introduced a linkage program to its FDI strategy in 1986 when it established the Local Industry Upgrading Program (LIUP) to upgrade, strengthen and expand the pool of local suppliers to foreign affiliates, by enhancing their efficiency, reliability and international competitiveness. LIUP is implemented in 3 phases: Phase 1 - improvement of overall operational efficiency, such as production planning and inventory control, plant layout, financial and management control techniques; Phase 2 - introduction and transfer of new products and processes to local enterprises; Phase 3 - joint product and process research and development with foreign affiliates' partners. Activities could be undertaken simultaneously in all the three phases.

The role of the LIUP is to offer organizational and financial support to upgrade and develop vendors. It operates with the involvement of foreign firms, which are encouraged to enter into long-term contracts with local suppliers and assist them to upgrade their products and processes.

The LIUP offers several support measures. The EDB contributes to the salary of a foreign investor's representative seconded to a local firm to help the firm in upgrading its technologies and become more competitive. Specific benefits are also provided to foreign investors to encourage them to join the vendor development program.

As part of the program, foreign affiliate partners organize seminars and workshops for local firms. Specialists, including those from foreign affiliates, conduct sessions on issues such as quality control, package design and requirements, quick die-change and general industrial engineering practices.

The case of Philips Electronics illustrates the benefits of the program. The affiliate Philips Electronics in Singapore has been in partnership with its local plastic component supplier, Yeakin Plastic Industry. Under the program Philips worked with Yeakin to reduce its rejection rate to sub-1 percent (the best-in-class level) from an average of 2 percent (the industry average). Such reduction in rejection rate would save Yeakin S$300,000 per year. Philips also worked on upgrading Yeakin's internal inspection system, so that Philips need not carry out inspections. The target is to move from existing 70 percent of Yeakin's supplies that go without inspections to 90 percent. This would result in savings of S$100,000 per year to Philips.

Source: Economic Development Board, Singapore. (www.sedb.com).

Sixth, one of the reasons cited by the foreign investors for not having strong linkages with the local universities/research institutes in the Lviv Oblast has been that the latter do not specialise or are not strong enough in the fields relevant to the foreign company. This indicates that the *academic curriculum may need to be modified in accordance with the changing needs of the economy*. Even in the food-processing field, in which the region is considered to have strength, companies have reported that the local universities do not have adequate specialisation. Funding of research in the universities in the broad areas of relevance to the industry can help in building up such capabilities. Companies can then utilise these broader specialisations by sponsoring research projects in specific technologies. Such research collaborations between local universities and foreign firms help in mutually beneficial knowledge flows. Appointment of industry representatives, including from foreign companies operating in the region, to the governing boards of universities and research institutes will help in fine-tuning their academic profile and foster closer linkages between academic institutions and industry.

Seventh, some of the low-cost seeking FDI reported (e.g. Leoni) that they would relocate more operations to Lviv Oblast from abroad. They also reported that some of their competitors also plan to relocate from abroad, based on the experience of the first strategic FDI project. The government should encourage such FDI by *developing a specialized cluster* with all the facilities needed for that type of industry, including the infrastructure and supply of trained human resources. Such clusters will

help create dynamic effects and externalities across different sectors of the economy. Several regional governments across Europe are making efforts to create such clusters (see Box 15).

Box 15. Cluster Policies at the Regional Level in Europe

The creation of clusters has been highly attractive as an approach to regional development as the concept brings together many thematic strands of policy. The term 'cluster policy' covers a wide diversity of policies, ranging from a-sectoral networking initiatives to complex programs of industrial development (Nauwelaers, 2001).

Pais Vasco (Basque Country) in Spain has been one of the most active regions in Western Europe in developing a cluster approach to regional development. Following the strategy development by the regional government, the Cluster Technology Plan explicitly focused on the development of a series of emerging clusters in the local economy. These sectors include automotives, machine tools and telecommunications. The cluster strategy was implemented through a number of specific initiatives and programs designed in collaboration with businesses and universities. Pais Vasco's approach consists of a number of interesting features, such as its strategic focus, the relationship between regional and national level activities and its involvement of different organisations within the local economy.

The Pais Vasco's approach consisted of government support for the establishment of largely self-selecting cluster associations and the subsidy of several initiatives, as agreed between the government and these associations over a period of several years. While cluster development is a part of the overall strategic framework for Basque's economic development, its promotion was a marked strategic shift by the regional government in its industrial development priorities: cluster support has been one of the strategic priorities of the region's successive development frameworks since the 1990s. However, in terms of policy-making, it has largely operated outside the existing policy-making structure. It involved new agents through the extensive consultation with the private sector in the design and delivery of the policy, rather than the regular policy-making structure.

Arve Valley in France is another leading cluster in Europe. Cluster strategy in France has traditionally been a combination of centralised national technology policy and localised self-help activities. In recent years, the French regional policy ministry (DATAR) started supporting local groups of industries directly by subsidizing cluster development programs. One of the largest of these programs is the industrial district of the Arve Valley within the Rhône-Alpes, focusing specifically on the metal cutting and precision tool complex. Starting in 1997, a partnership of local business associations and district councils has been implementing a cluster strategy to support these sectors by encouraging inter-firm networking. Arve Valley is a good example of a highly localized and sector-specific approach to cluster policy.

Source: Raines, 2001.

Eighth, now the Lviv Oblast borders the expanded EU, the Ukrainian government should *negotiate a preferential trade agreement with the EU* (e.g. products manufactured in Ukraine may be negotiated to come under the EU regulation on Rules-of-Origin). Such a preferential trade agreement would not only promote FDI inflows, but would also contribute to the embedding of FDI as the case of Suzuki in Hungary provided in Box 16 shows.

Box 16. Embedding of Suzuki's FDI in Hungary

Suzuki, the Japanese automobile manufacturer started its operations in Hungary in 1992 as Magyar Suzuki. Suzuki's decision to invest in Hungary and to develop a local supplier network was influenced mainly by the preferential treatment given by the EU to goods manufactured in Hungary. Suzuki's project was aimed at gaining market access to the EU for its cars. In order to enjoy the duty-free access to the EU, Suzuki had to procure either Hungarian inputs or materials originating in the EU and in other European countries, which, through what is called *cumulation*, are considered as local inputs for at least 60% of its car value. By 2000, 29% of the components used by Magyar Suzuki were produced in-house, 26% were procured from Hungarian suppliers (both domestic and foreign-owned), 15% were sourced from the EU and 30% were imported from Japan.

In 2000, to strengthen its local integration, Suzuki prepared a cluster-based subcontracting promotion plan, called the 'Mid-Hungarian Automotive Cluster'. Suzuki provided information on infrastructure and financing facilities to potential suppliers, both Hungarian and foreign. Suzuki also organised international seminars for 47 potential foreign suppliers and jointly with the local authorities prepared other publicity material for dissemination of information. In 2001, the Esztergom Industrial Park was opened for potential newcomers, with facilities such as water pipeline, sewage, electricity, gas and telecommunications networks.

Source: UNCTAD (2001), p. 166.

Ninth, NGOs such as the European Business Association and the Chambers of Commerce and Industry are fairly active in the Lviv region. The local authorities can seek *NGOs help in identifying and developing the potential supplier industries* in the region. Such business associations can also persuade foreign investors to establish strong linkages with the local economy as part of their *corporate social responsibility*. The OECD guidelines for multinational enterprises call for embedding of FDI into the local economy (see Box 17). However, these guidelines are voluntary instruments, and not binding obligations on multinational enterprises. It is up to the discretion of the multinational enterprises to decide how they will discharge their obligations in this regard.

Box 17. OECD Guidelines for Multinational Enterprises

The OECD Guidelines for Multinational Enterprises (chapter VIII) encourage enterprises to adopt, where viable, practices that permit the transfer and rapid diffusion of technologies and know-how, with due regard to the protection of intellectual property rights (p. 26). Multinational enterprises are expected to "contribute to economic, social and environmental progress with a view to achieving sustainable development" (p. 19, chapter II, General Policies, paragraph 1).

The Guidelines also refer to the need for multinational enterprises to perform science and technology development work in host countries to address local market needs, as well as employ host country personnel in a (science and technology) capacity and encourage their training, taking into account commercial needs. Paragraph 1 of chapter VIII reinforces this view by stating:

"Endeavour to ensure that their activities are compatible with the science and technology (S & T) policies and plans of the countries in which they operate and as appropriate contribute to the development of local and national innovative capacity" (p. 26).

Source: OECD (2000).

Last, all the above will only work when the *micro-level business environment*, where firms create jobs, value addition and knowledge, is conducive. This would involve making changes in particular to legislation, rules and regulations. The bureaucratic red-tape also needs to be reduced considerably. *Training of field-level officers on business-related aspects* may help in making them more business friendly.

Potential for Cross-border Co-operation in FDI

Effective cross-border co-operation between Lviv Oblast and its neighbouring regions in Poland could only be built on a step-by-step basis, over a long period of time. To begin with, a cross-border co-operation project can be developed between the universities of the two regions, which will link the students, researchers and the businesses. In this context, the experience of Öresund University that promotes co-operation between regions in Denmark and Sweden may be useful (see Box 18). In the Öresund's region the education sector has been at the forefront of promoting co-operation for knowledge development. Co-operation between universities located in the two regions existed for

many years, but this informal co-operation was formalised in 1997, with the creation of the Öresund University.

Box 18. Öresund University – promoting cross-border co-operation

Öresund University is a consortium of fourteen universities and university colleges on both sides of the sea (Sound) in the Scania (Skåne) province of Sweden and the Zealand (Sjaelland) province of Denmark. This consortium of universities emerged due to geographical proximity and a long common history and culture. The Skåne region of Sweden was once part of Denmark.

With the region aiming to become a significant 'science region', the consortium was established to increase quality and efficiency among the participating institutions by opening up all courses, libraries and other facilities to all students, teachers and researchers. Thus, the education and research of both countries can complement each other, making Öresund a scientific and educational stronghold.

Öresund University is directed by the fourteen vice-chancellors of the participating institutions. A secretariat manages the daily activities of the university and coordinates all projects in which the university participates. The various cooperative efforts within Öresund University take place mainly at faculty and departmental level as projects, networks or formalised agreements about education and research. Co-operation also covers other university activities such as study administration, contacts with the surrounding community, international issues and information.

As part of its programme, Öresund University launched an online web portal called 'Öresund Study Gateway' which gathers information about all the study possibilities at the 14 universities in the consortium. For students wishing to study in the Öresund region, the portal offers an easy overview of more than 4000 educational programmes and courses offered by the universities. In addition, the portal contains information about the Danish and Swedish university system, admission requirements, social life at the universities and the possibilities for taking courses at another university within the consortium.

Öresund Summer University is another one of the university's innovative programmes. It is a unique study experience, intensive both academically and socially. Academically, classes are conducted several times a week and ECTS-points can be transferred to the home university of the participant. Socially, participants get to meet students from other cultures and countries and thereby get an opportunity to establish networks around the world. The summer school has a European bias, with one-third of the participants coming from Scandinavia, one-third from other EU-countries and the rest from around the world including, USA, Canada, Australia and Japan.

Source: *www.uni.oresund.org*

Similarly, the Öresund region has also formed the Öresund Science Region to promote and strengthen cross-border co-operation. The Öresund Science Region is funded by the Foundation for Technology Transfer in Lund, the Danish Ministry for Information Technology and Research, and Öresund University as well as companies and research hospitals. Öresund Science Region is an alliance between six regional and bi-national network organisations: Medicon Valley Academy, Öresund IT Academy, Öresund Food Network, Öresund Environment Academy, Öresund Logistics and Öresund Design.

