
Unlocking the benefits of local sourcing for companies
and society

Final report

4 December 2018

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EXECUTIVE SUMMARY

Local sourcing is a key driver of economic development

Local sourcing is one of the key pathways through which private sector activity contributes to a country’s development. By buying goods and services locally, companies support incomes and jobs at local suppliers. Furthermore, they contribute to the overall capabilities of the country by transferring knowledge and skills.

However, companies often only source a part of their goods and services locally. Especially in developing economies suppliers often lack the scale or knowledge to provide the required quality and/or quantity of goods and services. This leaves a large part of the development potential of the private sector untapped.

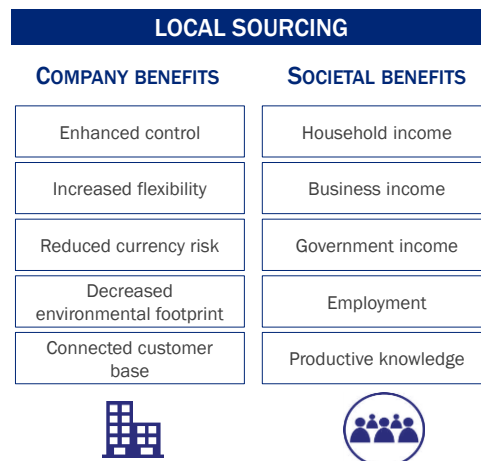
The magnitude of this untapped potential is well illustrated by DEG’s portfolio of investments into private sector clients. In 2017, DEG’s clients spent just under EUR 23 billion on local procurement, 74% of total procurement expenses. This is already a significant share. Still, if an increase of 1% could be reached, this would shift EUR 80 million towards the pockets of people in developing countries. Hence, providing private sector companies with the opportunity to increase the local part of their sourcing can have large effects on the money spent and value created in developing markets.

This paper explores how local sourcing can be increased to unlock developmental benefits.

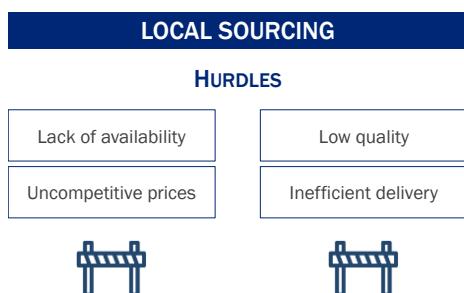
Local sourcing may deliver diverse benefits to companies and societies

Unless local supply is not on par with a company’s requirements, there is no reason for companies not to source locally. Local sourcing enables strong supply chain control and increases flexibility due to simplified logistics: custom clearance is avoided, and lead times and costs are generally reduced. Moreover local sourcing helps companies avoid currency risks and reduce the environmental footprint of transport. Furthermore, it may add to a company’s local customer base and license to operate.

Local sourcing also generates strong benefits for societies. Buying inputs locally leads to increased incomes in the domestic economy as revenues are partially spent on incomes for households (salaries), businesses (profits), and the government (taxes). Additionally, local sourcing can strengthen the local economy by transferring knowledge and skills, thereby creating opportunities for suppliers to upgrade to higher value added activities.

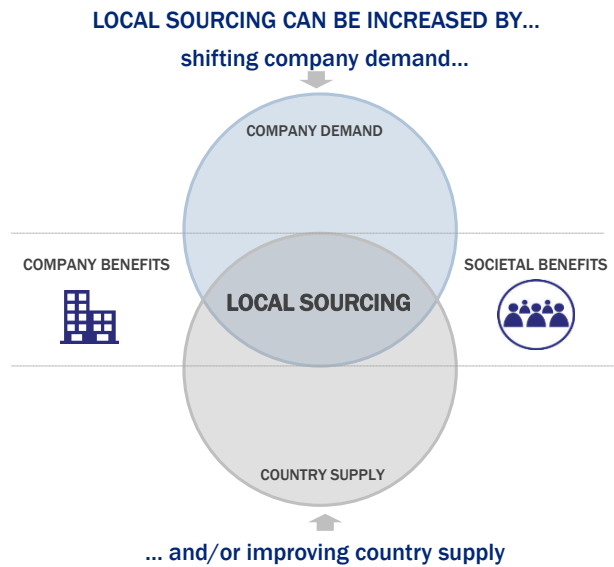


Hurdles to local sourcing can be tackled by shifting company demand and/or improving country supply



Notwithstanding the benefits for companies and societies, many companies in developing countries source only part of their goods and services locally. This can be explained by at least four common hurdles: a lack of local availability, low quality, uncompetitive prices, and the inefficient delivery of products.

