MNC-SME LINKAGES in Latin America

White Paper

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MNC-SME Linkages in Latin America

INTRODUCTION

Multinational corporations (MNCs) and small and medium sized enterprises (SMEs) play distinct roles in the global economy. The past three decades have seen an acceleration of globalization, as measured by international capital, trade and human capital flows. International collaboration and trade deals have also significantly benefited Asian and Latin American and Caribbean (LATAM) economies. MNC business models were ideal for spreading innovation globally, tapping into diverse sources of human capital, taking advantage of lower production costs, and accessing various sources of finance.

In the case of SMEs competing in the 21st century’s globalized world, smallness can be a virtue. To begin with, smallness along with technology are the great “equalizers”. It is increasingly accessible and affordable to firms of all sizes and across a spectrum of industries. Technology-based systems and sources are now within the reach of firms for market intelligence, production, management information systems, control, financial management and customer service, thereby helping to level the playing field for SMEs as they compete with MNCs. Furthermore, smallness permits SMEs greater flexibility, latitude and speed in responding to threats or opportunities. Additionally, whether the SMEs are from industrialized nations or emerging markets, market liberalizing and reform measures by governments (e.g., tax, investment, monetary, and regulatory policies) may enable SMEs to be more productive, efficient and profitable, while also attracting greater investment.

As the LATAM business environment becomes increasingly competitive, MNCs and SMEs are faced with both challenges and opportunities to boost profitability, profit growth, market share, and equity value of their firms. Among the key strategies to meet their goals, MNCs and SMEs have come to realize that linkages can produce the desired results.

This white paper explores the issue of MNC-SME linkages as it relates to MNCs operating in LATAM and reports on the experiences of a number of companies who have established linkages with SMEs in the region. In particular, this white paper focuses on synergistic linkages, or those that strive to help both actors grow, become more competitive and innovative. The document is organized as follows, the next section contextualizes MNCs and SMEs in general and in LATAM in order to highlight the importance of MNC-SME linkages in the region. We then present a discussion on the types of linkages that can be established, and the factors that encourage and impede synergistic linkages. We then outline the findings from interviews conducted with six MNCs operating in LATAM before presenting the study’s conclusions. Hopefully, the experiences and lessons learned will be helpful to both MNCs and SMEs as they consider linkages in the future.

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1 Exemplary cases in points are General Electric, Tata, Rio Tinto, Siemens, and Embraer.
MNC-SME LINKAGES IN LATIN AMERICA

Background and Context

This section provides an overview of the economic context under which MNCs and SMEs are operating, with special focus on conditions in LATAM.

THE AMERICAS

Over the past 15 years, LATAM economies have experienced average annual GDP growth of about 3 percent, far slower than growth in other developing regions. Over the same period, China, South Asia, and sub-Saharan Africa exhibited the fastest annual growth at more than 5 percent. Almost 80 percent of LATAM’s GDP growth over the past 15 years has come from strong labor inputs reflecting growing populations rather than rising productivity (see Fig No 1).

While the outlook for LATAM is relatively positive, recent years have not been good. The region was most severely affected during the latest global economic recession. Deceleration of the economy and weak commodity prices resulted in a 14% decline in FDI flows to South America. Output contracts declined by 3.6%. The bright side was that mining, motor vehicle manufacturing, and cross-border M&A activity resulted in equity inflows climbing from $2 billion in 2015 to $9 billion by end of 2017. Rising commodity prices will help exporters and will bolster both private consumption and public finances.

LATAM’s economy is expected to accelerate in 2018, with GDP forecasted to expand this year at the fastest pace since 2013. The anticipated financial recoveries of Argentina and Brazil are the primary drivers of the region’s forecasted growth. Reform efforts and a healthy global backdrop will likely support growth in Argentina, while Brazil is expected to benefit from lower interest rates and a recovering labor market.

Conditions vary from country to country, but forecasters predict that LATAM will register modest economic growth of 1-1.5% this year. Brazil and Argentina are coming out of recessions. Mexico, Chile, Colombia and Peru are expanding at a sluggish rate of 2-3%. Only in Central America, the Dominican Republic and Bolivia is growth a respectable 4%. Venezuela’s economy is collapsing. Many countries are adjusting nicely to the commodity price dip. The region’s current account deficit narrowed by 1.4% percentage points for GDP last year; inflation is falling, allowing central banks to cut interest rates.

However, rising public debt and political uncertainty pose a threat to the slightly rebounding economies. The rise in public debt stems from government spending. The primary fiscal deficit (i.e., before interest payments) in the region as a whole increased from 0.2% of GDP in 2013 to 2.6% last year. Additionally, many governments are starting to scale back spending, which could limit investment in much-needed economic development elements, such as infrastructure and wide-scale technological development.

The risk posed by political uncertainty is also inhibiting greater growth. The renegotiation of NAFTA and the threat of populist policies from the U.S. has not had significant effects on the Mexican economy, but the country is being impacted by unpredictability. Recovery efforts were hampered by the two massive earthquakes in September, but robust external demand and healthy tourism revenues seem to be propping up growth for the time being.

Domestic politics add to this threat: the region will not return to faster growth unless it solves the structural and developmental problems that hold it back. These include poor infrastructure and education, badly-designed taxes and regulation, and rampant corruption among public officials. Currently, the only president who is even moderately popular is Mauricio Macri of Argentina. In Brazil, Michel Temer has an approval rating of 7% and may be removed from office because of corruption allegations.

In light of all this, it is hardly surprising that investment remains depressed. In the short term, growth is coming mainly from a small recovery in exports and from import substitution. The results of 2018 presidential elections in Brazil, Colombia, Paraguay and Mexico will be crucial in determining long term growth prospects. We will now turn to providing a general discussion of MNCs and SMEs within the context of Latin America.

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6 FocusEconomics. https://www.focus-economics.com/regions/latin-america
MULTINATIONAL CORPORATIONS (MNCS)

MNCS account for only 2% of the world’s jobs but own or coordinate supply chains that account for 50% of world trade, comprise 40% of the value of the West’s stock markets, and own most the world’s intellectual property. They support 80 million jobs and turn a profit of $1 trillion.9

Over the last two decades, a new generation of multilatinas with regional presence and global ambitions has emerged in LATAM.10 (See Fig No 2). Bimbo, LATAM Airlines, Cemex, Techint, and Falabella, have joined emerging market multinationals from other regions, primarily Asian companies such as Lenovo, Hyundai, and Tata to become specialists, shapers, regionals, or integrators in their geographic scope.11

While MNCS still dominate global business, they have been facing serious challenges. Profits have dropped 25% over the past five years. A strong dollar, low oil and other commodity prices, and increased competition from local, increasingly sophisticated firms have slowed the growth and return on equity of multinationals companies.12

The economic recovery in Latin America will be gradual, and the 2018 outlook is clouded by uncertainty related to the upcoming elections in various countries.