The main purpose of the Science Region is to promote innovation and growth through co-operation. Öresund Science Region has a strong base for development, including 140 000 students and 12 000 researchers at the fourteen member institutions of Öresund University; a large number of successful high-tech companies, small start-ups as well as major international companies; a number of science parks and an innovation-oriented public sector (see Box 19 for the objectives with which the Öresund Science Region was created).

Box 19. Öresund Science Region

Overall aims of the Öresund Science Region are the following:

- Establishing state of the art scientific clusters and networks.
- Stimulating new knowledge within areas where Öresund region is competitive on a global scale.
- Developing and securing an innovative environment and an efficient commercialisation structure.
- Global branding of Öresund as a high-tech region.
- Promoting integration across borders in the region (disciplines, academia, industry, the public sector, Denmark and Sweden, Öresund and the world).
- Organising conferences and symposia.
- Promoting and initiating courses, PhD-programmes, summer universities and life-long learning.

Source: *www.uni.oresund.org*

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CHAPTER 5. POLICY RECOMMENDATIONS

This chapter sets out the key recommendations of the OECD review panel on FDI attraction, aftercare and long-term embedding policy development in the Lviv region. The last section of the chapter outlines some cross-border co-operation initiatives that could help enhance the FDI attractiveness of the region.

FDI Attraction

Develop a coherent FDI attraction strategy

A coherent FDI strategy requires a clear vision of how FDI can contribute to the economic development of the region. It is therefore recommended that Lviv Oblast authorities develop an FDI policy, building on the general economic development strategy, but specific and focused on the FDI market opportunities and Lviv competitive positioning. This policy should formulate:

- Clear realistic objectives.
- Organisation roles and responsibilities.
- Tangible results and performance indicators.
- Feasible timeframe.
- Structured action plan.

To elaborate such a strategy the government of Lviv Oblast would have to engage in a dialogue with various stakeholders including local industry players, business associations e.g. European Business Association, Chamber of Commerce, industry associations, NewBiznet and other professional consultancies, NGOs, academics and investors.

Elaboration of a structured plan of policy actions based on a clear vision of objectives and targets combined with realistic estimation of necessary financial, technical and human resources is a prerequisite for effective FDI attraction. The proposed plan for the development and implementation of an FDI attraction strategy foresees four steps for the Lviv regional government. The first two steps lay the basic investment promotion blocks, the third step deals with the organisation of the FDI policy, and the fourth step should build up on previous policy actions and ensure the implementation of investment promotion strategy.

Step 1: Identifying directions for FDI strategy

- Develop an overall FDI strategy jointly with all concerned stakeholders.
- Identify realistic FDI objectives.
- Inform the public about the strategy.

Step 2: Setting targets for FDI attraction

- Analyse and monitor key FDI indicators on competitor locations, key source markets, and potential foreign investors.
- Evaluate the region's competitive position.
- Identify sector, market and company targets.

Step 3: Organising FDI attraction

- Set up a "one-stop-shop" for FDI attraction, co-ordinating the activities of all bodies concerned.
- Plan and allocate necessary resources for FDI attraction.
- Identify policy actions to take.

Step 4: Implementing FDI attraction strategy

- Improve the business environment for FDI, including human resources development, infrastructure and property development.
- Launch effective marketing and promotion tools.
- Undertake company targeting, lead generation, relationship building and account management.

Adopt a targeted approach to investment promotion

The experience of many OECD countries, including Ireland, the Netherlands, the UK, Australia and Canada has demonstrated that a targeted approach to FDI attraction is by far the most cost-effective way of achieving the strategic objectives of FDI policy. A targeted approach to FDI attraction mirrors the sales process of the private sector when selling their products or services.

Targets for FDI attraction should be identified with extensive use of market intelligence and analysis of the region's competitive position. It is therefore recommended that the government of Lviv Oblast adopt a more targeted approach to FDI policy by narrowing down its inward investment promotion efforts.

As a starting point the following suggestions can be considered. Based on the field research in Lviv, priority sectors for attracting inward investment into Lviv could include: (1) food-processing; (2) transport equipment; (3) tourism & recreation activities; (4) wood-processing; and (5) paper industry.

The target markets depend on each sector, but could include the US (food), France and the UK (tourism) and Germany and Japan (transport equipment).

Set up an investment promotion body

It is recommended to replace the current complex system of investment promotion in the region with a single unit that will have the capacity to make and implement policy. The precise location and degree of autonomy of this body needs to be decided by local and national government in collaboration with their partners. It might be part of the Lviv Oblast State Administration, it might be an independent body or it might be a regional arm of the proposed national Ukrainian IPA.

Interviewed investors pointed out that authorities involved in investment promotion often lack understanding of the business environment. Since an investment promotion body operates in a highly commercial environment it is strongly recommended to employ private sector skills and experience ranging from international business, economics, marketing and industry expertise. Principles of private

sector sales organisations should also be applied to the organisation of the body in terms of its efficiency and flexibility.

It is also recommended to establish of a dispute resolution unit (investor mediator) within the investment promotion body.

At a later stage and subject to the availability of financial and human resources, this body could develop into a fully-fledged investment promotion agency. Based on best practice examples, the recommended structure of the agency could consist of six departments:

- **Advisory board** comprises representatives of local government, local industry, business associations and major investors. The board decides on overall strategy and policy actions to be taken to improve the attractiveness of the region.
- **Regulation and approval department** monitors and approves investment projects. A specifically appointed person (investor mediator) who processes companies' grievances and suggestions can also operate in the department. This would facilitate communication between investors and regional authorities.
- **Research and analysis department** monitors, collects and processes information and arranges informational support to all the agency's departments and clients.
- **Marketing and communications department** is responsible for implementing the agency's communication strategy in cooperation with the media and other stakeholders comprising local authorities, professional organisations, etc. It is also responsible for improving the image of the region abroad through various marketing tools. In addition, the department coordinates the network of sales representations of the region abroad.
- **Investment support department** supports the needs of potential and existing investors. It provides information on procedures required to invest and operate in the region comprising investor hand-holding and sign-posting. It also arranges contacts between multinationals and local companies for possible JV opportunities.
- **Operational department** ensures effective operation of the agency. It includes human resources, accounting and information technology support.

Develop initiatives to improve attractiveness of the region

While economic and political stability as well as a healthy investment climate are absolute pre-conditions for attracting significant investment in the region, effective product development policies including enhancing technological and human infrastructures are essential to successfully compete for and benefit from inward investment in the medium and long term.

It is recommended that Lviv regional authorities conduct feasibility studies of product development projects that could improve the quality of the location. These measures include simplification/fast-tracking of all company registration and license procedures using a one stop shop approach.

Due to issues of land ownership and infrastructure weaknesses, establishing dedicated industrial sites, with infrastructure, services and even living accommodation and amenities would be attractive to inward investors and the expansion of existing investors. This strategy is being followed by other emerging markets.

To overcome the lack of financial and technological resources, the opportunities of cross-border alliances with neighbouring regions of Poland and Public-Private Partnerships should be considered to improve the quality of infrastructure.

The Lviv Oblast has been a popular recreational and tourist area for a long time now. Its Truskavets spa resort is well-known in the ex-Soviet Republics and in neighbouring countries. A niche strategy focused on tourism and recreation could attract investment and raise the profile of Lviv region, as well as generating service sector employment. The most important steps to take are to define key target markets (initially one or two key countries) and then work with specialist travel companies to develop package offers including flights, transfers, accommodation and beauty/health treatment programmes. Potential links between tourism and other business sectors could also be examined.

Develop and realise an effective PR campaign to improve the region's image

Interviewed investors were almost unanimous in the fact that the perception of Ukraine in general and the Lviv Oblast in particular, did not align with the reality. There are too many stereotypes that persist. It is recommend therefore to launch an effective PR campaign to build a positive image of the region. To achieve its target, direct marketing should transmit a clear message and be very focused on the sectors where the Lviv Oblast is well placed to compete. The utmost goal of the image development should be creation of an ideal picture of the region's strengths and opportunities designed to attract the interest of foreign investors.

FDI Aftercare

Preparing for strategic aftercare in Lviv Oblast

The recommendations on FDI aftercare policies for the Lviv Oblast are based on the main models of aftercare identified by Young and Hood (1994). This research identified four main models of aftercare which were used to explore the implications for investor targeting, the time-frame and focus, the type of service provision and the pros and cons of each approach. Taken together, these models provide a framework where thinking on aftercare can be developed on a more formal and systematic basis. These models are:

Model 1 - The Company Friend:

This is a minimalist approach, providing limited operational support, trouble shooting, and help with regulatory compliance. Support tends also to focus on large or high profile investors mainly over the first two years after start-up.

Model 2 - Project-based Aftercare:

This approach does not attempt to be fully comprehensive. Aftercare resources are directed to specific operational aspects of subsidiary activity such as supplier development or training and recruitment, manufacturing services, R&D etc. Timescales reflect the requirement of the specific project/initiative.

Model 3 - The Aftercare Team:

Here a dedicated resource provides a "single door" for aftercare. The approach tries to provide more comprehensive support to as many foreign investors as resources will allow and is concerned with long-run outcomes. The aftercare team could be organised generally by investor geography or more specifically by sectoral specialisation, large and small firm specialisations or a distinction between strategic and operational issues. With broad spans of responsibility, team size usually becomes an issue of careful

deliberation as does the related matter of co-operation and possible integration with other related public sector activities.

Model 4 - An Integrated Approach:

This approach sees aftercare as a key component of a comprehensive plan for economic development focused on levering strategic economic benefits over the long run. The approach demands a high level of co-ordination within and between the different public sector bodies involved in economic development. Responsibility for investor aftercare becomes shared and more deeply embedded in the wider enterprise network as the relevant activities become more fully integrated across organisational and divisional boundaries.

With Lviv Oblast in mind, it is interesting to note that substantial parts of Models 1 and 2 can be implemented at regional level (and below) without reference to, or dependence on, a national framework. Moreover, both these models represent options which are the least costly (and least resource intensive).

Next steps for Lviv Oblast

Most of the lessons gleaned from the country aftercare case studies relate to a future when the FDI policy context in Ukraine is more fully developed and Ukraine has a larger stock of strategic investors. In preparing for that future, there are, however, steps which the State Administration should consider taking now. These are set out below.

The New Investment Promotion Agency (IPA)

The Lviv Oblast State Administration needs to be fully informed of the plans to roll out the new IPA for Ukraine and to understand:

- The timescale for organisational development.
- Whether aftercare will feature as part of the IPA's responsibility.
- How the IPA will relate to the regions of Ukraine etc.
- Whether new resources and capabilities will be made available for aftercare at the regional level.
- The implications for existing foreign investors in Lviv Oblast.

A pioneering role for Lviv Oblast

In the meantime, if there is any delay in the role out of the IPA, a policy vacuum could result. In these circumstances, the Lviv Oblast authorities could/should consider taking positive steps to begin the formal process of introducing good aftercare working practices. In turn, the emerging modus operandi could be used as an exemplar for other regions and contribute to the policy thinking of the new national IPA.

In this context the Lviv Oblast State Administration should also seek out more detailed guidance regarding protocols for establishing and promoting best practice in investor aftercare services. This would give practical guidance on such issues as: how to set up a modern investor database and Client Relations Management (CRM) system, how to target existing foreign investors and how to set up and undertake aftercare visit programmes. This advice is readily available form a number of para-statal organisations such

as the *Multilateral Investment Guarantee Agency (MIGA)*[12] The MIGA provides a range of relevant services including advice on best aftercare practice and some of this is available at *www.fdipromotion.com*.