These hurdles can be tackled by shifting company demand and/or improving country supply. First, to shift company demand, companies could review their supplier selection criteria, placing more emphasis on country of origin than price, and explore local alternatives that can substitute imported products. Second, to shift country supply, countries can tailor their institutional framework to incentivize local sourcing, develop business platforms/networks to better match local supply and demand, improve companies' access to capital, and actively build private sector capacity.

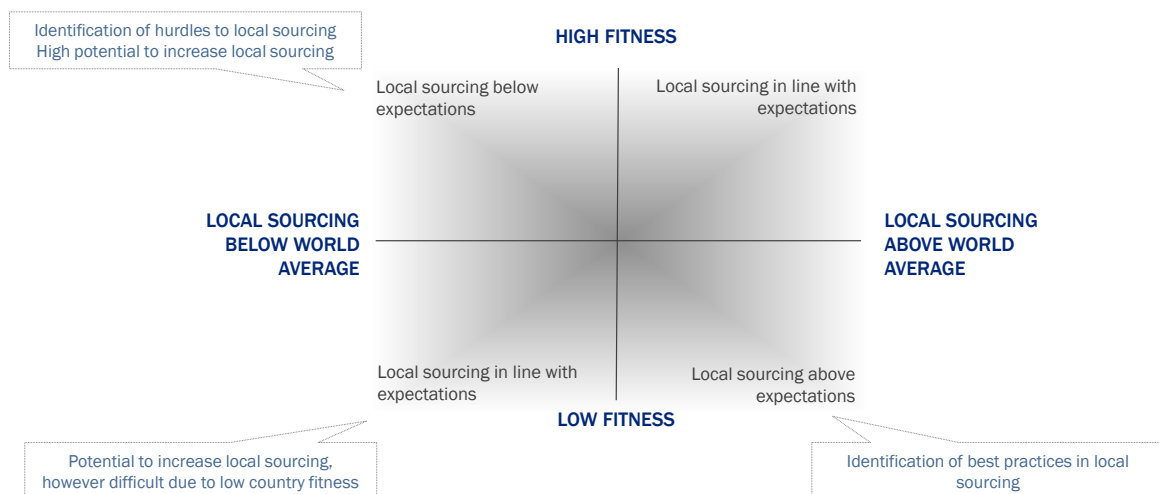


Tackling hurdles to local sourcing can unlock significant developmental potential. But where to start? This study approaches the topic from two perspectives: the country-level and the company-level.

The country-level approach identifies opportunities to increase local sourcing and discloses best-practices worldwide

Local sourcing opportunities and best practice can be identified by using a framework in which country-sector combinations worldwide are plotted. The position of the country-sector combinations in the framework is based on (i) the country's fitness; and (ii) the sector's sourcing practices. Country fitness reflects a country's productive capabilities, indicating whether or not the country is able to create a large variety of products. Sector sourcing practices reflect the average share of locally sourced versus imported products in a country, benchmarked against a world or regional average.

The framework below shows the different relations of country fitness and sector sourcing practices: local sourcing is expected to be high in fit countries, as these countries are likely able to produce or develop a large variety of products. In contrast, local sourcing is expected to be low in unfit countries due to their limited ability to produce different products. It follows that if a sector's local sourcing is low even though the country's productive capabilities are high (upper left quadrant), opportunities to increase local sourcing will likely abound. Furthermore, if a sector's local sourcing is high even though the country's productive capabilities are low (lower right quadrant), opportunities to learn from best practices are likely.



The country-level approach allows companies to compare their sourcing practices with peers in the same sector and country. The framework further allows financing institutions such as DEG to screen their portfolios of companies for areas of improvement of, or learning on, local sourcing.

The company-level approach is a hands-on tool for companies to identify and tackle hurdles to local sourcing

The key steps of the company-level approach are depicted below.