Growth prospects for Central America & the Caribbean remain depressed due to fiscal imbalances and acute political noise.

Panama and the Dominican Republic will be the fastest growing economies in 2018. Venezuela will continue to suffer with growth projected at -0.5%.


11 F. Robles, F. Simon and J. Haar, Winning Strategies for the New Latin Markets, Upper Saddle River, N.J.: Prentice-Hall, 2003. Specialists have a narrow geographic focus such as Delphi and Embraer. These firms are best in class in a specialty area or focus on part of the value chain. Shapers have a broad focus and create and dominate industry “slivers”—change sentence to read: they can shape a sector or reshape an industry. Softtek and Banco Santander are examples. Regionals are firms with access and scale limited to home or regional markets where they dominate, such as Chile’s Falabella. Integrators such as Telefónica and Cemex have global access and scale superiority and derive advantages from cross-border integration.

MNCs in LATAM

It is not possible to generalize about multinationals operating in the Americas, since competitive conditions, tax and regulatory policies, labor, and economic and financial conditions vary from country to country. The operating conditions for various industries and companies vary significantly as well. All of these factors determine the growth prospects for multinationals and their suppliers in the region. Overall, however, the business outlook for multinationals in the region remains positive.

MNCs in LATAM are faring relatively well. The percentage of MNCs in the largest 500 companies in LATAM has continued to grow since 1991. This growth is accompanied by a decline in government-owned companies, further benefiting MNCs in the region. As illustrated in Fig No 3, since 1991 there has been a steady decline of both government-owned and Latin-owned large national companies while MNC ownership has been increasing, from 27% of the largest 500 companies in 1991 to 39% in 2001.

MNCs typically expand their businesses in new countries through Foreign Direct Investment (FDI), which generates higher profit levels versus exporting to these markets. A joint venture is usually the best option when a company wants to get immediate understanding of the market and enter the market through a less capital-intensive approach. The LATAM region has witnessed a steep rise in joint ventures initiated by MNCs. In the long run, MNCs can generate value in regional acquisitions in two ways: increasing productivity and capturing synergies. Examples include Grupo Modelo (Mexico), Enersis (Chile) and CPFL Energia (Brazil).

FDI flows to LATAM fell by 14 percent to $142 billion in 2016, their fifth straight year of decline, according to UNCTAD’s World Investment Report 2017. FDI outflows by the region’s MNCs fell a staggering 98 percent to reach just $751 million. This was due to strong changes in intra-company lending flows that pushed overall outward investment into net divestment of foreign assets in Brazil and Mexico. FDI prospects for LATAM in 2017 remain muted. FDI to the region is also likely to be affected by uncertainties about economic policymaking in the United States.

Unsurprisingly, most challenges for companies operating in the region are related to fundamental political and structural risks. The lack of confidence in the state, both in terms of legal frameworks which

business operate under and the economic management of countries was a key theme in a recent survey of LATAM executives.\textsuperscript{15} There is also, of course, the problem of corruption. According to Transparency International, almost two thirds of people surveyed said that corruption had risen in the 12 months prior to when they were questioned (62 percent). More than half said that their government is failing to address corruption (53 percent). And one in three people who had used a public service in the last 12 months said they had to pay a bribe (29 percent). Bribery was found to be most common in Mexico and the Dominican Republic where 51 percent and 46 percent of those surveyed said that they had to pay a bribe to access public services.\textsuperscript{16} We will now turn our attention to SMEs.

**SMALL AND MEDIUM-SIZE ENTERPRISES (SMEs)**

Small and medium enterprises play a significant role in the economies of developing countries.\textsuperscript{17} SMEs represent over 90 percent of firms, and in spite of generally being less productive than large firms, they represent 40 percent of GDP in developing economies. SMEs contribute up to 60 percent of employment, creating 4 out of 5 new formal jobs. These numbers are higher if informal SMEs are included.

A World Bank Group study suggests there are between 365 and 445 million micro, small and medium-size enterprises in emerging markets: 25-30 million are formal SMEs; 55-70 million are formal micro enterprises; and 285-345 million are informal enterprises. Moving informal SMEs into the formal sector can have considerable advantages for the SME (for example, better access to credit and government services) and to the overall economy (for example, higher tax revenues, better regulation).\textsuperscript{18} SMEs also face internal competition and challenges from larger firms, including consolidation by large firms and their SME competitors and suppliers.

\textsuperscript{15} Written by Claudia Dill, Chief Executive Officer LATAM and Member of the Executive Committee, Zurich Insurance Group. “What are the top risks to doing business in LATAM?” World Economic Forum, www.weforum.org/agenda/2017/03/risks-business-latin-america/.


\textsuperscript{17} The OECD defines SMEs as “non-subsidiary, independent firms which employ fewer than a given number of employees,” which varies from country to country. The upper limit typically ranges from 200 to 500 employees. SMEs are also defined by financial assets as related to the cost of employee turnover as well as balance sheet limits. (stats.oecd.org).

BACKGROUND AND CONTEXT

SMES IN LATAM

SMEs play a vital role in economic growth and development via employment, innovation, tax revenue generation, entrepreneurial activities and their contribution to economic competitiveness of clusters and regions. Multinationals increasingly turn to them for services as suppliers, distributors, customers and innovators.19

SMEs in LATAM face major organizational changes due to globalization and shifting corporate paradigms—traditional, personalized hierarchies (the typical family-owned firm) are passé. Firms need to develop modern, nimble and transparent management and business structures.20

In the case of Nicaragua, a research study by the Chamber of Industries concluded that if SMEs could substitute imports utilized by large companies in the country, they would be able to reduce their costs by 8-15% and boost their sales by 20%.21

In LATAM, governments often make significant efforts to support SMEs in formalizing and growth. In Costa Rica, SMEs account for 95 percent of all enterprises in the country, generating 46 percent of employment and contributing 30 percent of GDP in 2012. However, estimates say that about 78 percent of SMEs are not totally legal. The government has therefore undertaken substantial efforts to train SMEs on business growth topics, such as accounting, finance, inventory management, investment in technology and more.