A preferred model of aftercare for Lviv Oblast

We recommend that Lviv Oblast adopt a strategic aftercare approach focused on key foreign investors. Moreover, this approach should be based primarily on the "Company Friend" model, suitably modified and adapted to the local operating environment. We recommend that the function responsible for adopting and rolling out this model should be part of the proposed investment promotion unit. The staff time devoted to support will reflect the size of the target group of investors and the amount of time and effort required to forge and maintain close relationships with key subsidiary managers. Staff should have excellent troubleshooting and advocacy skills within government and a deep understanding of the needs of international investors.

Key aftercare issues to be addressed

The type of issues which could provide the focus of a company-friend aftercare scheme would include those highlighted as key concerns by existing strategic investors such as Holger Christiansen and Leoni. Accordingly, the consistency and transparency of the application of Ukrainian regulations are likely to remain key concerns going forward where significant improvement is needed from a strategic investor perspective. In this context, the State Administration in Lviv Oblast could act as an additional channel enabling the views of strategic investors to reach the right people in top government at the right time. More specific operational concerns relate to issues such as:

- Customs and Excise.
- Tax and Social Security.
- Building and Land Approvals.
- Anti-competitive Practices.
- Improvements in Transport, Telecommunications and Utilities.

Given the relatively recent arrival of these strategic investors, there is also an immediate aftercare need surrounding the bedding down of the initial projects to ensure that full project roll-out is achieved efficiently and to schedule. This is especially important if the planned number of jobs associated with these investments is to be fully realised. Consideration should also be given to targeting the stock of Danish textile in order to better understand their present needs and to explore their future concerns, so that an appropriate aftercare response can be tailored.

The State Administration of Lviv Oblast needs also to appreciate the type of business that strategic investment represents. Subsidiaries such as Leoni and HC have sister plants elsewhere in Central Europe. As a result, follow-on investment can be highly mobile and contestable across borders, and future expansion may not follow automatically. Accordingly, the State Administration should attempt to forge close on-going ties with these investors. This will help the authorities to be aware of the operational and

12. The Multilateral Investment Guarantee Agency (MIGA)was created in 1988 as a member of the World Bank Group to promote foreign direct investment into emerging economies to improve lives and reduce poverty. MIGA fulfils this mandate and contributes to development by providing political risk insurance (guarantees) to investors and lenders, and by helping developing countries attract and retain private investment.

strategic needs of these subsidiaries going forward and to try to help ensure that their Lviv operations are well supported and fully competitive, and in a strong position to attract follow-on investment.

Moving to the next level of aftercare support

The above points provide the State Administration with a ready-made rationale for longer-term planning with a view to adopting an approach which more closely resembles the "Project-based Aftercare" approach of Model 2. In the absence of private sector providers, the ability of the local authority to intervene and to give positive support under this model will be limited by its statutory powers. It may be more feasible, for example, to provide support around issues such as recruiting and training skills from the local labour market but less feasible to intervene on issues such as international supplier development.

FDI Embedding

Envisage an FDI policy

The government (both regional and national governments) should envisage an FDI policy with clear objectives and integration in regional development plans and Lviv Oblast Social and Economic Development Strategy up to 2015. In deciding on the objectives, sectors and specific areas in which the region possesses relative comparative advantages should be considered.

Aim at targeted approach to FDI attraction

Once FDI policy objectives are clear, while encouraging other FDI, the region should also aim at targeted approach to FDI attraction. This would involve promoting the region to targeted investors and presenting them with the specific competitive advantages of the region (e.g. the region was home to electronics and chemical industries during the Soviet Union times). FDI in such areas of strength can foster its long-term embedding more quickly.

Consider introducing performance requirements in selected cases

In selected cases, the government (particularly the regional government) can stipulate performance requirements on the foreign investors in order to receive specified incentives. Presently, receipt of incentives does not depend on value addition or establishment of linkages. A system can be created, where an investor can receive additional incentives by undertaking higher value added activities. An investor can also be given additional incentives for the development of local supplier networks or helping in upgrading local small and medium enterprises. Some of the performance requirements that are trade-related (e.g. local content requirements) are directly prohibited under the World Trade Organisation and bi-lateral investment agreements[13]. But still several others (e.g. performance of R&D, training of local staff, etc.) are permitted under international agreements, if they are linked to any incentives (voluntary requirement) and not a compulsory requirement (mandatory) on a foreign investor. The competition for FDI among countries, may limit the policy space for a particular country to stipulate such requirements. However, they can be implemented relatively easily on FDI that is seeking access to a country's natural resources or domestic market.

13. Ukraine is not a Member of the WTO and hence it could still use the local content requirement, at least on the domestic-market and/or natural resource-seeking FDI.

Stimulate inter-firm alliances and networking between firms and institutions

With the emerging knowledge-based economy, a new territorial development paradigm is emerging in which regional growth processes are increasingly driven by innovation. Innovation in the new economy is seen as the output of a collective effort, rather than that of individual firms or universities (Cooke and Morgan, 1998; Storper, 1997). One of the most effective ways of achieving collective learning is through inter-firm alliances and networking between firms and institutions. Therefore, this may become a key focus for public policy. Foreign affiliates can play a key role in collective learning processes, particularly through the diffusion of new production processes and technologies to their supplier networks, and by forming collaborations with local universities.

Some governments are providing incentives to firms (both foreign affiliates and domestic firms) for establishing R&D co-operation with other firms or research institutes. For instance, since 1991, Brazil has been offering fiscal incentives to information technology companies that invest at least 5 per cent of local sales in R&D and 46 per cent of such expenditure was on projects carried out jointly with Brazilian universities or research centres. Several companies (including affiliates of foreign firms like Ericsson, NEC and Compaq) have availed themselves of these incentives. Based on this incentive, Motorola even established a Brazilian Centre for Semiconductor Component Development, as a global research centre in collaboration with local universities (Galina, 2001).

Promote entrepreneurship and SME development

The government should actively promote entrepreneurship and SME development. One of the critical reasons for the failure of FDI to establish linkages with the local economy is the absence or the weakness of the supplier industry in the host country. Most often either there are no suppliers of such components or where they exist the quality of those products does not match foreign investor's requirement. Promotion of entrepreneurship helps in expanding the product range of the local industrial base. SME development helps in technology upgrading of the local firms, improving the efficiency and quality.

All the above will only work when the micro-level business environment, where firms create jobs, value addition and knowledge, is conducive. This would involve making changes in particular to legislation, rules and regulations. The bureaucratic red-tape also needs to be reduced considerably. Training of field-level officers on business-related aspects may help in making them more business friendly.

Strengthen linkages between business and research

One of the reasons cited by the foreign investors for not having strong linkages with the local universities/research institutes in the Lviv Oblast has been that the latter do not specialise or are not strong enough in the fields relevant to the foreign company. This indicates that the academic curriculum may need to be modified in accordance with the changing needs of the economy. Even in the food-processing field, in which the region is considered to have strength, companies have reported that the local universities do not have adequate specialisation. Funding of research in the universities in the broad areas of relevance to the industry can help in building up such capabilities. Companies can then utilise these broader specialisations by sponsoring research projects in specific technologies. Such research collaborations between local universities and foreign firms help in mutually beneficial knowledge flows. Appointment of industry representatives, including from foreign companies operating in the region, to the governing boards of universities and research institutes will help in fine-tuning their academic profile and foster closer linkages between academic institutions and industry.

Support the development of specialised clusters

Some of the low-cost seeking FDI reported that they would relocate more operations to the Lviv Oblast from abroad. They also reported that some of their competitors also plan to relocate from abroad, based on the experience of the first strategic FDI project. The government should encourage such FDI by developing a specialised cluster with all the facilities needed for that type of industry, including the infrastructure and supply of trained human resources. Such clusters will help create dynamic effects and externalities across different sectors of the economy.

Consider negotiating a preferential trade agreement with the EU

Now the Lviv Oblast borders the expanded EU the Ukrainian government should negotiate a preferential trade agreement with the EU (e.g. products manufactured in Ukraine may be negotiated to come under the EU regulation on Rules-of-Origin). Such a preferential trade agreement would not only promote FDI inflows, but would also contribute to the embedding of FDI.

Seek NGOs help in identifying and developing the potential supplier industries

Non-Governmental Organisations (NGOs) such as the European Business Association and the Chambers of Commerce and Industry are fairly active in the Lviv region. The local authorities can seek NGOs help in identifying and developing the potential supplier industries in the region. Such business associations can also persuade foreign investors to establish strong linkages with the local economy as part of their corporate social responsibility.

Developing the potential for cross-border co-operation in FDI

The following initiatives and measures can foster cross-border co-operation and stimulate FDI promotion while improving local business conditions more generally. These might include initiatives designed to:

- Improve border-crossing infrastructure.
- Enhance the roads and roads maintenance and services of key commercial arteries which cross main borders.
- Improve international air and rail links.
- Simplify and speed up customs control procedures.
- Remove unnecessary barriers to the movement of goods and people.

In terms of FDI attraction, since it is not easy to build an image of a small community, it is recommended to examine the feasibility of conducting a joint marketing campaign with neighbouring regions in Poland to get on the mental map of investors. Once the attention is attracted, the regions could use other techniques e.g. incentives, technological expertise or JV opportunities to get investment projects.

A cross-border co-operation project can be developed between the universities of neighbouring regions, which will link the students, researchers and businesses. A creation of a science region could also be considered to promote innovation and growth through co-operation.

Initiatives such as these would help improve businesses efficiency and may enhance the attractiveness of the region. These initiatives might also allow businesses to take advantage of skills in adjacent cross-border labour markets when local skills shortages exist.

ANNEX I

THE PLACE MARKETING BENEFITS OF AFTERCARE

Existing investors represent an increasingly important market segment for a growing number of IPAs. In economies with a significant installed base of foreign investors, up to 60% of FDI flows can be attributed to follow-on investment and expansion activity. In Scotland in 2003, for example, the figure reached an unprecedented high of 85%.

It has often been asserted that aftercare adheres to the old sales adage that it almost nine times less costly to sell to an existing customer than it is to attract and sell to a new customer (MIGA, 2003). To the extent that this is so, attracting and retaining FDI through well developed aftercare programmes will be less resource-intensive than attracting new FDI.

The decision to invest directly in an overseas location is, self evidently, a strategically important decision for most corporations. As such, foreign investors have a legitimate expectation of follow up services. Moreover, if the investment decision is seen as akin to a major purchasing decision, aftercare services can help investors avoid feelings of post-purchase dissonance (Assael, 1992) and reinforce feelings that the correct location decision has been made.

By working closely with local management, staff of the IPA have the possibility of nurturing a positive and distinct local identity for the investment project which comes to be shared by the local management of the foreign investor. A number of benefits can flow from this: existing foreign investors are often the first-point-of call for new potential investors and the experience and opinions of existing investors are a key factor in location selection and evaluation; companies which may be fierce competitors are often quite willing to share the information they have about overseas locations, and existing investors will often actively help a competitor to establish.

Because corporations are very aware of their image among peers, customers and shareholders, it is important for them to encourage positive awareness and understanding of the places where they operate. This can be a rich vein of market benefits which IPAs can tap into via company testimonials, joint media campaigns, joint participation in overseas missions etc.

Developing close long-term relationships with foreign investors is part of good customer relations management (CRM) and is a strategically important task in its own right. By developing strong links with senior managers in the local subsidiaries of foreign multinational enterprises, IPA staff will be able to better understand how the business operates and impacts on the local economy. They will also be in a better position to understand the needs of the business and to identify at an early stage any new investment projects which may be in the company pipeline or to work with the local management to initiate new investment ideas with the parent corporation etc.

The combination of weaker FDI flows, market liberalisation and greater investor mobility has greatly increased competitive pressure amongst host-countries/regions in recent years. Aftercare programmes have grown in importance as a result. In marketing terms, such programmes can help positively differentiate host-country locations from the near and emerging competition and have a potentially important role to play in helping to anchor existing investors more firmly to the local economy by encouraging them to both augment and deepen their local commitments – “the Gulliver Effect”.