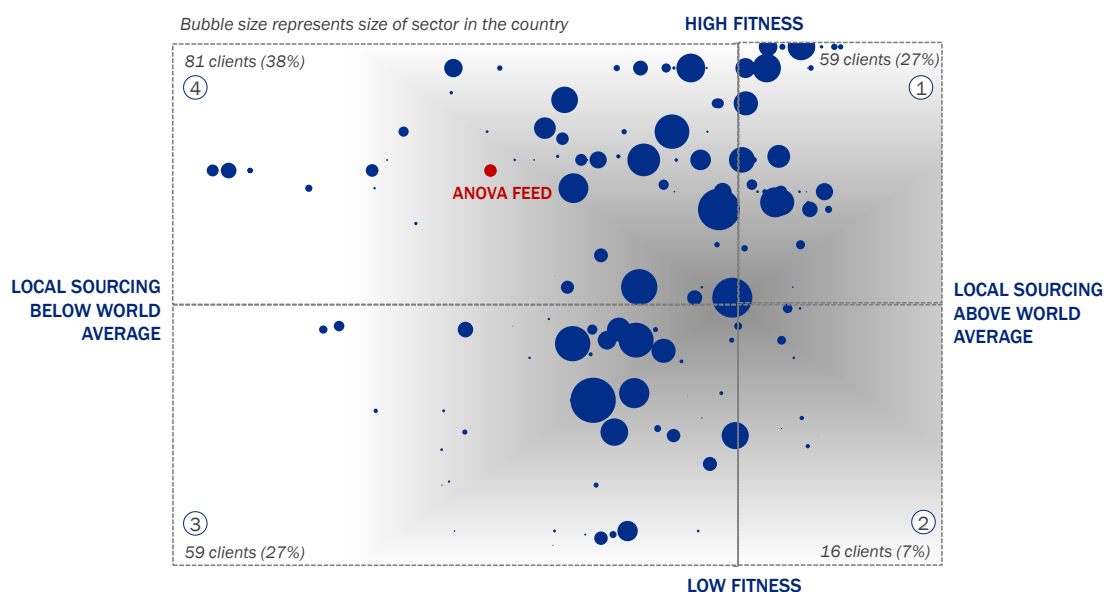
The first step is to analyse a company's supply chain and map the company's sourcing practices. It requires identifying a company's key inputs, as well as the geographical origin of these inputs. The next step is to qualitatively explore the current and potential business case of local sourcing for the company, as well as the societal benefits. Subsequently, a company's hurdles related to locally sourcing should be assessed. The final step of the company-level approach is to prioritize hurdles to tackle based on the expected benefits for companies of sourcing the product locally, and the company's influence in the market.

The company-level approach helps companies and their financiers to assess company value chains and opportunities for local sourcing in a structured manner.

From theory to practice: applying both approaches to the DEG portfolio

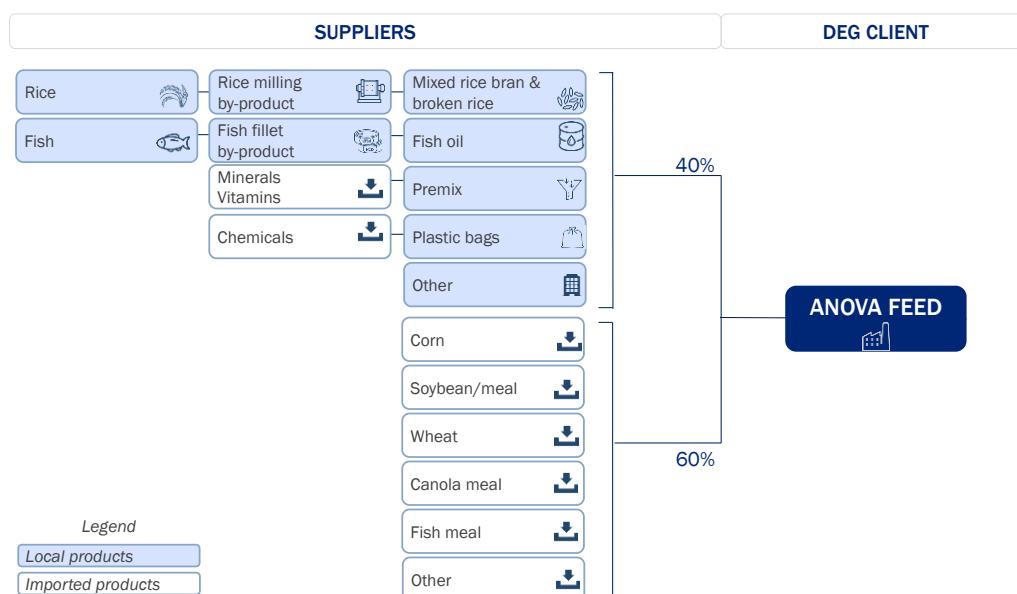
To illustrate how these approaches work out in practice, we implemented them to DEG's portfolio of corporate investments (see graph below). The country-level approach pointed us towards companies with potential to increase local sourcing: companies in countries with high fitness, but operating in sectors with lower-than-average local sourcing (box 4). The approach also highlighted DEG clients which were in unfit countries but way outperforming their global benchmarks in their local sourcing (box 2) – a great opportunity to find best practices and to learn.