MNC’s supply chain success depends largely on their ability to build long-term, mutually-beneficial relationships with local suppliers, whether in manufacturing or services. This is challenging, as SMEs often do not operate as efficiently as MNCs, and both their company and national culture may differ greatly from that of MNCs. MNCs that master the ability to outsource production of services, and who are able to successfully manage and navigate complex supplier relations stand to gain from partnering with SMEs. Meanwhile, small, local, small companies can be enormously bolstered by having huge multinationals as a client. This often comes with substantial learning and an increase in reputation that makes them more attractive to other big clients.

For SMEs, penetrating global value chains is a daunting challenge. The barriers to entry are high with large firms demanding a solid track record of quality, compliance with standards, capacity, and reliability.22 Globalization may not allow local companies to access all the technologies and brand equity that MNCs enjoy, but they do have a number of advantages that give them a competitive leg up: engaging deeply with customers and end users, partnering with local suppliers, fostering the development of the local talent pool, shaping the regulatory and institutional environment, and participating in the broader development of social value. Natura Cosméticos in Brazil is a prime example.23 The company integrated its sales and distribution activities with community life, bolstering its profitability while also adding social value through its relationship (corporate outreach) managers. They also integrated their local supply base by working closely with local communities and suppliers, often in remote regions, to develop their skills and methods. Local suppliers like being associated with Natura because the relationship helps improve their capabilities and reputation. In return, they offer the SME lower costs and better service. Again, the access to technology and its increasing affordability, combined with the enabling role of government (i.e., technical assistance, financial support, etc.), provide SMEs with a boost to their competitiveness in the marketplace as well as the possibility to leverage their agility and flexibility. All this also helps determine the type of linkages that can be established between MNCs and SMEs.

Access to technology, technical assistance, and financial support can boost SMEs’ competitiveness and enable them to leverage their agility and flexibility


Types of Linkages

Promoting and tightening relationships between large companies, whether multinationals or not, and small local enterprises located in less developed areas may trigger regional development. The public sector often plays an important role by providing expertise and financing.

Forging linkages between MNCs and SMEs is the one termed “backward vertical”, in which the role of SMEs are as suppliers of input goods or services to MNCs. A secondary kind of linkages are “forward linkages”, in which SMEs are purchasers of MNC outputs.

Recent business sector developments, especially the increasing reliance on outsourcing, have both increased the importance of linkages and affected their sectoral composition. Much of the outsourcing has consisted of industrial companies divesting non-core activities and sourcing them from outside service providers. Consequently, the linkages between large industrial enterprises and smaller service vendors, including in the developing world, have gained prominence. SMEs are well-positioned to collaborate with MNCs to improve productivity, since they enjoy low overhead costs and have the ability to specialize in certain niches, enabling them to deepen their expertise in core activities and do things larger companies cannot do.

BACKWARD AND FORWARD LINKAGES

The most commonly considered kind of linkages between MNCs and SMEs is the one termed “backward vertical”, in which the role of SMEs are as suppliers of input goods or services to MNCs. A secondary kind of linkages are “forward linkages”, in which SMEs are purchasers of MNC outputs.

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For MNCs the strength and vitality of global value chains are of significant importance as they call for stable and sustainable relationships with high performance partners. Working with SMEs can help large companies increase their productivity, drive innovation, access talent and markets and adapt to changing conditions. In selecting SME suppliers, MNCs look for price, quality and delivery capabilities. Therefore, SME suppliers that focus on core competencies have the best success in partnering with MNCs.

MNCs connect with suppliers in a variety of ways. Online resources—supplier portals, e-auctions and e-tenders—are among the fastest growing methods for connecting. As MNCs consolidate their supplier base and begin replacing short-term transactional relationships with long-term collaborative ones with their suppliers, SMEs benefit. MNCs take greater interest in them and are more likely to invest in them, providing expertise and financing. MNCs seek to gain from increased loyalty and cheaper prices.

Recent business sector developments, especially

28 Ibid.
thought to be at a disadvantage vis-à-vis other domestic enterprises. MNCs often find it in their interest to enhance and compound backward linkages. MNCs’ foreign affiliates generally seek local supplier relationships to reduce their dependence on intra-company trade. The reasons for this vary, but generally they center around price, proximity and speed of delivery. Some examples are Benchmark Electrónica and Ciber Electronics in Mexico and Tupy and AB Sistema de Freios in Brazil. Proximity can lower costs by allowing for closer monitoring and greater flexibility in changing specifications and in developing new inputs.

Forward linkages are traditionally set in the context of SMEs acting as purchasers of the outputs of MNCs. The business transactions in this category are legion, ranging from small manufacturers buying their capital equipment from multinational enterprises, to retailers selling the merchandise of international brand producers, to small enterprises factoring their accounting and auditing to multinational professional service groups. Business models have emerged in recent decades that give greater prominence to forward linkages between SMEs and MNCs. For example, in many countries small enterprises increasingly rely on leasing or factoring of machinery and office equipment instead of buying it outright. This creates a stronger link between the service providers and their clients, including an ongoing training effort and consultations in the context of upgrading and expansion. Perhaps even more importantly, retail trade and other parts of the service sector have seen a strong growth in the prevalence of distributors and franchises, by which small and new outlets “rent” the right to use the brand name of a large established enterprise. From the viewpoint of the owner of a franchise, this implies that the enterprises with which it engages in forward linkages have a direct impact on the value of its brand name. Such business relationships therefore often involve an element of direct cooperation and ongoing training effort.

In this document we add capillarity to the typology of linkages presented above in order to be able to have an elevated discussion, especially while presenting our findings. We enumerate six types of linkages along with examples of how they are currently occurring in LATAM:

1 | Customer Engagement, such as when MNCs hire SMEs to manage logistics for their customers. UPS, for example, worked with and subsequently purchased two logistics companies in Costa Rica.

2 | Supplier Interaction, which allows companies to manage complex supply chains with many different players. Unilever partners with Quala, a major Colombian distributor, to quickly access different markets.