ANNEX II

FDI AFTERCARE LEARNING MODELS

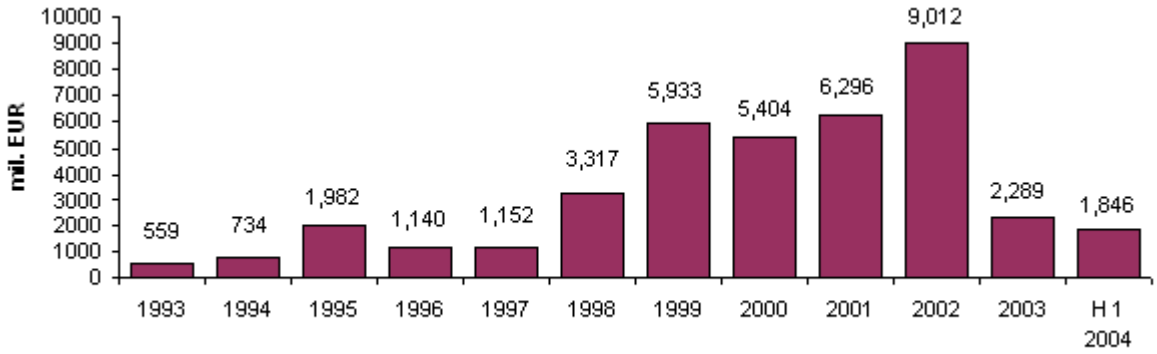
THE CZECH REPUBLIC[14]

The Czech Republic (CR) is one of the most successful transition economies in attracting foreign direct investment. Comprehensive official statistics are not compiled. According to **CzechInvest** (CI), however, there were 1061 major foreign investors in the CR, as at August 2004.

Market liberalisation, privatisation, preparation for accession to membership of the European Union and the introduction of investment incentives in 1998 have been key drivers of the upsurge in FDI which was evident up to 2002 (see Chart 5). Cumulatively, almost EUR 40 billion in FDI has been recorded since 1992.

An improving business climate and infrastructure, privatisation of remaining government stakes in state-owned enterprises and a continued rise in the level of expansion activity is expected to attract significant amounts of FDI in the future.

Chart 5. INFLOW OF FOREIGN DIRECT INVESTMENT TO THE CZECH REPUBLIC



Source: Czech National Bank, September 2004

CzechInvest Aims

CzechInvest was established by the Ministry of Industry and Trade (MIT) in November 1992. Its task was:

- To promote the (CR) internationally.

14. The author is grateful to Petr Adamek of Berman Group (http://www.bermangroup.cz) for the information and advice provided without which this case study could not have been prepared. The views expressed remain those of the author.

- To ensure a sustained inflow of foreign direct investment that would support industrial restructuring and development.

Originally a marketing agency, CI has evolved into a more powerful and fully integrated economic development agency with national level responsibility.[15] This change, supported by both the MIT and the European Union, has followed the successful implementation of key programmes to strengthen the international competitiveness of the CR. These programmes include the introduction of: the main national scheme of financial incentives, industrial zoning and a world-class supplier development programme.

In this new setting, aftercare remains a recognised core activity of CI and part a comprehensive range of services for investors which include: the handling of investment incentives; identification of business properties; supplier identification; business infrastructure development; and access to EU Structural Funds.

The Aims and Origins of Aftercare

According to the CEO of CI, the main goals of aftercare services in the CR are:

- To generate new leads, strengthen links and anchor the Czech end of the value chain for CI's main target sectors: automotive, electronics, information technology and precision engineering.
- To accelerate the growth of clusters in selected sectors such as automotive manufacture.
- To fulfil an advocacy role with government to ensure that the Czech business environment is conducive to anchoring the highest value-added, technologically driven activities by enabling existing investors to upgrade their operations.

An aftercare unit was first established within CI in 2002. The unit was spun out of the Sourcing Department which existed to help Czech suppliers link up with newly established foreign investors in CR. The aftercare unit is now part of the Investment Projects Department which together with the Incentives Departments of and the Department of Sourcing form the Investment Support Division (ISD). Thirty people are employed in ISD. The staff breakdown is as follows:

- Three people work in aftercare.
- Three work in the Sourcing Department.
- 11 work in the Incentives Department.
- 13 people work on investment projects.

However, as a main priority for CI as a whole, aftercare is viewed as a cross-departmental activity and other specialised departments also participate in aftercare activities.

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15. In 2003, as the CR prepared for EU accession and the management of structural funds, the MIT recognized that in an increasingly competitive global business environment a strong policy and programme implementing body was required. In April 2003 three agencies with complementary activities were merged to create a single structure. The agencies involved were CzechInvest (foreign investment promotion), the Business Development Agency (SME support programmes) and CzechIndustry (sector operational programmes and structural funds preparation). CzechInvest now describes itself as an "investment and business development" agency.

When first established, CI's aftercare unit had six full time staff including HR specialists, lawyers etc. Now that the organisation has become a more fully integrated economic development body providing business development services etc., the aftercare unit has lost 50% of its capacity through staff redeployment to other departments. Today the three full-time staff in aftercare work as project managers, not functional specialists.

A number of factors underpinned the first-time establishment of dedicated aftercare services in the CR. These included:

- The role of foreign advisors and experts who were helping CI to rethink its strategy and identified the opportunity to introduce new services, including aftercare.
- Extensive pre-existing contact with established foreign investors via:
  - CI's supplier development and sourcing programmes etc.
  - Company expansions which required assistance and support, especially in relation to dealings with other government departments.

The last point is especially important. Rising levels of expansion activity are the by-product of the large installed base of foreign investors which the CR has attracted. The existence of such a base was the single most important pre-condition for the introduction of dedicated investor aftercare service. CI was the public sector partner of choice for investors looking to expand as in most instances CI had already assisted in the pre-investment decision and pre-manufacturing phase of the original investment.

The Aftercare Service Portfolio

The main aftercare services which are currently provided by CI include:

- **Expansions**: facilitating the expansion of existing foreign investors.
- **Troubleshooting**: helping remove any barrier to business faced by existing foreign investors.
- **HR assistance**: assist with design and implementation of HR policies.
- **Advocacy**: input to the legislative process of the CR on the basis of the collective opinion of existing foreign investors.
- **Legal Services**: support existing foreign investors on legal issues in governmental matters.
- **Communication**: act as a one-stop shop, conduit and facilitator in foreign investor contact with government.

These services are freely provided to foreign investors. The cost of these services is not recorded and there is no third- party service provision involving the private sector.

Aftercare Delivery and Resources

According to the CEO of CI, the following criteria are used to define and target the customer base which exists for aftercare services:

- Whether an investor is an existing client of CI – these businesses make-up the bulk of the aftercare mix.

- Investors operating within sectors and clusters deemed by CI to be of strategic importance.
- Investors with potential for R&D and/or headquarter activities.
- Investors with potential for local sourcing.
- Investors that could be/are part of an exporting cluster.

The way this typically works in the CR can be characterised as follows:

- All foreign investors assisted by CI automatically become aftercare clients once their operations in the CR have started. (In exceptional cases foreign investors become aftercare service clients as soon as they have taken the formal decision to establish operations in the CR.)
- There is usually a short transition period when the assigned manager providing the pre-start assistance hands over the client investor, including electronically held data, to the new aftercare manager.
- Both CI managers would be present at the formal opening of a new facility when CI's aftercare services are formally introduced to the foreign investor.
- Subsequently, if an investment–lead is identified by the managers in aftercare unit it is passed to CI's Marketing Department and is afforded the same status and treatment as any other live investment project.

Other foreign investors eligible to apply for investment incentives, who established in the CR unassisted, are also eligible to receive aftercare support. CI now recognises the development potential of these investors which form an important part of the foreign company base in the CR.

CI's contact database is one of the most important tools in CIs aftercare toolkit. CI uses Lotus Notes as a basic CRM system: all client investor contacts, links, documents, e-mails, visit reports, minutes and transcripts of meetings are filed and held electronically. This system provides a record of the history of CI's contact with any foreign investor from initial mailings and meetings, through location and site selection (including site visits etc.), to operational start-up and aftercare.

CI has two main coding systems for recording and tracking projects – status based and priority based. Status based coding tracks the project according to the stage reached in the location decision cycle – from cold prospect to fully operational facility. Priority based coding assigns letters from A (high priority) to D (low priority). Prioritisation reflects the current priorities of government with respect to regional policy, key sectors/clusters and expected economic impacts etc. Regional policy, for example, is an active priority at the moment and under this criterion some investment projects in Prague would be C classified while similar projects in Ostrava would be A classified.

Most contacts come from existing foreign investors facing a variety of post-start-up problems and needing assistance. To this extent the CI aftercare service is reactive. However, there is also a pro-active component to existing investor support: CI staff with aftercare responsibilities aim to visit each Class A investors at least twice a year. There are around 70 Class A investors currently enrolled in CI's aftercare programme. The reactive component to the work makes it is difficult to plan and manage the work load. Experience suggests that three dedicated staff can provide support to around 270 foreign investors in the CR context.

The aftercare unit also maintains contact with non-visited foreign investors via newsletters sent by mail and e-mail and other custom mail shots targeted at particular categories of investors and particular categories of contact within companies, depending on purpose and subject.

On a regional basis, CI also co-operates with regional development agencies on aftercare. The strategy, goals and target sectors for these bodies are set by CI and the Ministry of Industry and Trade. Regional development agencies are a source of the intelligence and data needed for aftercare activities. RDAs also share the aftercare responsibility for smaller investors and help resolve problems at the regional level. Regional politicians are also involved in CI events.

Measuring Performance

The success of aftercare is largely measured in terms of its contribution to achieving CI's operational objectives. For aftercare this is defined as the number of expansions assisted every year. The target set for 2004 was ten expansions – and this was readily achieved.

The success of the aftercare unit and its staff is assessed using a "Performance Measurement Matrix" which measures achievement on three main dimensions:

Client Investor Services:

This carries a 60% weighting and includes a range of activity such as visiting and meeting with investors, troubleshooting, consultancy, providing assistance, liaising with other government departments and agencies, organising seminars etc. The measurement criteria used include the number of reports, letters and e-mails generated etc.; the number of seminars run and the number of attendees; and the results of a customer satisfaction surveys.

Structural Issues:

These carry a 30% weighting and relate to the formal reporting of structural issues (and related suggestions for improvement) which are highlighted as a result of undertaking aftercare duties. The measurement criteria used include the number of reports generated and the number of suggested solutions made.

Client Investor Performance:

This carries a 10% weighting and relates to the expansion activity of client investors. The measurement criteria used include:

- The number of jobs, and the annual percentage change in the number of jobs, associated with expansion leads passed over to marketing for investors in manufacturing, business support services and technology centres.
- The level and annual change in employment for all existing investors receiving financial incentives.
- The amount and/or annual change in the revenues, exports, profits and investment made by all existing investors receiving financial incentives. These metrics are also calculated for the economic gain "additional" to that associated with the investment incentive.

The results of the most recent survey of the level of satisfaction amongst existing foreign investor did not lead to any significant changes in the work of the aftercare unit: there were no complaints about quality and no service gaps were identified.

Recent Experience

Expansions are an increasingly important source of FDI for the CR. This is now recognised by the inclusion of expansion activity as a separate category in CI's annual investor awards. The award for "existing investor of the year" is based on a calculation of economic contribution associated with foreign investor expansion activity (i.e. total investment x newly created jobs x degree of social benefit, expressed in terms of rate of unemployment) The 2004 winners were:

- Continental HT Tyres (tyre producer) which invested EUR 74 million in an expansion of its activities in Zlin where 430 new jobs will be created.
- TG Safety Systems Czech, S.R.O. (manufacturer of steering wheels and airbags) which invested EUR 28 million in its Chomutov activities, creating 350 new jobs.
- Panasonic AVC Networks Czech, S.R.O (manufacturer of television sets) which invested EUR 44 million in the expansion of activities in Pilsen, creating 550 new jobs.