In this study, DEG focused on improvement potential. An interesting combination in this category has been the manufacturing sector in Vietnam. One of the DEG companies in this country-sector combination, the animal feed producer Anova Feed, served as a case study for this study.



The implementation of the company-level approach to Anova Feed showed that the approach is a helpful structure in discussing supply chains and bottlenecks to local sourcing. A key prerequisite is

that a company is willing to cooperate and share procurement information. The figure below shows the value chain map developed for Anova Feed. The full case study is included in the appendix of this study.



Conclusions

Local sourcing is a relevant topic for companies and their financiers as it generates both business benefits and developmental effects to societies. Providing private sector companies in developing markets with the opportunity to increase the local part of their sourcing can have large effects on the money spent and value created in these markets, and enables DFIs to maximise the developmental effects of their investments.

This study disclosed two approaches for companies and its financiers:

1. A country-level approach to (i) benchmark local sourcing practices; (ii) identify best-practices and improvement potential (per sector-country combination); (iii) allow a structured exchange within private sector networks.
2. A company-level approach to (i) hands-on identify and tackle hurdles to local sourcing; and (ii) structurally include the local aspect into general value chain management.

1 INTRODUCTION TO LOCAL SOURCING

Local sourcing - buying goods and services locally - can boost economic growth while providing opportunities to reduce negative environmental impacts. By sourcing locally, companies create linkages with domestic suppliers upstream in their value chain. These so-called 'backward linkages' directly generate a rise in incomes and employment at suppliers. Furthermore, backward linkages could transfer knowledge and skills, thereby improving supplier processes, products and managerial capabilities. These are important ingredients for enabling long term economic development.¹ In addition to these economic benefits, local sourcing can reduce the environmental footprint related to transport as inputs need to travel fewer miles. These reduced environmental impacts speak to a growing group of conscious consumers, and improve the sustainability of the business.²

"Local sourcing makes sense both for your wallet and for the environment, and it contributes towards many of the SDGs."

Sustainable Development Goals Fund

However, most companies only source part of their goods and services locally. In the current globalised world, where national borders place few constraints on private sector activities, procurement has progressively become a key source of competitive advantage.³ Managers look globally for suppliers who can deliver the best product for the best price. Consequently, local suppliers may lose from their peers abroad. This is especially true for developing economies, where suppliers often lack the scale, knowledge or skills to effectively compete on global markets. This leaves a large part of the development potential of the private sector in developing economies untapped.⁴

"Local sourcing is not an easy journey and you have to persevere."

Paul Stanger, Heineken Local Sourcing Director

For DFIs local sourcing is relevant as it could unlock benefits for companies and society while boosting the impact of investments: if portfolio companies source inputs from domestic suppliers, a larger share of the economic effects of an investment will stay in the local economy.

Definitions

Local sourcing: *buying goods or services of domestic origin.*

Global sourcing: *buying goods or services of non-domestic origin.*

The origin of the inputs, supplies, materials, or goods matters regardless of whether the establishment directly imports them or not. We use 'sourcing' and 'procurement' interchangeably.

If we refer to private sector actors in general we will use 'companies' or 'businesses'; we use these interchangeably. If we refer to a company that supplies a good or service specifically, we will use 'supplier'.

Based on definitions of the World Bank Enterprise Survey

For these reasons, DEG - one of the leading European Development Finance Institutions (EDFIs) - included local sourcing into its Development Effectiveness Rating (DERa). DEG promotes private enterprise initiatives as a contribution to sustainable growth and improved living conditions by providing long-term financing and advice to enterprises worldwide. DEG uses the DERa to monitor and maximize the development impact of its investments. However, insights into how local sourcing contributes to the maximization of development impact and what can be done to increase local sourcing are limited. DEG therefore asked Steward Redqueen to carry out a study on this topic.

¹ UNCTAD, 2001.

² Quote derived from: Sustainable Development Goals Fund, 2018.