3 | Talent Development particularly in technology. The so-called “spillovers” of know-how and technology from foreign-invested enterprises to the incumbent business sector is often one of the main benefits of FDI to development. If the linkages between the two categories of enterprises are strengthened, the benefits of direct investment in the host economy will most likely be boosted as well.29 In Peru, for example, small software companies can learn from MNC expertise through participating in The Peruvian Association of Software Producers (APESOFT). APESOFT plays an important role in facilitating training and capacity-building for software firms and helping to forge partnerships with Brazilian companies to serve the Peruvian and foreign markets.30

4 | Regulatory and Institutional Evolution —MNCs can often greatly benefit from partnering with smaller local companies that can facilitate the challenges of complying with stringent environmental regulations. Mining companies, for instance, are partnering with Chilean biotech SME Aguamarina to comply with stricter environmental regulations.

5 | Investment Opportunity, much like elsewhere, MNCs are nurturing business ecosystems by investing in startups. An example is Google’s investments in Mexican start-ups Unima, Econduce and Tizkka. Econduce is an electric scooter company, while Unima is a healthcare startup aiming to bring disease diagnosing technology to remote areas in the developing world. Tizkka meanwhile is a fashion app designed to help people share ideas related to looks and styles.

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6 | Societal Development is another way in which MNCs partner with SMEs to improve the broader ecosystems of the firm. Natura Cosméticos of Brazil partners with SMEs to reduce its environmental footprint as much as possible.

Clearly, partnering with MNCs provides SMEs advantages such as increasing sales and enhancing firm reputation; accessing new markets via established MNC channels; leveraging MNC technical knowledge; improving quality and productivity to meet MNC supplier standards; and developing a stronger base for future growth.\(^31\)

Recognizably, MNC-SME interactions are partnerships of unequals. Large firms have relatively greater financial and technological resources for R&D and their resources and capabilities position them for innovation that demands large sophisticated teams and large-scale investment in production facilities, extensive distribution networks or relatively long-time-to-value investments. In contrast, small firms’ advantages center upon entrepreneurial dynamism, internal flexibility and responsiveness to changing circumstances. The cross-fertilization of resources and capabilities of MNCs and SMEs spur innovation. SMEs can play a vital role in the distributed innovation processes of MNCs. Concurrently, MNCs can play an important role as a path to commercialization for technological innovations from small firms.\(^32\) We will now turn to discussing factors that encourage synergistic linkages between MNCs and SMEs.

Factors that Encourage Linkages

There is much governments can do to promote MNC-SME linkages. The foundation for linkages lies in lowering trade barriers, stimulating economic growth, creating an attractive environment for MNCs to come in, and provide financing opportunities for SMEs. By doing this, governments can further equip SMEs to have the capabilities to acquire and retain MNC partners. These SME promotion programs can provide information on market intelligence, processes and strategies, and access to financing.\(^33\)

The Salvadorean government, for example, is undertaking serious efforts aimed at increasing the formality and quality of employment by strengthening the productivity of enterprises and local services that foster job creation. In addition, the government has implemented target programs to strengthen SMEs and is considering public-private partnerships to foster productive business linkages with MNCs.\(^34\)

Chile has a substantial tradition of such partnerships. The government has 125 mechanisms (as of 2005) to promote production. 99 of these are directed to SMEs and micro enterprises. These mechanisms are contained within 20 public institutions which develop programs, such as the Supplier Development Program, which aims to strengthen the diagnosis and development of both public and private business projects to improve the quality and productivity of suppliers. The creation and consolidation of stable subcontracting relationships between an enterprise and its suppliers helps generate reciprocal business linkages.\(^35\)

There are many incentives for both MNCs and SMEs to create linkages that are mutually-beneficial. MNCs for their part, want to be seen as good corporate citizens. The first factor that enables linkages is public policy. Labor and tax laws, and favorable regulatory and compliance conditions that encourage linkages and technological transfer, as well as positive treatment of SMEs, all help create an environment in which

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35 Ibid.
the two types of companies (MNCs and SMEs) can interact and collaborate.

Another factor that enables linkages is technology and innovation transfer. Platforms and marketplaces that facilitate interactions and engagement with SMEs can lead to improved technology and innovation capabilities, which in turn could lead to customer engagement and societal development linkages.

MNCs and SMEs could both benefit technologically from linkages. On one hand, tech intensive MNCs are keen to spread their technology to other companies. This business to business evangelization is crucial in the cloud-centered era the world is entering. Adoption of platform or cloud technologies by as many companies as possible is a significant incentive for MNCs. SMEs, meanwhile, gain from increased access to better technology which can make them more efficient and reduce costs.

On the other hand, MNCs can also tap into smaller firms for innovative processes, products and services. This reflects the built-in potential of strong linkages: companies can be acquired and with them, their innovative products and cultures. Similarly, MNCs can spin off new ventures and engage their local partners to support in the post-hand off phase. Both types of companies stand to improve their abilities to gain new markets for their products and services while gaining prestige and credibility.36 Görg and Seric in their research found that for the average domestic firm supplying multinationals in the country, there is a positive association with product innovation. Buying from an MNC is also positively associated with labor productivity.37

Aggregators are another factor that enable linkages. Aggregators augment SME capabilities through internal and external (for example, at a university) training programs for managers. SMEs stand to improve their capabilities through collaborating with MNCs. Not only can they learn from processes and company culture, the very process of partnering and collaborating can lead SMEs to strengthen core operational or strategic capabilities. This could in turn lead to the third kind of linkage, one linked to talent development.

Formalization occurs when MNC partners help improve SME capabilities, thus increasing their competitiveness. This factor may lead to the second type of linkage, supplier interactions. In Costa Rica, a multinational cement company runs a program to build capabilities for SMEs in its value chain, while also working with banks to relax credit conditions to improve investment options for these small companies. The SMEs have thusly achieved higher levels of formalization, which results in greater participation in the market. The MNC funds this project (exercising full autonomy over it) and benefits from a substantial increase in efficiency by those participating. SMEs have experienced positive results in terms of improved business management, increase in sales, and higher profit margins. Finally, SMEs have achieved greater control of their internal finances, as well as improvements in their inventory systems. The program has enabled an increase of 78 percent in the reliability of inventories, substantially reducing the cost for loss.

Finally, investments can facilitate linkages through MNCs by helping SMEs gain access to capital markets and by taking equity positions in SMEs. This may naturally lead to the investment opportunity type of linkage. In the following section we analyze factors that can block or discourage synergistic linkages between MNCs and SMEs.