CI hosts various networking events for foreign investors which are regularly attended by top politicians. These include: formal events to recognise the contribution and achievement of foreign investors and partner organisations, and less formal exchanges where discussion is focused on providing direct feedback from top management to politicians on key aspects of the business climate in the CR.

Key Lessons

The aftercare visit programme has been appreciated by investors. This allows CI to pro-actively build up a strategic understanding of plans for future investment and to identify emerging problems at an early stage. The customised newsletter service is also well regarded by investors. Investors appreciate the "can do" attitude of CI, its responsiveness and its flexibility. This contrasts with investor experience of other central government bodies in the CR. As such CR can lead the challenging process of changing bureaucratic cultures which can be excessively rigid and inflexible from a business perspective.

Well defined overall aims, a well defined customer base, close linkage between the aftercare unit and the Marketing Department, and the use of a performance measurement system which links activities to outputs are the main operational strengths of the CI approach to aftercare. Moreover, building aftercare around the existing scheme of national financial incentives "in principle" gives the Czech approach to aftercare a degree of coherence.

However, aftercare services in the CR remain an enabler of FDI, not a driver: survey evidence indicates that in most cases foreign investors feel they would expand without the services of CI as other more important factors involved. Moreover, the lower performance weighting of aftercare activity related to the identification of "structural issues" and "expansion activity" compared with "client hand-holding" also suggests that aftercare policies consistent with the aims of strategic economic development have yet to emerge.

IRELAND[16]

The Irish approach is internationally recognised as a highly successful model of economic development. The **Irish Development Agency** – IDA Ireland - is one of a number of national government agencies at the heart of Ireland's economic development effort (see Annex 2). The IDA has primary responsibility for attracting foreign direct investment (FDI) and developing the existing base of foreign investors (aftercare), but has no formal responsibility for promoting trade or outward direct investment. The IDA has existed in one form or another since 1959 and in all probability is the first development agency of its type in the world.

The IDA has long had the aim of increasing the quality of the operations undertaken by existing foreign investors in Ireland and the IDA's aftercare approach is now well developed. (NB The aftercare services provided, the method of delivery and the resources devoted to aftercare are described more fully in Annex 3) The focus of this study, however, is on the recently developed model which the IDA has adopted to help lever greater long-term economic benefits from aftercare support. It represents the latest stage in the evolution of an aftercare approach that is overtly concerned with the strategic development of FDI and the potential long-term benefits which this can bring to the Irish economy.

The Strategic Context of Irish Aftercare

While aftercare happened to a limited extent in the 1970s and 1980s, the approach gained significant momentum in the 1990s as the size and economic contribution from existing foreign investors grew significantly. For example:

- Over the ten-year period to 2001, there was a rise of almost 44% in the number of FDI companies operating in Ireland, and an increase of over 75% in the permanent employment directly derived from this in the decade since 1992 (see Table 5).

- More than 50% of the related job approvals came from existing foreign investors: in particular, the contribution of expansion activity to jobs growth rose sharply on a year-on-year basis between 1993 and 1999 - when a five-fold increase occurred (see Table 6).

Accordingly, the activity of existing foreign investors is now a key driver of the Irish economy employing around 140 000 people directly and many more indirectly. These businesses account for 25% of GDP and over 80% of Ireland's exports. Today the IDA has the specific objective of consolidating and building on the 1300 or more foreign investors in Ireland through the provision of strategic aftercare support.

The existence of such a large installed base of foreign investors also means that over time there is a growing replacement need as initial investments reach the end of their life cycle. The rate of annual job loss among existing foreign investors in Ireland runs generally around 5-6% of the related employment base. Going forward, the IDA anticipates that the replacement requirement will rise above this norm as international competition continues to intensify. The challenge for the IDA is not necessarily to replace like with like, but to identify upgrading opportunities.

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16. The author is grateful for the information provided by Jan Smit of CSES (www.cses.co.uk) without which it would not have been possible to prepare this case study. The views expressed remain those of the author.

As Irish economic conditions have changed through the 1990's the Irish operations of many leading multinationals, such as Intel and Apple[17], have already undergone significant transformation through the expansion, diversification and upgrading of their functional and technology capabilities. However, not all foreign investors have been able to transform their operations in this way, and encouraging more to do so is also a major policy objective. The imperative for the IDA, therefore, is to enable this process not only to broaden in scope and to cover as much of the existing foreign investor base as is practicable, but to try to radically accelerate this process in the current decade.

Table 5. FDI Employment in Ireland: 1992-2001

EMPLOYMENT DATA	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
No. of Companies	860	879	914	968	1,047	1,113	1,174	1,290	1,287	1,237
Permanent Employment	78,583	81,264	85,761	92,585	99,690	109,423	118,351	126,972	142,030	138,009

Table 6. Job Approvals re. green-field/Expansion Activity: 1992-2001

All IDA Ireland Projects	Type	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
No. of Jobs approved	Green-field	7,658	5,146	4,508	7,170	6,980	8,336	8,682	8,821	12,442	6,227	9,780	2,410
No. of Jobs approved	Expansion	3,314	1,679	3,154	2,100	5,875	10,615	15,493	12,876	14,650	11,955	5,942	2,245

17. When Intel announced their EUR 300 million investment in Leixlip in October 1989 it was hailed as a milestone in Ireland's industrial development. However, nothing remains of that project today. Intel in Ireland has progressed through and out of the manufacture of circuit boards and systems, replaced its original wafer fabrication plant, and is now constructing its third plant will place Leixlip at the cutting edge of microprocessor technology in the world, operating at sub-micron level (90 nanometer logic technology).

Apple's Irish operation in Cork used to be just a large scale manufacturing plant, but over recent years it has been radically re-engineered. The lower value manufacturing process has been moved out of Ireland but Cork retains a facility with 100% configure-to-order capability. Importantly, Cork has become Apple's European Headquarters. It also has the European (multi-lingual) customer relations centre and technical support, on-line electronic sales, and a range of important functions including Treasury, Order Management, Logistics, and Data Centre.

The result is that today 30% of Apple's Irish workforce is in value added and sustainable manufacturing activities and 70% are in high value services. All these functions have been integrated into one highly cost effective model adding value to Apple Inc and increasing its embeddedness in Ireland.

Aftercare and the Future of FDI

The change imperative is rooted not only in the FDI trends and issues described above but in the Irish Government's future vision for the economy to become "innovation and market driven" (see Annex 4). Going forward, the prime requirement, according to the IDA, is for foreign investment which adds high value, requires high skill levels, is oriented more to innovation than production, and better integrates with an increasingly sophisticated local business environment because of its complexity. Moreover, in the absence of the strong labour surplus which typified the past, it will be economic activities with these characteristics which are needed to support high wage levels and allow economic growth in Ireland to be maintained.

Foreign direct investment, including expansion activity, is seen as essential to the successful realisation of this vision and will be fully incorporated into the IDA's future operating model. It is anticipated, however, that foreign direct investment will be increasingly integrated and interwoven with an Irish business-base which is becoming increasingly international in outlook. This will require that Ireland's infrastructure become comparable with that available in advanced countries: it is well recognised within Irish policy circles that the traditional policy approach of compensating for infrastructure weakness with grant incentives is now ending. As high value activities require world class infrastructure, education and services, the timely roll-out of infrastructure under Ireland's National Development Plan (NDP) will be a critical factor in developing the contribution of the installed base of existing foreign investors. Because of the nature of Ireland's regional problems, the impact of these developments can only be optimised if complemented by the implementation of the National Spatial Strategy (NSS).

The next stage in Ireland's progression towards an innovation-driven economy is expected to be completed by 2010. The installed base of existing foreign investors has a key role to play in this process and the aftercare approach adopted by the IDA fully reflects this. The nature and evolution of this approach and its implications for service delivery are explored below.

A New Model for Aftercare

As the examples of Intel and Apple illustrate, promoting a progression in the sophistication and breadth of the Irish operations of existing foreign investors means not only increasing value added in their manufacturing operations, but also adding innovative capabilities with corporate level impact such as R&D and service, logistics and supply chain management functions alongside manufacturing. The objective, therefore, is to create a more rounded and strategically important set of operations within the overall corporation. Such operations tend also to embed themselves more deeply in the local economy and are better suited to the competitive characteristics of the Irish economy going forward.

To achieve this objective, the IDA has adopted an eight-stage strategic model (see Delaney,1998) of the path multinationals might typically follow as they acquire higher value functions and increase their local embeddedness. The IDA uses this model to identify points of "client intervention" and has developed a tool kit of support around these points. These interventions are backed up with a number of incentive schemes focused, for example, on encouraging clients to undertake dedicated R&D in Ireland. Each stage will now be described more fully.

Stage 1: Establishing Start Up

This simply involves getting a foreign subsidiary off the ground in terms of premises, people, suppliers, regulatory licenses etc. Typically, the parent company will make the key decisions and provide the subsidiary with the route map it is expected to follow. The key IDA interventions at this stage are carried out by "new business" executives in regional offices. This is largely an after sales process of

ensuring premises are available, people are recruited, agreed training assistance is provided and any capital or employment grants approved are paid as per the agreed schedule. A key objective is to minimise the parent company management time and the effort required during the set-up phase, and to increase the credibility of the IDA and the local management of the Irish subsidiary.

Stage 2: Satisfactorily carrying out the Parent Mandate

New business executives will formally hand projects over to "company development" executives at this stage. Typically, the parent corporation will expect the subsidiary to deliver against the goals set for it. Here the obstacles in the establishment phase have been overcome and the subsidiary meets the expectations of the parent's performance model. The IDA believes that this is a key phase in attracting significant incremental investment, particularly for projects that are relatively easy for the parent to scale at a number of possible locations. Parent corporations may have concerns that Ireland's small size limits its ability to host a large project, but Ireland may be efficiently able to host a smaller project which also serves as a test bed of the local delivery mechanisms. The IDA invests significant resources in adding value to this stage via recruitment consultants, specialist property providers, local academics etc. to ensure that all undertakings given to the parent corporation are met or exceeded. This is designed to increase confidence in Ireland's problem solving capacity and to reduce the perception of risk. There is some evidence that this approach works in the number of initial investment decisions where major expansions followed within 18 months or so. These include Intel, Xilinx, Microsoft and Citibank among others in recent years.

Stage 3: Performing the Mandate in a Superior Way

This is the point at which a subsidiary can begin to evolve into a more independent entity or remain at a stage where its future development remains wholly beyond its control. This is the vital stage where the subsidiary can be seen to add significantly greater value to the global activities of the parent corporation compared with its peers, and thus enhance the possibility of attracting new capacity, product lines or higher value activities. The key elements that the IDA can help the subsidiary address to improve its performance at this stage are: recruiting and training key skills, providing local access to key suppliers, and supporting the development of new working practices, processes and systems. Specifically:

- The company development executive can mobilise resources from the national training authority to audit skills, deliver improvement plans and fund training programmes, including management training.
- In the area of supplier development, the IDA company development executive with the support of the regional office and others, provides an equivalent sourcing service to that provided by the Regional Supply Offices in the UK.
- The company development executive will also investigate whether the IDA can help identify and fund process or system improvements or limited product improvements which will help to provide a superior performance. Help can also be provided to identify necessary expertise and to fund feasibility studies, prototype development and testing or R&D projects.

Possible outcomes at this stage of development include a significant increase in the scale of subsidiary operations as additional capacity increases are directed by the parent to the most efficient subsidiaries. The functionality of the subsidiary operation may be broadened to include limited responsibility for process improvement and/or product enhancement or by developing a role in value added (customised) manufacturing or logistics.