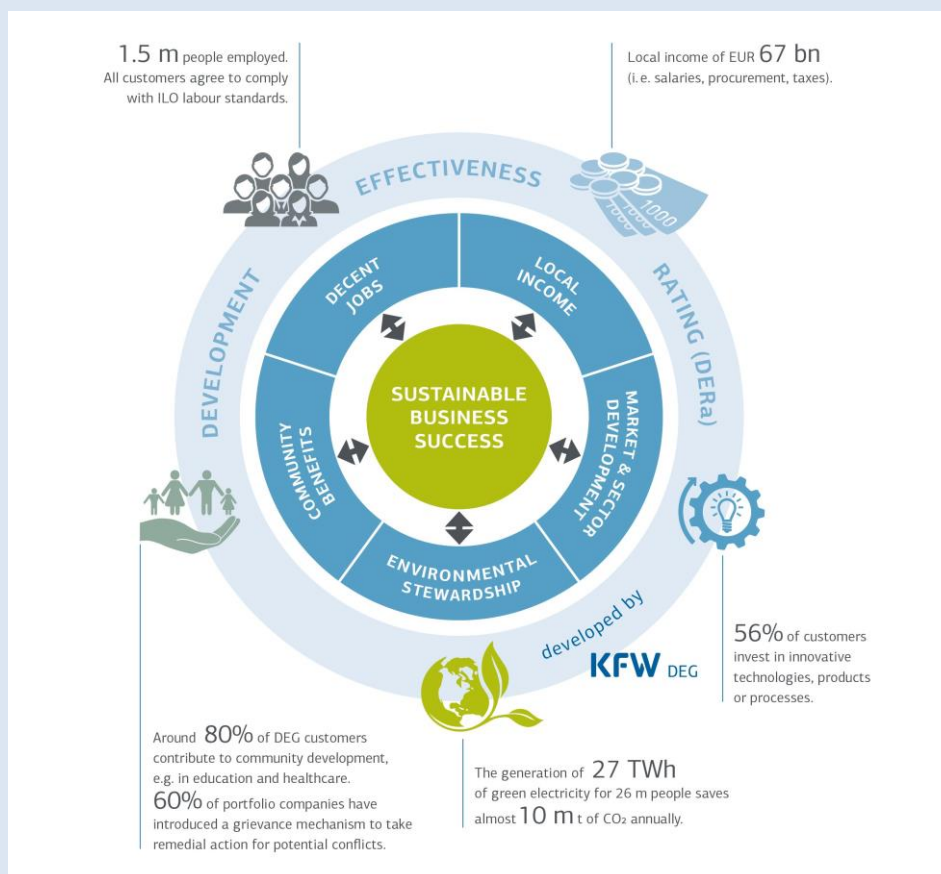
³ Kapstein & Kim, 2011..

⁴ Quote derived from: Base of the Pyramid Innovation Centre, 2016.

Monitoring the impact of investments at DEG: the DERa

The DERa is summarised in the figure below. As shown, it is structured along five outcome categories: 'decent jobs', 'local income', 'market and sector development', 'environmental stewardship' and 'community benefits'. The first three are key private sector categories. The latter two relate to responsible business.

This study focuses on local procurement, which is a sub-category of local income. An increase in local income, or the taxes, profits, personnel expenses, supply costs, and interests paid by companies, means an increase in opportunities for people in developing countries to make self-determined decisions. The private sector is the main source of local income. Its contribution is even greater where a company's business model has closer links with the local area, i.e. if companies employ local staff, pay taxes locally and source goods from local suppliers. The Agenda 2030 underscores that the mobilization and effective use of domestic resources are central to achieving the SDGs.



This study captures the following:

- Chapter 2 discusses the benefits that local sourcing may bring to companies and to society;
- Chapter 3 presents an overview of hurdles that companies may experience concerning local sourcing and ways to tackle these hurdles;
- Chapter 4 introduces a country-level approach to identify opportunities to increase local sourcing at portfolio level and a company-level approach to identify opportunities to increase local sourcing at company level;
- Chapter 5 provides recommendations;

Furthermore the report has several Annexes which provide a guidance note for investment officers, more information about our methodology, a detailed overview of all data sources and the Anova case study.

2 BENEFITS OF LOCAL SOURCING

In theory, companies would source the inputs they need from suppliers in the local market. Since sourcing from companies that are located around the corner brings diverse business benefits, why would a company go through all the challenges of procuring inputs from far flung countries? Indeed, unless local supply does not meet a company's requirements, there is no reason not to source locally.

In addition to benefitting the buyer, local sourcing may bring significant developmental effects to societies. These include short-term gains pertaining to local incomes and employment, and long-term gains that can enable structural economic transformations.

Exhibit 1 provides an overview of the benefits of local sourcing for companies and society.