Factors that Impede Linkages

SMEs generally have an interest in seeking closer linkages with MNCs—especially in the case of backward linkages, which involve entering into a supplier relationship with larger enterprises. MNCs, as mentioned above, have also shown a keen interest in developing commercial relationships with smaller companies, but they need to be more selective. It is in their interest to cooperate with SMEs that operate at a sufficient level of sophistication and whose corporate profiles fit with their own corporate strategies. Consequently, much of the debate about obstacles to linkages tend to focus on factors that may make SMEs unable to partner with MNCs, and that make MNCs unwilling to partner with SMEs.38

The first factor that prevents linkages is the in-

In business environments with risks, barriers and inefficiencies, SMEs’ abilities to create complex partnerships worsen

herent difference in fit and size. In practice, there is evidence that both types of firms are naturally more geared to doing business with firms of similar sizes. This may be because small firms have trouble gaining access to MNC decision makers. To be able to acquire an MNC as a client, capabilities—including reputation and access to key decisions-makers—may have to be pre-established.

Another significant constraint particular to SMEs is access to finance. SMEs do not have the financial wherewithal (or the sources) to appropriately finance their operations. Small companies can offer little in the way of collateral and are often seen as a high credit risk by lenders. It has sometimes been argued that bank loans may be an inappropriate way of financing small and new enterprises. Equity participation, providing the financier with a right to a share of potential profits in return for assuming the default risk, might help make funds more easily available to SMEs.

Moreover, linkages can be held back by lack of information, search costs and uncertainty. SMEs and MNCs in search of commercial partners do not possess perfect information about their potential counterparts and mostly rely on readily available information. Additionally, this may lead SMEs to fear that headquarters of the MNC may decide to terminate the relationship. Another undesired outcome to linkages is that SMEs are at risk of being potential acquisition targets and subcontractors to MNCs. These incalculable risks can be a strong deterrent to establishing a costly relationship under conditions of flawed or insufficient information.

Perhaps due to this, local firms are often allegedly more interested in serving local clients than in undertaking the substantial technological and managerial improvements necessary to become qualified suppliers to MNCs. Additionally, SMEs may simply lack the time and resources needed to successfully create and run complex ventures.

Another factor preventing linkages is related to vetting and incurring the risk of partnering with a small company. Not all MNCs specialize in selecting SMEs with which to partner, and audits increase transaction costs for MNCs. Clearly, a lack of local capacity underlies many of the complaints of affiliates that local firms are not willing or interested in meeting their needs. Local firms are said to fail in meeting the following requirements: competitive price; quality control (low defect rate); promised time of delivery; flexibility and efficiency to change production; ability to design parts and components; and long-term commitment.

Aside from challenges stemming from SME capabilities or lack thereof and the asymmetry of the relationship, there are other obstacles to linkages. Another key one is related to the objectives of different companies. In entering into strategic alliances, MNCs tend to have strategic motivations whereas SMEs have short run commercial motivations. MNCs, as opposed to SMEs, have far greater learning capacity, which puts them at an advantage in linkages, which are essentially transfers of information.

There are also systemic challenges. Often, as supply chains consolidate, suppliers follow their MNC customers into foreign markets, eliminating the need for local suppliers and further widening the gap between local and foreign companies. This cluster co-location enables foreign suppliers to continue serving their MNC clients in a synergized way, but it also provides challenges for local SMEs. Finally, government dysfunctionality surrounding tax, regulatory and administrative inefficiencies create barriers for thriving business environments. With limited resources, SMEs suffer the most in such environments and their abilities to create complex partnerships worsen. The following section outlines our findings.

Findings from Interviews

Six interviews were conducted at the end of 2017 with executives working with LATAM—CISCO, SAP, Microsoft, UPS, Citi and Google (summary table included in the Appendix). All of these MNCs see LATAM SMEs as essential to their current business as well as to their growth prospects. Technology MNCs in particular, also believe in helping SMEs become more innovative and competitive in order to level the playing field and allow them to challenge incumbents. Based on the typology of linkages developed for this study (see section III above), and the types of companies interviewed, we found the following:

1 | UPS has three segments: Enterprises (composed of large MNCs), Mid Market (made up of smaller MNCs and large local companies) and the SME segment, for which it offers an On-Boarding Program (OBP) to ensure a first positive experience for SMEs. This helps SMEs view UPS as a one-stop-shop for all their logistics needs (including Import/Export, Customs Clearance, Optimization, scheduling technologies, returns management, tracking and visibility solutions, etc.). The program’s aim is to help SMEs realize that UPS can be a consultant providing logistics advice for growth and competitiveness. Thus, UPS focuses on customer engagement linkages and exemplified its relationship with LATAM SMEs through the offering of bundled logistical solutions (including single freight movements with specialized packaging) that enhance end-to-end visibility for end-customers and facilitate cross-border e-commerce and trade for two Mexican SMEs: one that exports piñatas and another that exports Halloween masks to the USA.

2 | Citi advances responsible finance in LATAM through state of the art technologies that promote efficiency (by lowering transaction costs), inclusion (through capillarity and expeditious regulatory compliance) and transparency (by working closely with governments in the region). Citi engages with LATAM SMEs in three different ways: as suppliers, as clients, and through solutions offered to MNC clients. Thus, Citi develops customer engagement linkages with LATAM SMEs. In particular, its Supplier Finance Solutions are offered to MNC clients which, through mobile banking platforms, accelerate accounts receivables for SMEs at lower costs, in turn enhancing SMEs’ productive capacity and their business growth potential. In addition, Citi conducts regulatory and institutional evolution linkages. This was highlighted through Citi’s partnership with an Argentine FinTech SME in order to bring a compliant solution to the marketplace in an accelerated fashion given the government’s requirement for banks to process immediate real-time payments (Instant Payments).

3 | CISCO promotes talent development linkages through DEVNET, a network of developers, which includes LATAM SMEs, that produce software (interfaces, functionalities, etc.) to complement its own offering at lower costs and shorter turnaround times. Thanks to this network, CISCO can engage with LATAM SMEs through customer engagement linkages or supplier interaction linkages. In particular, CISCO mentioned a Costa Rican SME that learned how to design additional functionalities to CISCO’s product offering through DEVNET. CISCO and the SME can then go together to market and offer their complementary products to enable end-customer purchasing decisions that benefit both actors. Alternatively, when a customer, for example a Peruvian SME, comes to CISCO requiring product functionalities that it is not in a position to offer at low costs and/or expeditiously, CISCO points the customer to a DEVNET SME that can (for example the Costa Rican SME). This not only enables a synergistic relationship between the MNC and SMEs, but also among LATAM SMEs.