Stage 4: Extending the Basic Mandate

Any extension or evolution of the mandate of a subsidiary is risky for the parent company. It may impact on the original mandate by siphoning off scarce local management resources or it may fail with a consequent loss of resources and/or failed delivery to customers. The IDA experience is that the initial extension of the mandate to new areas such as R&D or design requires considerable development effort and vigorous advocacy by local management with the corporate parent. In essence, the IDA seeks to partner with willing local managers to ensure that they receive support both in developing concepts and promoting them to decision makers at HQ. This will include the mobilisation and leverage of IDA overseas office resources, academic resources and even in some cases, political resources to influence the decisions of the corporate parent. The IDA will also use its network of contacts throughout corporate network both with the parent or other subsidiaries to lever influence. It is the IDA's expectation and experience that once the hurdle of gaining a low risk mandate extension is successfully negotiated, further extensions are more easily gained by the local subsidiary management based on the enhanced credibility which comes with a track record of successful delivery.

In the Irish experience, there are examples of local managers operating a "skunk-works" approach to build R&D capacity by hiring R&D engineers rather than manufacturing engineers and using this capacity to address unrecognised or unallocated development issues. The IDA may also provide some R&D assistance to support this process.

Stage 5: Extending the Basic Mandate –Strategic Development

Having succeeded in a low risk mandate, the Irish subsidiary is then considered to be in a much stronger position to seek mandate extensions of a more strategic nature in key areas including:

- Research, development and design.
- Strategic sales and marketing operations for a line of business.
- Value added manufacturing or logistics.
- Customer services and technical support.

The approach adopted by the IDA is similar to that of stage four, but this time the proposition on IDA support and funding is more detailed and developed. The IDA overseas offices typically have a larger role to play and in some cases (e.g. where new head office managers or a new division is involved) the project may be classified as a new business project. This is an internal IDA management judgment. Sector divisional managers are responsible for both new pursuits and company development and are thus able to maximise the knowledge, influence or resources needed to capture the project.

Stage 6: Becoming a Strategic Centre for the Corporation

At this stage the Irish operation ceases to be a solely a subsidiary and takes on regional (e.g. European, EMEA) or global corporate responsibilities. Typically, a subsidiary could assume "business line" responsibility including responsibility for global R&D for a particular product/service domain or it may become a centre of excellence or shared service centre. In the ICT industries, for example, such mandate extensions are often service projects or functions that add significant value to the corporation by helping to build customer bases, extending corporate market bandwidth or providing technological or systems advantages to the global corporation. The key distinction is that these competences are unique and are therefore not duplicated elsewhere in the corporation. The IDA approach is decided on a case by case basis in these instances. However, this may result in substantial resources of time and money being expended to help Irish subsidiary managers identify and develop opportunities and present the location

specific advantages of Ireland. Incentives may also be offered to assist with R&D, skills enhancement and employment creation. Ireland also offers tax incentives for R&D. The IDA incentive approach is based on an assessment of the value added by the project compared with proposed Irish economy expenditures (salary levels are often used as proxies for value added). In effect, IDA executives have a target not simply to create jobs but to create highly paid jobs.

Stages 7&8: Becoming a Strategic Pivot or Apex

Having proved its ability to take on a global role the Irish subsidiary may successfully lobby for a larger or more significant global role. In these cases the operation moves from having functional responsibilities specific to a product range (and global lines of responsibility) to high levels of autonomy where the subsidiary gains the strategy development and planning and control responsibilities from its parent HQ. In addition to supporting the local management in developing initiatives, the IDA can assist by mobilising key influencers who may be part of the corporation's network of high level contacts in Ireland or elsewhere globally (e.g. Irish ex pats working in key positions within the corporation, leading bankers, academics etc).

The objective of seeing some operations in Ireland move to full strategic autonomy is one reason why the institutional and political establishment has created networks and networking opportunities to allow major international players to influence public policy in areas such as infrastructure development, labour market and immigration policy and the legal regulation of the internet and e-commerce etc. The process connects leading players to key working groups in government and other institutions shaping key aspects of public policy.

Evaluation and Appraisal

This final section considers the important matter of evaluation and appraisal. The IDA is subjected to organisational evaluation by Forfas and in turn IDA executives are included in a personal performance and evaluation process broadly based on a balanced scorecard.

It is worth noting that Forfas carries out two surveys of foreign owned companies in Ireland outside the scope of Central Statistics Office operations and thus is able to sum individual company results to derive results for IDA divisions and/or individual executives. The two surveys are the annual Employment Survey and the annual Irish Economy Expenditure Survey. The key macro indicators used are:

- New first time jobs created (first time job creation is new jobs over previous peak level employment).
- Change in full time employment in IDA supported companies.
- Average cost per job sustained.
- Change in estimated Irish Economy Expenditures and Corporation Tax paid.

Forfas and the IDA have recognised that falling natural increase in the labour force and a limited ability to replace this with net in migration limits the ability to grow GDP by capacity increases (see Enterprise 2010 – A New Strategy for the Promotion of Enterprise in Ireland in the 21st Century, published by Forfas January 2000). A target has been set of an annual average increase in GDP of 5% to 2010 and the only to achieve this, given capacity constraints, are to maximise capacity utilisation in less well developed regions with spare capacity, and to increase labour productivity more generally (as measured by value added per person employed). This has led to a new set of macro targets for the IDA in line with the policy objectives of stimulating employment in less favoured regions and encouraging the creation of well-paid jobs.

At an individual executive level a balanced scorecard approach is utilised to measure and appraise performance. Key measures continue to include new jobs and higher paid jobs in existing businesses, contributing to the expansion of the Irish part of the supply chain and adding new functionality such as R&D to existing plants. Importantly, it is recognised, however, that capability expansion in the IDA client is not always immediately measurable and in many cases it will show up as prosperity improvements elsewhere through other difficult to capture transmission effects (e.g. as the position of suppliers improves, or as new skills lead to an acceleration of Irish salaries relative to the rest of the corporation, while unit costs remain competitive etc.).

The IDA Board has decided to adopt an ad hoc approach to metrics in these areas recognising the impossibility of reducing all the impacts to a measurable effect that can be captured by the IDA. Thus, each year executives will agree a plan including common targets (new jobs, new jobs over GBP 25,000 etc, new Irish supply chain purchases of £x etc) coupled with company project specific targets (e.g. finalise a stepping stone to attracting a new product line or new R&D activity).

Key Lessons

The organisational structures which support the Irish model of economic development show a high degree of co-ordination and integration both within and between the key public sector bodies concerned.

The work of the IDA lies at the heart of this effort. A pronounced feature of the IDA is its strategic approach, integrated service delivery and its flexibility: the IDA is constantly moving its focus and direction in response to a) the economic development challenges and needs which Ireland faces b) the changing nature of foreign direct investment globally; and c) the changing needs and structures of global business.

This strategic responsiveness is fully reflected in the IDA's approach to aftercare and the eight-stage model of subsidiary development which has been adopted. Each phase of this model provides a customer-led focus for the provision of a specific range of tailored aftercare services.

The IDA recognises that this model is only a characterisation and that the subsidiary operations of individual foreign investors can and do vary in terms of the nature, extent and speed of their development. Moreover, the IDA recognises that there are also many exogenous factors which can influence subsidiary development paths and that these factors lie well outside the powers and responsibilities of the IDA. It remains the IDA view, however, that most subsidiaries can be positioned within this framework and that in many cases it will be possible to pro-actively manage a transition from one stage to the next.

This model is also seen as a useful learning tool to introduce the concept of subsidiary evolution to managers in foreign companies from an economic development perspective. It also helps IDA executives and Board to agree what represents a valuable outcome from this development process. From the parent corporation perspective, each stage represents a greater ability of the subsidiary to add to the global company's value base.

SCOTLAND[18]

The inception of dedicated strategic aftercare services in Scotland broadly coincided with the bedding down of **Scottish Enterprise** (SE), [19] while much of their subsequent development occurred at a time when the new structures of government associated with Scottish devolution[20] were being set up. The most recent organisational change has been the establishment of Scottish Development International[21] in 2002 when the bodies previously responsible for trade promotion and providing services (including aftercare) to help attract and retain foreign direct investment (FDI) were brought together for the first time in Scotland.

Thus, the evolution of dedicated aftercare services in Scotland has occurred during a period of unprecedented institutional and organisational change. Devolution has also altered the Scottish policy context. Responsibility for the main levers of fiscal policy remains with the UK Parliament at Westminster, rather than the Scottish Parliament at Holyrood. The main factors underpinning the introduction of dedicated aftercare services in the Scottish context include:

- Awareness of the growing relative importance of the existing installed base of foreign investors as a source of FDI projects which perhaps could be targeted more easily and at lower marketing cost. (Indeed, the first modality analysis of FDI in Scotland was undertaken in the late 1980s by researchers in the Business Intelligence Unit of the Scottish Development Agency, one of SE's main predecessors).
- A slow down in the traditionally strong flow of large green-field projects; intensification of place competition at the regional level within the UK and internationally.

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18. The author is grateful for the information and advice provided by Colin Williamson and Sarah Thomson of Scottish Enterprise (www.scotent.co.uk) without which this case study could not have been prepared. The views expressed remain those of the author.

19. Scottish Enterprise is the leading economic development body in Scotland. Established in April 1991, Scottish Enterprise brought together the economic development and training powers of its main predecessor bodies, the Scottish Development Agency and the Training Agency in Scotland. A key feature of this new arrangement was the establishment of 13 Local Enterprise Companies – stand-alone bodies responsible for the local delivery of economic development service (including business development), but fully funded and monitored by SE. Determining the role which the LECs could play in aftercare was one of the main early challenges.

20. A change in government brought New Labour to power and devolution to Scotland, Wales and the English Regions. This gave Scotland its first parliament since 1707. The Scottish Office had its remit changed accordingly. The cabinet post of Secretary of State for Scotland disappeared and the new non-cabinet post of First Minister for Scotland was created. Scottish Office Departments responsible for devolved matters became the Scottish Executive supporting the Scottish cabinet of ministers consisting of Members of the Scottish Parliament (MSPs) from the elected party of power.

21. Scottish Development International is 100% government funded and is jointly operated by the Scottish Executive and Scottish Enterprise. Headquartered in Glasgow, Scottish Enterprise is the main economic development agency for Scotland covering 93% of the population from Grampian to the Borders.

    SDI has almost 100 staff and representatives in 15 countries throughout the UK, mainland Europe, North America and Asia Pacific. Its main aims are to stimulate and support: Partnership investments between Scottish and other companies to open new channels to markets, technologies and products; Increase trade growth by encouraging the expansion of Scotland's portfolio for first class exported goods and services to new markets; Licensing deals between Scottish and overseas companies and universities; The attraction of direct investment, concentrating on research, design and development projects with high knowledge content.

- A desire to see existing foreign investment anchored more firmly to the local economy and to see such investment become a source of higher value activity and better quality jobs with attractive salaries.

Establishing Aftercare Support (1993-1997)

The development of dedicated aftercare services for existing investors from outside of Scotland started with the appointment of a Locate in Scotland (LiS) aftercare manager in 1993. Prior to this, aftercare support was provided on an informal basis. For example, desk officers in the Glasgow HQ of LiS[22] would often undertake post-investment visits to existing foreign investors to gather company testimonials: company endorsement of the location-specific advantages which Scotland offers is a key tool in international place marketing.

The following describes the more important aspects of the process of establishing and developing strategic aftercare services in the Scottish context:

Investor Database:

An early priority for the new aftercare manager was to establish an investor database which would define the client baseline for the first time and thereby provide the basis of an effective customer relations management (CRM) system. While LiS had pre-existing lists of established investors from outside of Scotland, CRM purposes required the adoption of a more co-ordinated approach to recording more fully comprehensive investor information in real time, which could be electronically accessed.