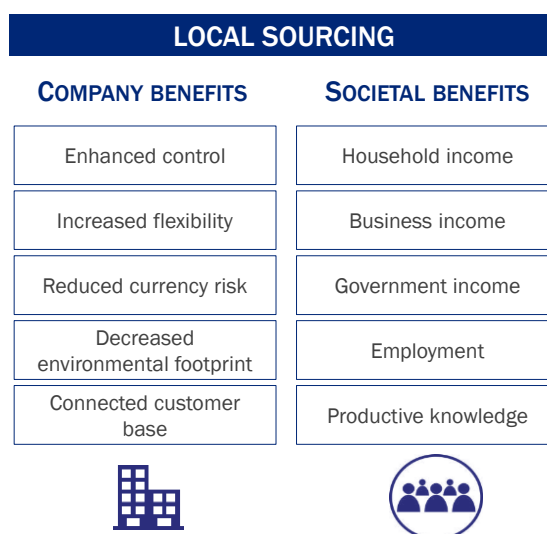


Exhibit 1: Key benefits of local sourcing for companies and society

2.1 Company benefits

Enhanced supply chain control

When suppliers are located close to a company's premises, *control and oversight* of suppliers to ensure they meet deadlines and quality requirements is often easier. Supply chain demands and issues can easily be explained in face-to-face meetings. Furthermore, sourcing from local suppliers simplifies *communication* and reduces the risk of things being 'lost in translation'. Lastly, shorter local supply chains enhance *transparency*, which is relevant for companies in terms of compliance, but also in responding to customers' increasing demand for supply chain transparency.⁵

"The quality and quantity checks we carry out at the local suppliers' premises help us to avoid significant delay in production."

Procurement Director Anova

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Increased flexibility and reduced costs

By sourcing products from local suppliers, companies avoid *custom clearance*, which can be a costly and time consuming process. In combination with shorter transport distances, this reduces *lead times* of local suppliers versus global suppliers, making them

"Local sourcing helps to avoid risks related to disruptions of trade due to political tensions. In Vietnam this is particularly relevant with regards to China."

Managing Director, VI Group

⁵ Tunisini, 2011; Interview Procurement Director Anova Feed.

typically more reactive. The higher responsiveness of local suppliers enhances a company's supply chain *flexibility*, e.g. orders can more easily be changed. Furthermore, *logistics* costs of locally sourced products are often much lower than those of imported products due to the reduced need for stock keeping, avoidance of import duties as well as shorter transport distances.⁶ Another benefit of the shorter transport distances is that it lowers the risk of *damages* to products during transport.

Reduced currency risk

By sourcing from (local) suppliers using the same currency, companies avoid financial risks related to *fluctuations in currency exchange rates*. Foreign exchange rates can fluctuate significantly over the course of a supplier contract, dramatically affecting prices of imported products. Especially for companies operating in countries with volatile currencies, currency exchange rate risks can be substantial.⁷ Local sourcing helps companies avoid non-financial risks as well, including risks related to trade wars and instable regimes abroad.

“Our biggest risk related to imports is exchange rate volatility. This can substantially increase costs of imported products.”

Procurement Director An Cuong

Decreased environmental footprint related to logistics

Local sourcing helps companies to avoid *transport-related carbon emissions*. Transport is one of the largest contributors to greenhouse gas (GHG) emissions worldwide. Especially air transport is very polluting. By sourcing products and services from local suppliers, companies avoid these types of emissions, thereby enhancing the sustainability of their business. Furthermore, companies using local suppliers often keep less stock. This means they need less storage capacity than when they import products, which reduces their *energy usage*.⁸

Connected customer base

A key advantage of local sourcing is that it can contribute to a company's credibility and can help drive sales. In sectors such as mining and oil, companies are often scrutinized for not contributing anything to the local economy, and in some cases leaving communities worse off environmentally and economically. Local sourcing could help generate the broad community support companies need to sustain their *license to operate*. Furthermore, businesses can capitalise on the growing *consumer preference* for local goods. By offering products produced with local inputs they can reach a broad customer base. Moreover, while the buyer increases its bottom line, so do its suppliers. A *flourishing local economy* boosts consumer spending, which improves long-term sales.⁹

2.2 Societal benefits

Incomes for households, business and government

Procurement of goods and services leads to revenues for suppliers. These revenues are subsequently spend on incomes for at least three kinds of beneficiaries: employees who receive salaries; the government that accumulates taxes (e.g. payroll tax and corporate income tax); and companies that generate profits. As such, when goods and services are procured from local suppliers, these three income streams remain in the country.

⁶ Interview Procurement Director Anova Feed.

⁷ Interview Procurement Director An Cuong.

⁸ Smith, 2018.

⁹ Smith, 2018; Kapstein & Kim, 2011.