4 | SAP engages with LATAM SMEs through its general business approach, predominantly through SAP Business Partners (SAPBPs) with dedicated sales and service teams, and its commercial approach, with specialized knowledge and expertise by industry, both of which help SAP establish customer engagement linkages. In addition, SAP has a Start Up Focus Program (SSUFP) that allows the MNC to establish investment as well as talent/societal development linkages. SSUFP’s participants receive technology, training, and specialized know-how from SAP which helps SMEs become more competitive and innovative. In turn, SAP may decide to take equity positions in prominent SSUFP’s participants (resulting in investment linkages), or go to market with them to either leverage the MNC’s engagement with other clients (yielding customer engagement or supplier interaction linkages), or help SSUFP’s participants raise capital for growth, which once again reinforces investment linkages. In particular, SAP believes in enabling SMEs to help other SMEs become more competitive and innovative. Specifically, SAP explained how it has worked with Brazilian SMEs focused on fraud detection technologies and unstructured data analysis (to identify net promoters in social media). Consequently, Brazilian SMEs in general now have access to services that only large firms or MNCs could afford.
**Microsoft** establishes *customer engagement linkages* by offering LATAM SMEs platforms on which to develop their businesses. As a result, platform growth is enabled through strategic alliances with local SMEs. The MNC also establishes *talent/societal development linkages* by working through conveners and aggregators (such as chambers of commerce, industry-based organizations, accelerators, etc.). This allows the MNC to identify local SMEs with which to partner so as to help them reach the next level through training, coaching, mentoring, VC funding, government connections, etc. Moreover, **Microsoft for Startups** helps entrepreneurs to scale-up their companies based on three pillars: the MNC’s cloud platform, deep technical engagements with local and global Microsoft talent, and go-to-market strategies to help startups succeed through their growth phase. Microsoft strives to become a strategic partner for startups through *investment linkages*. In sum, when SMEs grow, Microsoft’s platform utilization also grows yielding a synergistic relationship. Because of this, the MNC also works on enabling SMEs to help other SMEs become more competitive and innovative. This is exemplified by SMEs in Argentina and Chile using Microsoft’s cloud platform to develop products and services for that purpose. The Argentine SME developed an app to help manage small dairy farms, while the Chilean SME provides data analytics services to other firms.

**Google’s Marketing Solutions** offers LATAM SMEs tools to assess the productivity of their advertisement investments in real time. These tools help SMEs grow, become more competitive and innovative. This in turn results in more LATAM SMEs engaging with Google’s Marketing Solutions through *customer engagement linkages*. Thus, SMEs now have access to high quality productive advertising, a key service usually only accessible to large firms or MNCs. In addition, Google works through networks of advertising agencies that help SMEs design, monitor and monetize their digital advertising strategies, to establish *talent development linkages*. For example, an advertising agency in Chile helped an SME client amplify its revenue streams, making it more competitive and willing to engage further in targeted advertising. These networks of advertising agencies in turn allow Google to calibrate and redesign their tools based on SME feedback.

Fig No 4 below is a graphic representation of our findings. All MNCs interviewed provide services that are essential to many industries, namely: logistical, financial, and technological services. All MNCs highlighted the importance of being able to provide LATAM SMEs with specialized knowledge in order to be able to better serve their needs. Critically, all MNCs through their product/service offering, subscribed to the importance of being part of and contributing to robust and vibrant digital ecosystems by industry. This is the first stage (S0) in the figure below.
In order to effectively contribute to these digital ecosystems the MNCs interviewed take two paths: the direct engagement path (preferred by logistics and financial services), or the network/SMEs serving SMEs path (preferred by tech firms). In the first path, which is represented by the inner loop of the figure, MNCs pursuing their own growth and competitiveness (S1) decide to establish mainly customer engagement linkages (and in the case of Citi also regulatory and institutional evolution linkages) with LATAM SMEs. MNCs can do this by developing new product/service offerings (involving technology) such as Citi’s Supplier Finance Solutions or its Instant Payments compliance, and UPS’ bundled solutions with enhanced end-to-end visibility (S2B). These new products or services in turn, can help SMEs become more competitive and innovative (S3), through increased productive capacity or cross-border e-commerce. All of which feeds into a robust digital ecosystem by industry that works for the benefit of both MNCs and SMEs.

The second path (or the network/SMEs serving SMEs path) is represented by the outer loop in the figure that involves an additional stage. Here, Tech MNCs pursuing their own growth and competitiveness (S1) develop networks (such as CISCO’s DEVNET, SAP’s SSUFP participants, Microsoft for Startups, or Google’s Advertising Agencies) or partner with conveners and aggregators (in the case of Microsoft’s work with chambers of commerce and industry-based organizations) in order to identify and effectively address SMEs’ needs as well as to filter and vet potential SME partners (S2A). Thanks to these networks, Tech MNCs are able to establish talent/societal development linkages that can turn into customer engagement linkages or supplier interaction linkages (as with CISCO’s Costa Rican SME ALTUS and Google’s fast food stand renter in Chile) and/or investment opportunity linkages (such as Microsoft for Startups or SAP’s SSUFP). Similarly, Tech MNCs are able to contribute to and be part of vibrant digital ecosystems insofar as their product/service offerings allow SMEs to help and serve other SMEs (S2B), effectively helping level the playing field. This happens because services that used to be affordable only to large firms or MNCs (e.g., data analytics, fraud detection, net promoters in social media, high quality advertising strategies, etc.) can now be offered to LATAM SMEs by other LATAM SMEs such as Microsoft’s partner MetricArts, SAP’s Brazilian SME partners, and Google’s advertising agencies, themselves SMEs. All this activity not only helps make LATAM SMEs more competitive and innovative (S3), but feeds back into a robust digital ecosystem from which both MNCs and SMEs emerge as winners.