Network Leadership:

The LiS aftercare manager led the development of the new investor intelligence database. This process involved establishing a standardised template for the type of information required (e.g. accurate current employment on a full time equivalent basis, rich activity descriptors, accurate ownership details etc.) and an agreed set of protocols for recording, processing, and accessing investor intelligence.

Network Co-ordination:

The challenge of establishing the systems to support this database was not insignificant. *Inter alia,* this required effective liaison with the LiS area teams (North America, Asia/Pacific and Europe), national sector teams (electronics, software, food and drink, energy including oil and gas etc.) within SE and securing Board-level approval from the 13 Local Enterprise Companies which delivered SE services to sub-regions and districts within Scotland. The aftercare manager was able to secure network-wide co-operation by highlighting the business development advantages of nurturing close working relationships. For example:

- LiS could directly advise and support foreign investors on all aspects on the UK grant regime, and especially Regional Selective Assistance (RSA) which was the main financial support available.

22. Locate in Scotland (LiS) was established in 1981 and charged with the responsibility of attracting and retaining inward direct investment to Scotland. LiS was Europe's first one-stop-shop for inward investors. LiS had its own advisory board and was staffed with civil servants from the Scottish Office and economic development professionals from the Scottish Development Agency. The post devolution period has seen LiS introduce a progressively stronger sectoral focus to its organisation and operation. LiS was subsumed into Scottish Development International which was established in 2002.

- Staff in LiS overseas offices could provide access to key decision makers in the corporate parent of a Scottish subsidiary.

- LiS also offered direct access to Ministers and other parts of the Scottish Executive as part of its one-stop shop approach.

Market Segmentation:

To better understand the make-up of the investor population, the aftercare manager analysed the existing installed base of investors using a number of filters including: sector alignment, size, activity, added value, and alignment with the geographical markets which LiS targeted. Segmenting in this manner prepared the way for the introduction of an aftercare approach based on "account management".

Segmenting in this manner clearly can not in and of itself guarantee the realisation of the longer-term economic development goals of aftercare as the scope for significant expansion and upgrade in the future can vary significantly, even within the target segment of investors offering greatest potential. Importantly, however, such a process helped to identify a small cadre of around a dozen foreign investors with Scottish subsidiary managers who had the drive and ability to influence the investment intentions of the parent corporation.

Aftercare contact also established that the credibility of these individuals within their wider corporate network was often based upon the value-added to the wider corporation by "skunk work" undertaken within the subsidiary. Moreover, it was discovered that recognition of this value by the parent corporation could help stimulate re-investment and enable some subsidiary mandates to be pro-actively extended beyond that originally intended.

Resource Management:

LiS adopted a matrix approach to the management of aftercare resources. Rather than dedicated aftercare staff, each of the 12 case officers in the Glasgow HQ of LiS were expected to devote half their time to new investment projects and half their time to aftercare projects. Aftercare objectives were also built into personal performance contracts, but individual targets were still weighted in favour of new rather than existing investment. Individuals reported jointly to the LiS aftercare manager and the relevant LiS desk manager. (NB There were three main desks in LiS Glasgow covering North America, Europe and Asia/Pacific. This reflected the marketing principle which LiS had adopted of working on the basis of key geographies.) In practice, the 50% rule of thumb was difficult to maintain due to the nature and volume of the work associated with the generation and conversion of investment leads from overseas.

http://www.scottishdevelopmentinternational.com/pages/AboutSDI/AboutSDI.asp - top#top

Measuring Success:

The introduction of dedicated strategic aftercare services also required the adoption of new performance measures. Conventional measures of expansion activity, such as the amount invested and the number of jobs created and safeguarded, both directly and indirectly, were supplemented by other measures related to subsidiary upgrading (e.g. resources dedicated to the development of new international products, processes and services; the number type and strength of linkage with local research institutes and universities; the amount of extra value added etc.).

Embedding and Extending the Aftercare Model (1997-2001)

In 1997 a dedicated aftercare team of three full-time staff was established in LiS for the first time. "Customer Segmentation" and "Account Management" continued as the preferred method of managing aftercare delivery. The key development during this period was the delegation of greater responsibility for the handling of the day-to-day relationships with existing overseas investors to the business development functions with the 13 LECs. A key factor enabling greater delegation was the development of new guidelines and protocols on aftercare. This process required LEC agreement. The agreed working practices were published internally in an operating manual entitled "Network Investor Support Guidelines".

Another key development during this phase was the introduction of global teams. These were established to enhance the ability of LiS to support "key accounts" at every stage in the process of subsidiary expansion and upgrade. "Key accounts" were identified through a process of prioritisation according to level of economic impact (high, medium, low). It was decided that high and medium impact companies would be account managed and that account plans would be prepared for each existing investor. In terms of account management responsibilities, LiS would lead on high impact companies, with LEC support. These responsibilities were reversed in the case of medium impact companies. Formal contact with low impact companies would also be maintained, but this was expected to be less frequent and not on a face-to-face basis.

The global teams consisted of three people, usually a member of the LiS aftercare unit, a LEC business development executive and a member from the LiS overseas field staff. Where a US corporation had a regional HQ with business unit responsibility for the Scottish subsidiary the aftercare team might also include a member of the LiS field staff in Europe. Global teams had account leaders and this was usually the person closest to the key decision makers and influencers in the overseas company.

Global teams operate on the basis of an "Account Desk Plan" which is signed off with the company. This plan represents a joint agreement on the support needed and provided. Typically this relates to existing programmes of business advice; LEC assistance for any planned diversification; identification of expansion projects; and the level of support which could be provided under SE's current business development programmes etc.

The Current Model

In October 2001, the Scottish Executive launched its new strategy for Scotland's international economic development following the launch of its blue-print for a "Smart, Successful Scotland" (Scottish Executive, 2000). Scottish Development International was then formed, to bring together the former inward investment group (LiS) and the former export promotion group (Scottish Trade International).

At the time of writing, ongoing support to existing overseas investors was managed and co-ordinated by the Investor Support Team within SDI. Working closely with account managers across the domestic and international network of Scottish Enterprise, the team of three dedicated staff supports the continued pro-active development and expansion of subsidiary operations through a comprehensive aftercare programme delivered by SDI and the SE network. Currently the services provided include: business development support; marketing, market research and PR assistance; facilitated access to international networks; specialised training and re-training; and increasingly specialised financial support. The latter is a key component of investor support in Scotland. The financial incentives and supports[23] currently available

23. **Tax Credits for Business Expenditure on R&D:** For mall and medium sized enterprises (SMEs) this programme gives companies tax credits on the qualifying money they spend on R&D by increasing the tax relief they can claim from 100 per cent to 150 per cent on their qualifying R&D spending, if they are in

reflect the high priority which the UK Government attaches to the promotion of innovation throughout the economy. These schemes constitute an important component in a chain of public and private sector funding to stimulate and support innovation and commercialisation.

The main investment incentives and the tax regime are attractive to large companies wishing to invest in R&D. The UK Government has also targeted discretionary funding to stimulate and support business-based R&D projects. There are grants to support training and job creation, and public investment funds to stimulate innovative new technology ventures in key industries.

Strategic Aftercare in Action

Strategic aftercare has already facilitated significant change amongst leading foreign investors in Scotland. In the past this was especially pronounced in the experience of subsidiary expansion and upgrade of companies such as Hewlett Packard (South Queensferry) and NCR (Dundee). And such developments continue to characterise the subsidiary development of leading foreign investors in Scotland today.

Polaroid UK Ltd

Now a Division of the Petters Group Worldwide following its acquisition in January 2005, Polaroid has been in Scotland for 40 years and continues to play a major role in the Polaroid Corporation. In partnership with Scottish Enterprise, Scottish Development International and Dunbartonshire Enterprise, Polaroid UK Ltd. has successfully implemented a strategy which has seen the operation in Scotland migrate from a manufacturing cost centre to a business centre with a higher value skills set covering: high specification film, sunglass lens and digital equipment manufacturing, product and customer service and over half the company's design and development capability.

National Semiconductor

National Semiconductor is another established investor which has faced major challenges recently. Attendance at a Locate in Scotland (now Scottish Development International) sponsored seminar on corporate influencing in May 2000 was one of the most significant forms of aftercare support which the company has received. The resulting initiatives and on-going LEC support have had a major impact in turning around the fortunes of National Semiconductor's manufacturing facility in Greenock.

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profit; or giving them a cash payment of GBP 24 for every GBP 100 they spend on R&D if they are not in profit.

Large companies can claim an extra tax deductible allowance of 25 per cent on top of the existing 100 per cent first year allowances on qualifying R&D spending. For example, if a company spends GBP 100 000 on qualifying R&D, it can deduct GBP 100 000 from its taxable income under ordinary tax rules and an additional GBP 25 000 under the R&D tax credit. And for a company paying the main rate of corporation tax at 30 per cent, the total credit would give a reduction in tax of GBP 37 500.

Regional **Selective Assistance (RSA)** RSA is a national grant scheme, aimed at encouraging investment and job creation in the areas of Scotland designated for regional state aid under European Community law (the Assisted Areas). Eligibility criteria include: Location (it must take place in an Assisted Area); number of jobs created and safeguarded; capital investment must be involved; commercial viability; the investment must need RSA to make it happen. Most grants represent about 10-20% of project capital expenditure. These grants generally work out between GBP 5000 and GBP 10 000 per eligible job, with more for higher quality jobs. For projects involving relatively low levels of capital investment, assistance can be calculated against the first two years' salary costs of new project jobs. RSA is not limited to a single grant, and can be awarded for subsequent expansion projects.

IBM:

In 1954, IBM expanded from temporary premises into its first custom-built manufacturing facility in Scotland. When IBM celebrated its 40th anniversary in Scotland, its Greenock facility was one of the most advanced electronics plants in the world and its workforce of 2500 were responsible for producing one fifth by value of all of Scotland's manufactured exports. Today, server and desktop manufacture has been wholly outsourced and 75% of the 3500 people on-site help IBM to maximise value-adding technical services through their expertise in applications integration, languages and procurement. This transition has been achieved with the help of a pro-active approach to aftercare.

The impact of aftercare support is now tracked closely on a project by project basis. Particular attention is paid to investment projects which enhance a Scottish subsidiary's capability to undertake R&D and to create high value jobs (i.e. jobs with salaries in excess of GBP 26 000). However, to date there has been no comprehensive assessment of the economic impact of aftercare support in Scotland.

Key Lessons and Future Directions

Scotland now has one of the largest and most active investment promotion networks in Europe. Scotland has a long track record of success in targeting high-value-added sectors, such as microelectronics, life sciences, energy, creative industries and financial services. This was most recently recognised when Scotland won the Financial Times' FDI Magazine award for "European Region of the Future 2004/5". Pro-active aftercare policies have made a substantial contribution to this success by enabling close long-term relationships to be forged with strategically able managers in the Scottish subsidiaries of leading foreign investors. The evolution of aftercare support in Scotland holds a number of practical lessons. These include:

- The importance of segmenting the client base in order to identify the key local subsidiaries and subsidiary managers which offer the best prospects of leveraging the greatest long-term economic benefits; this also enables scarce resources to be focused and tailored to need.
- The strategic importance of forging and maintaining close relationships with key subsidiary managers through a well-manage "key account" approach.
- The significant challenge of establishing new working practices and leveraging resources for aftercare from the centre and on a network-wide basis – when additional resources are scarce.
- The adoption of smart working models, such as functionally based matrix management, does not guarantee higher productivity, and win-win outcomes.
- Enhanced understanding how leading foreign investors can help other businesses to scale (via supply-chain development and/or technology transfer, for example), and open up significant export opportunities.