Local sourcing by DEG's corporate clients

DERa results for corporates in DEG's portfolio in 2017 show that local sourcing of corporates financed by DEG amounted to EUR 15.7 billion. Most of this amount (EUR 6.3 billion) relates to local sourcing of corporates in the Americas. Corporates in Africa spent EUR 4.6 billion on local sourcing, in Asia EUR 2.7 billion and in Europe EUR 2.0 billion. These sourcing expenditures generate incomes for households (supplier employees), the private sector (supplier profits), and governments (supplier tax payments).

Employment

By sourcing locally companies support employment at local suppliers, as logically, people are needed to produce these goods and services. The number of jobs supported is highly context dependent. It matters how labour intensive the locally procured goods are: when labour intensive goods and services are bought relatively more jobs will be supported compared to capital intensive sectors. Furthermore, if local suppliers source their inputs from other suppliers within the country as well, significant 'multiplier' effects may arise. This way, local sourcing generates ripple effects throughout the economy, with incomes and jobs not only being supported among direct suppliers, but also among indirect suppliers.¹⁰

Examples from DEG's corporate portfolio

Ohorongo supports more than 2,000 indirect jobs

Ohorongo, a subsidiary of German company Schwenk, is Namibia's first and only cement producer. The company sources all key inputs, such as for protective gear, pallets, and transportation services, locally. A case study carried out for DEG showed the plant supports more than 2,000 indirect jobs with these activities. Furthermore, suppliers benefit in the form of financial support and skills-transfers from Ohorongo.

The Ohorongo case study can be accessed [here](#).

Virú supports significant farmer jobs and improves their standards

Virú is among Peru's three largest agricultural exporters. It procures fruits and vegetables from smallholder farmers, which it processes locally, before the products are shipped all across the globe. The company works closely with its 275 small-scale suppliers, thereby supporting significant local employment. Furthermore, Virú cooperates with these suppliers to ensure that they comply with ILO labour standards and that employees receive trainings, such as in occupational health and safety.

The Virú case study can be accessed [here](#).

Anova supports few jobs as it mainly sources food waste products

Anova is a Vietnamese animal feed producer. In 2017, the company spent EUR 98 million on procurement of inputs such as rice, corn, premix and plastic bags. Anova sourced only 40% of these inputs from local suppliers, which supported EUR 124,000 in salary payments and some 29 jobs among its local suppliers. Incomes and jobs supported are relatively low as the locally sourced inputs mainly consist of basic products (e.g. fish oil, rice bran).

The Anova case study is included in Annex 4.

Productive knowledge

Local sourcing can contribute to the cumulative productive knowledge base of a country, which is considered an important driver for growth.¹¹ Countries develop when they are able to move from producing simple products (e.g. commodities) to more complex products (e.g. machinery). Typically countries move toward products that are close ('adjacent') to what they already produce. By sourcing locally and cooperating with suppliers, companies – in particular multinationals – can push a country forward towards producing more complex products.

Companies enhance local capabilities by contributing their (international) know-how, technology, business practices, and managerial skills to local capabilities.¹² They can thereby 'upgrade' local

¹⁰ Kapstein, 2011.

¹¹ According to the theory of economic complexity, which has proven to be highly predictive of economic growth, economic development is driven by productive knowledge. Hausmann, 2011.

¹² Humphrey, 2001.

suppliers, or in other words, enable local suppliers to generate more economic value added.¹³ We can broadly distinguish between the following four types of upgrading:

1. *Process upgrading*: enables a supplier to achieve increased efficiency;
2. *Product upgrading*: enables a supplier to switch to higher value added products within the supplier's current activity;
3. *Functional upgrading*: enables a supplier take on new and higher value added functions in the value chain; and
4. *Chain upgrading*: enables a supplier to move to new, higher value added, value chains all together.

“Upgrading presents a major opportunity for economic development. Take the chocolate industry: only 2% of the total value created by this industry benefits Ghana. By moving towards processing cacao, more value can be captured locally.”

Programme Director Invest in Africa

The relevance of upgrading is recognised by SDG 8 – Decent Jobs and Economic Growth, which includes targets on diversification and technological upgrading.