**Findings from Interviews**

**Conclusions and Recommendations**

These findings help realize that the factors that impede MNC-SME linkages (or preventing factors, presented on page 10) are actually pointing to associated MNC tactics that could be implemented in order to overcome them. These MNC tactics can, at the same time, leverage factors that encourage linkages (or enabling factors, discussed on page 9) that help corroborate the type of linkage to be established in order to overcome obstacles. Implementing the MNC tactics presented in Table 4 below should also help MNCs build synergistic relationships with LATAM SMEs that advance growth, competitiveness, and innovation for both.

Customer engagement and talent development are the two critically important arenas in which MNCs and SMEs can work individually and in partnership to strengthen company performance and competitiveness. In the first instance, multinationals can engage SME clients and potential partners by helping them to

<table>
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<tr>
<th>Preventing Factors</th>
<th>MNC Tactic</th>
<th>Enabling Factors Leveraged</th>
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<tr>
<td><strong>Fit/Size — lack of SME capabilities to adequately partner with MNCs</strong></td>
<td>Establish supplier interaction linkages, with SME capacity building efforts</td>
<td>Partnerships focused on formalizing SMEs and helping improve their capabilities and competitiveness</td>
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<td><strong>Financing for SMEs</strong></td>
<td>Establish regulatory and institutional evolution linkages</td>
<td>Public policies — Government efforts favorable to SMEs</td>
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<td></td>
<td>Establish investment opportunity linkages</td>
<td>Equity positions with future upsides and improved access to capital markets</td>
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<td><strong>Informational Asymmetries</strong></td>
<td>Establish customer engagement and societal development linkages</td>
<td>Technology platforms and market places that facilitate interactions and engagement with SMEs</td>
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<td><strong>Vetting</strong></td>
<td>Establish talent development linkages</td>
<td>Networks of aggregators that help augment SME capabilities</td>
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Table 4. Factors that Impede Linkages and Associated MNC Tactics to Overcome Them (as well as factors that encourage linkages leveraged by each MNC tactic)
help themselves. Bundling, be it software or logistical or financial solutions, is an excellent starting point. Assisting small firms with supplier finance solutions, as Citi has done in Argentina, improves the likelihood that a commercial relationship will be established in the long term. The SME turns to the MNC for a host of services, while availing themselves of those services to attract and retain SMEs’ customers who highly value the broader and improved range of services. UPS’s experience in Mexico is a good example as is Google’s Marketing Solutions Program.

With respect to talent development, both MNCs and SMEs in technology place a high premium on developing and retaining a cadre of technically proficient professionals. CISCO’s promotion of talent development linkages through DEVNET, a network of developers is a prime example. SAP and Microsoft work on their own and with SME counterparts to support talent development, including nurturing start-ups by providing mentoring, coaching, and even investing in high potential tech start-ups. MNCs also support talent development as well by financing the continuing professional education of their employees as well as broad-based scholarships for college students in scientific and technical fields, with graduates of those awards joining not only MNCs but smaller firms as well.

In general, as indicated in Table 4, MNCs can do much to support SME development by partnering with them to improve their capabilities and competitiveness, achieving mutual benefits from their efforts. In the financial realm, SMEs are often constrained by a lack of access to both investment capital and working capital to sustain and grow their businesses. MNCs can help by providing their SME customers and partners with short-term financing as well as investment capital (an equity position) and also encouraging host country governments to develop public policies which institute financing mechanisms and other support for local SMEs. Finally, MNCs can strengthen MNC-SME linkages by providing technology platforms for SMEs and supporting networks of aggregators to help increase SME capabilities. Sharing these “open source” formats and tools can produce significant goodwill and provide concrete benefits for SMEs who ordinarily would not be able to pay for such facilitating mechanisms.

Despite periodic hiccups along the way, the global economy continues its relentless trajectory of interdependency, shaped by technological advancement. The rapid emergence of a digital ecosystem means that for companies large and small, embracing change is no longer a choice but a necessity. This holds true for the relationship not only between large companies but between big firms (MNCs) and smaller ones (SMEs). There are many different forms of linkages between MNCs and SMEs, as presented in the various typologies cited in this white paper—all which can be leveraged for innovation, growth, and competitiveness. It behooves both MNCs and SMEs to explore ways of enhancing their existing linkages and exploring the possibility of establishing new ones. In the end, such a strategic choice will enable them to thrive in a globally interdependent economy.

It behooves both MNCs and SMEs to explore ways of enhancing their existing linkages and exploring the possibility of establishing new ones
### Appendix (Tables with interview summaries)