Strategic aftercare, with its greater focus on leveraging asset-augmenting investment which enhances Scotland's innovative capacity and capability, has already contributed to Scotland's success. Progressive embedding under SDI's co-ordinating influence has ensured .that aftercare is now much more of a shared responsibility across the SE network, rather than the exclusive domain of a few dedicated aftercare staff in a single specialist unit. The next step in this progression is expected in the near future when the present aftercare responsibilities of IST will be fully integrated into enhanced SDI sector teams. [24]

24. These teams will provide support to Scottish-based businesses (regardless of ownership) on all aspects of their international development. This will encompass both trade and investment promotion and support,

ANNEX III

THE IRISH ECONOMIC DEVELOPMENT MODEL

Currently, the IDA is one of a group of national state agencies involved in Ireland's economic development effort (see Chart below for more details). The IDA works alongside Enterprise Ireland (which promotes the development and international competitiveness of indigenous enterprises) and Science Foundation Ireland (which promotes the development of research skills in business and in the third-level education system). This structure has existed since 1994. Prior to this the IDA had a broader remit.

All three bodies are responsible Forfás – another government body. Forfás is the national policy advisory board for enterprise, trade, science, technology and innovation. . Forfás has a co-ordinating role to ensure there is coherence in the activities of the different bodies. It operates under the auspices of the Department of Enterprise, Trade and Employment. Forfas is the body in which the legal powers for industrial promotion and technology development have been vested. It is also the body through which powers are delegated to Enterprise Ireland for the promotion of indigenous industry and to IDA for the promotion of inward investment. This structure has existed since 1994. Prior to this the IDA had a broader remit.

IDA is funded by government grant and supported by European Union programmes. IDA is directed by a 12 member, largely private sector, board. The IDA service delivery is organised around four sector divisions in Dublin, 14 foreign offices around the world and three Area Directors responsible for ten regional offices around Ireland (see Chart below). There are no independent organisations at super region or regional level almost without exception. The exceptions are Udaras Na Gaeltacht, the regional authority for the Gaelic speaking areas and Shannon Development, with special responsibility for the development of the Shannon Airport area. Even in these cases the IDA and Enterprise Ireland provide key marketing and company development services. In the planned regional dispersal of Enterprise Ireland's current activities, it seems likely that Shannon Development will be subsumed within EI ( ). At county level, enterprise agencies are usually small and largely deal with relatively small Irish owned start up companies. Chambers of Commerce are voluntary membership organisations which may provide local assistance in dealing with local authority services or accessing other local services. They also play a role in lobbying local and national politicians on local development and infrastructure issues.

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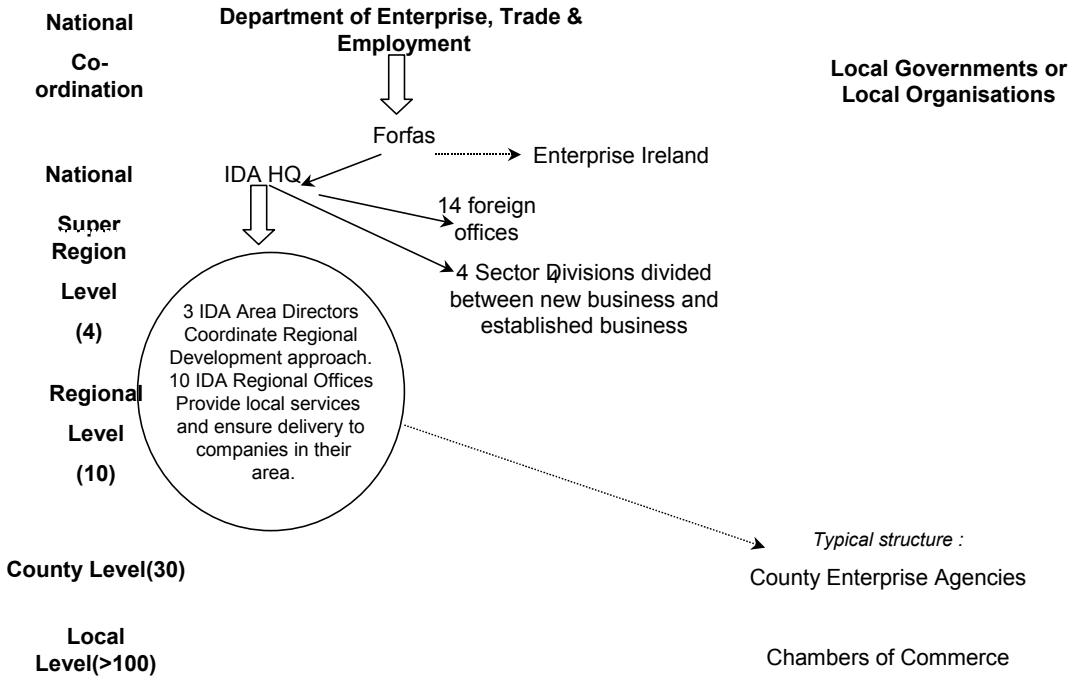
and as such, represents a fully integrated approach to international business development. The model is most probably the first of its kind.

IPA levels



Source: IIDA Annual Reports, Forfas Strategy 2010, Enterprise Ireland Guide

ANNEX IV

THE IRISH APPROACH TO AFTERCARE: SERVICES, DELIVERY AND RESOURCES

Aftercare Services

The main services currently delivered by the IDA to existing investors include: the provision of information on key business sectors and locations within Ireland; assistance in expanding a business in Ireland; and advice on property solutions.

Financial assistance is also a key element of the aftercare support package. The types of grants which are available to existing foreign investors wishing to expand include: employment grants, R&D grants, training grants and capital grants. IDA evaluates potential projects through a process of negotiation: the unique characteristics of any proposed project determines the incentive package available, in particular it's location.

The IDA's development programmes with existing investors also include a new range of support to enhance the level of functionality in local operations. This includes areas of specialist activity such as marketing responsibility, logistics management, supply chain management, customer care, financial and shared services and ultimately, research and development.

Delivery of Aftercare

The IDA operates a sector-focused structure. Current priorities include advanced manufacturing projects in the information and communication industries, life sciences (pharmaceuticals and biopharmaceuticals), medical technologies and engineering sectors; and internationally traded services in sectors such as software, financial services, shared services and customer support activities. The senior managers of sector divisions also have a regional focus (to add to the drive to deliver on regional development objectives) and a business development focus (to focus more attention on the existing base of investors and their development) to their remit.

Sector divisions are divided between "new" and "established" company development executives. The new business executives are concerned with the capture of new projects and their immediate post establishment period. Depending on the complexity of the set up process, projects are typically handed over to established company development executives between six and 18 months after start-up. Each company development executive has a portfolio of companies that they manage to meet targets set as part of their annual personal appraisal and evaluation approach.

The company development executive is the main player in the provision of aftercare support. It is their responsibility to maintain regular contact with their portfolio of companies and to leverage the IDA and other resources required to meet the development objectives agreed with companies.

The company development executive is not necessarily a sector-specific specialist, but would have sufficient depth of knowledge to be credible with senior executives in that sector. (The sector knowledge expected would be typical of that expected from a finance director in the sector). Close working relationships within the sector-focused divisions are promoted to ensure efficient knowledge sharing and transfer. The IDA invests substantially in training programmes.

The company executive is also expected to build a network of key relationships to assist the company development approach. This is likely to include key local academics, service providers, key potential suppliers and regulators etc. It can also include key executives in the European or higher level strategic control of the Irish subsidiary in partnership with the subsidiary management. The IDA overseas offices would be involved in any contact with headquarters executives in their territory to maintain existing relationships. The IDA also employs contemporary knowledge and relationship management techniques including the utilisation of the Internet, Intranets and existing IDA company databases to improve knowledge capture and transfer.

The company development executive role is primarily a strategic development role. Aftercare support for day-to-day operations is provided by the network of ten IDA regional offices. The regional office has a major role in the establishment phase in ensuring:

- Sites and premises are delivered to specification and on time.
- Planning, environmental and other regulatory processes run smoothly.
- New companies are introduced to local service providers and utilities; and integrated into local company networks (e.g. Chambers of Commerce and sector specific groups).

The regional office continues to be responsible for the identification of any local obstacles to development and also acts as the local "eyes and ears" of the IDA. The regional offices are expected to develop a network of contacts in the local authorities, local educational institutions and local service providers to ensure that they are kept informed of developments which may impact on companies in their areas. The regional office executives are required to be kept informed of any contacts with companies in their area by company development executives. It is normal for a regional office executive to attend any meeting by an IDA HQ executive to a company in the region to ensure maintenance of local relationships.

Aftercare Resources

It is difficult to determine the actual level of resources devoted specifically to established business rather than new business other than to agree that overall about 50% of regional office and sector division time is spent on this element of activity. The view of independent professionals who have knowledge of the IDA is that this could represent about 40 sector division company development executives at HQ. The IDA claims that there are over 1300 overseas companies in Ireland implying an average portfolio of over 30 companies per executive. However, the informal view of one insider is that typically a company development executive would have from 40 to 60 companies in their portfolio with about 20 active cases at any one time. Such discrepancy merely highlights the difficulty of balancing the re-active with the pro-active elements of aftercare and the implications this has for task allocation, time-management and staff head counts.

ANNEX V

THE IRISH GOVERNMENT'S VISION AND STRATEGY TO 2015.

Vision for the Irish Economy

The vision of an "innovation-led" economy for Ireland is based on the following assumptions:

- Economic growth and prosperity in the most advanced countries will be driven by innovation rather than by efficient conversion.
- Innovation is now transnational. It occurs where talent is nurtured, where expertise and research skills are greatest and where creativity flourishes.
- Innovative local milieu, such as clusters and ecosystems which underpin national competitive advantage, play a considerable part in this.
- Innovative local milieu enable research and knowledge, high level skills and expertise, high quality infrastructure and business services to be efficiently formed and combined in flexible and creative ways.

Ireland's New Enterprise Strategy

The report of the Enterprise Strategy Group, "Ahead of the Curve: Ireland's Place in the Global Economy was published in July 2004". This sets out the first private-sector developed enterprise strategy for Ireland in 12 years. It makes a series of key recommendations designed to ensure competitive advantage and to build the conditions essential for strong and sustainable enterprises in Ireland to 2015. The recommendations concentrate on matching Ireland's established expertise in manufacturing with comprehensive capability in sales and marketing and in R & Development. It is hoped that this will enable Ireland to exploit new opportunities in high value manufacturing and internationally traded services.

Key recommendations include:

- The establishment of a two complementary structures within Enterprise Ireland: Export Ireland and Technology Ireland. Export Ireland is to take a focused approach to export market intelligence and promotional activities. Technology Ireland is to develop a strategic approach to market-led applied R&D.
- The placing of 1000 extra sales and marketing professionals in Irish firms over five years.
- The matching of public funding for applied research and in-firm R&D with that invested by the Department of Enterprise, Trade and Employment in basic research.
- The allocation of an annual budget of EUR 20 million for five years to support the creation of enterprise-led networks, which would collaborate in areas such as marketing, R&D and training needs.
- The implementation of a national 'One Step Up' initiative to encourage participation in ongoing learning.

- Continued Government commitment to the 12.5% corporation tax rate.
- The introduction of a common Chairperson for the Boards of Forfás, IDA Ireland and Enterprise Ireland, to facilitate greater co-ordination of the enterprise development agenda.

In order to see the recommendations implemented, the Group has proposed an Expert Group of Secretaries-General of six Government Departments and four private sector representatives, which would meet four times a year to prioritise and progress the enterprise agenda. Their work would feed in to a full Cabinet meeting, dedicated to enterprise, held every six months.