<table>
<thead>
<tr>
<th>Firms*</th>
<th>Strategy/Objective</th>
<th>MODELS (examples of linkages with LATAM SMEs)</th>
<th>Factors that facilitate linkages with LATAM SMEs</th>
<th>Factors that impede linkages with LATAM SMEs</th>
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<tr>
<td>UPS</td>
<td>Deals with 3 segments: Enterprises (large MNCs), Middle Market (smaller MNCs and large local companies) and SME segment&lt;br&gt;&lt;br&gt;Has On-Boarding Program (OBP) to ensure first positive experience for SMEs so that UPS is seen as consultant providing logistics advice for growth and competitiveness&lt;br&gt;&lt;br&gt;OBP should eventually lead SMEs to see UPS as one-stop-shop for all logistics needs (including Import/Export, Customs Clearance, Optimization, Technologies for scheduling, managing returns, tracking, visibility, etc.)&lt;br&gt;&lt;br&gt;UPS has partnered with SMEs exporting piñatas and Halloween masks from Mexico into the US. These SMEs adopted bundled solutions (such as single freight movements with specialized packaging) to enhance end-to-end visibility of shipments for them and for end-customers, which increased service levels as well as revenues.&lt;br&gt;&lt;br&gt;UPS learned the type of solutions that can be offered to SMEs to help them deploy cross-border e-commerce strategies</td>
<td>SMEs’ agility and ability to implement logistics advice promptly, allows them to experience UPS’s value-added proposition through revenue growth&lt;br&gt;&lt;br&gt;SMEs’ ability to adopt new technologies and facilitate systems’ integration&lt;br&gt;&lt;br&gt;Government programs that train SMEs and help them develop the capability to market and position their products in foreign markets (especially through digital platforms)</td>
<td>General awareness about the need for, and benefits associated to, sound logistics and supply chain management advice&lt;br&gt;&lt;br&gt;Better financing and payment options for SMEs&lt;br&gt;&lt;br&gt;Limited access points or points of service (limits UPS’s ability to reach more SMEs)</td>
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<tr>
<td>Citi</td>
<td>Interacts with SMEs in 3 different ways: SMEs as suppliers, SMEs as clients, and through supplier finance solutions offered to MNCs.&lt;br&gt;&lt;br&gt;SME clients are common in Mexico where Citi’s consumer bank has significant capillarity, but also in Argentina, Brazil and Colombia where it is regulatory driven (government asks for portion of bank’s portfolio to serve SMEs)&lt;br&gt;&lt;br&gt;Supplier finance solutions to MNCs entail mobile banking platforms that accelerate accounts receivables process at lower costs. This in turn optimizes SMEs’ working capital as well as their productive capacity, which enable business growth.&lt;br&gt;&lt;br&gt;Citi advances responsible finance through state of the art technologies to promote efficiency (as with supplier finance), inclusion (through capillarity and expeditious regulatory compliance) and transparency (by working closely with governments in the region)&lt;br&gt;&lt;br&gt;LATAM governments are asking for greater speed and efficiency within their financial systems to reduce transaction costs and enhance the competitiveness of their economies. In particular, governments require the processing of immediate real time payments. However, this requires integrating bank platforms with that of central banks and ACHs for clearing and settlement purposes. In order to comply, Citi partnered with a local Fintech in Argentina to launch “Instant Payments.” This allowed Citi to be the first bank to bring a compliant solution to the marketplace in an accelerated fashion, and also to develop a blueprint for doing so in other LATAM countries.</td>
<td>SMEs ability to work at a faster pace and more cost effectively than MNC</td>
<td>SMEs’ limited technical and legal knowhow (essential to effectively leverage capital markets for financing growth)</td>
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<td>CISCO</td>
<td>When SMEs adopt CISCO’s solutions, the firm’s revenues grow as well as those of its brand representatives. Because of this, CISCO has a network of developers (DEVNET) that produce software (interphases, functionalities, etc.) to complement CISCO’s solutions offering at lower costs and shorter turnaround times&lt;br&gt;&lt;br&gt;ALTUS, an SME from Costa Rica, focuses -through DEVNET- on designing additional functionalities to complement CISCO’s offering to other SMEs in LATAM. This allows more SMEs from other LATAM countries to adopt CISCO’s offerings</td>
<td>SMEs’ creativity, flexibility and agility&lt;br&gt;&lt;br&gt;SMEs that see technology as a key differentiator to be sold through education, such that end customers understand ROI to tech appropriately</td>
<td>Founder impressions and intuitions&lt;br&gt;&lt;br&gt;Lack of organization and formality (especially regarding SME finances)&lt;br&gt;&lt;br&gt;Education and awareness (lack of diffusion)&lt;br&gt;&lt;br&gt;Poor access to capital leaves SMEs exposed to “shootout” acquisitions&lt;br&gt;&lt;br&gt;Lack of a coherent regional SME strategy (e.g., tax benefits)</td>
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<tr>
<td>Firms*</td>
<td>Strategy/Objective</td>
<td>MODELS (examples of linkages with LATAM SMEs)</td>
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<td>SAP</td>
<td>SMEs entail a different approach requiring commitment, capabilities and specialized knowledge of ecosystems by industry such that corresponding software extensions are relevant and easily adopted. SAP serves SMEs in two ways: through its general business approach with dedicated sales and service teams (75% of SAP’s SME business is done through SAP Business Partners–SAPBPs), and its commercial approach with specialization by industry (and tailor made solutions developed at SAP LABS Latin America). SAP also has a Start Up Focus Program (SSUFP) to help level the playing field by allowing new-comers to challenge big incumbents. SAP may take equity positions in SSUFP participants, and may go to market with them, enabling SMEs to leverage the firm’s engagement with other clients</td>
<td>SAP partnered with Brazilian SMEs to offer other SMEs access to capabilities that help level the playing field (i.e., fraud detection technologies as well as unstructured data analysis for identifying net promoters)</td>
<td>Being close to marketplaces with on the ground presence</td>
<td>Governments’ and Universities’ lack of proficiency in supporting SMEs with specialized approaches by industry (taking a “plain vanilla” or cookie cutter approach to SMEs)</td>
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<td>Microsoft</td>
<td>The company’s mission is to empower every person and organization to achieve more. Because of this, it offers SMEs platforms on which to develop their businesses. Thus, platform growth is enabled through strategic alliances with local SMEs. Microsoft identifies SMEs with which to partner by working with chambers of commerce, industry-based organizations, as well as with aggregators/convener. The aim is to help SMEs reach the next level through training, coaching, mentoring, VC funding and government links. In addition, Microsoft for Startups helps entrepreneurs to scale-up based on three pillars: the MNC’s cloud platform, deep technical engagements with local and global Microsoft talent, and go-to-market strategies to help startups succeed through their growth phase. Microsoft strives to become a strategic partner for startups throughout all their development stages</td>
<td>TAMBERO in Argentina and MetricArts in Chile are SMEs that use Microsoft’s cloud platform to develop products and services that help other businesses. TAMBERO has an app for managing small dairy farms and MetricArts provides data analytics services. As these SMEs grow, Microsoft’s platform utilization also grows</td>
<td>New regulations that reduce barriers to entry by facilitating the incorporation of new business, or provide tax exemptions for SMEs</td>
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<td>Google (Marketing Solutions)</td>
<td>SMEs use Google’s tools to assess the productivity of their investments in advertising real time. These tools, which must vary by industry, allow SMEs to grow and innovate. The more SMEs grow, the more productive their investments, and the more SMEs will decide to use Google’s Marketing Solutions. Thus, as high quality and productive advertisements are no longer only affordable by large companies, Google helps level the playing field. As many SMEs do not know how to leverage Google’s tools, the firm works with a network of advertising agencies to help SMEs become digitally enabled and more competitive</td>
<td>Fast Food Stand Renter in Chile was helped by an advertising agency to leverage its investments in advertising and expand its revenue streams. Advertising agencies not only help SMEs turn data into business analytics about their customers and their competition, they also help Google aggregate SME needs to help make their lives easier (e.g., through tool usability)</td>
<td>SMEs comfortable taking risks, adopting new technologies and tools, as well as undertaking and managing trial and error processes</td>
<td>Lack of knowledge and awareness</td>
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</table>

*NON-TECH FIRMS: UPS, CITI. TECH FIRMS: CISCO, SAP, MICROSOFT, GOOGLE (MARKETING SOLUTIONS)
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About

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