Not all value chains offer the same opportunities for supplier upgrading. The distribution of power in the value chains between companies and suppliers is important here: which firms determine how financial, material and human resources are allocated and flow within a chain?¹⁴ When suppliers have stronger relationships with the companies of their products, they are more likely to reap benefits from this cooperation. Power relations between companies and suppliers can be shown on a continuum, with on one end low levels of cooperation between companies and suppliers (transactions are often governed by price, usually simple products) and on the other end strong levels of cooperation (transactions are often governed by quality and service, usually more complex products).¹⁵

Anova Feed: sourcing based on market prices

Anova, the Vietnamese animal feed producer introduced above, sources primarily based on prices. The animal feed industry is a commodity business in which raw materials account for about three quarters of total costs. Net profit margins are relatively low. To offer its feed for a competitive price, Anova needs to source commodities as economically as possible. As Anova's Procurement Director Ms. TruÓ'NG Thi Ngoc Bich states:

“Commodity prices are very volatile, which strongly affects our procurement decisions. We constantly monitor world market prices, and might adjust our formula accordingly, as long as the nutritious content remains the same.”

In this competitive industry supplier-buyer relationships are thus driven by price. Opportunities for upgrading are likely to be scarce: quality alternatives are probably available at affordable prices, either domestically or on global markets.

The Anova case study is included in Annex 4.

Heineken Vietnam: cooperating to produce plastic crates locally

Heineken's subsidiary in Vietnam sources its plastic crates – used for transporting the beer - from a local supplier. Initially this supplier had to import the various moulds used to manufacture the crates from suppliers abroad. Heineken closely worked with its local supplier to help it develop the capability to produce its own plastic crates using self-made moulds, which enabled the supplier to generate higher value added.

More information can be found in Heineken Vietnam's Sustainability Report, which can be accessed [here](#).

The potential contributions of local sourcing to a country's productive knowledge and thereby its longer term economic development, thus not only hinges on the volumes that are being sourced. Value chain relationships are important too. Ensuring that local suppliers have good and close relations with companies can facilitate the upgrading possibilities of these local suppliers.

¹³ Schmitz, 2000.

¹⁴ Gereffi, 1994.

¹⁵ This discussion is based on: Gereffi, 2005.

3 HURDLES TO LOCAL SOURCING AND HOW TO TACKLE THEM

Despite the positive effects of local sourcing for companies and society, many companies source only part of their goods and services locally. Especially in developing economies, where suppliers often lack the capacity to effectively compete on global markets, local suppliers often lose from their peers abroad. Here we discuss common hurdles to local sourcing faced by companies, and explore opportunities to tackle these.

Local sourcing by DEG's corporate clients

Out of the 169 corporates in DEG's portfolio in 2017 for which DERA information is available on local sourcing, 60% indicated to source more than half of their goods and services locally. Local sourcing shares were the highest in Latin and South America and the lowest in Europe. Furthermore, DERA data shows that corporates in agriculture source the most locally: 77% agricultural corporates indicated to source more than half of their inputs locally, compared to 66% of the services corporates and 51% of the industry corporates.

3.1 Hurdles to local sourcing

This lack of local sourcing likely points to a mismatch between company demand and country supply: a product required by a company is either not offered on the local market (lack of availability), or not offered in a way that it meets company demand. Literature on supplier selection highlights price, quality and delivery as the top three factors guiding a company's procurement demand. For most purchasing departments, these are the so-called 'order qualifier' criteria. Order qualifiers are the characteristics that are required for the good or service to be even considered by companies. Hence, hurdles related to these order qualifying criteria and the lack of local availability likely shift companies towards international procurement, leaving important opportunities to benefit domestic economies untouched. Exhibit 2 summarizes these key hurdles.

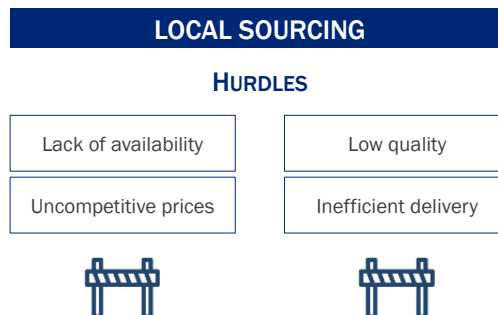


Exhibit 2: Key hurdles to local sourcing

Other criteria, including the geographical location of a supplier, can be important, but are 'order winner' criteria for most purchasing departments. Such criteria describe characteristics that will win procurement, but are only taken into consideration after the 'order qualifier' criteria are met.¹⁶

The relative importance of supplier selection criteria could change over time, and is product and industry specific. For example, for simple products (i.e. rice) it is likely that purchasing departments consider price the primary factor in supplier selection. Conversely, for more complex products (i.e. machinery) purchasing departments likely consider more factors such as quality, safety and convenience, while price becomes relatively unimportant.¹⁷

¹⁶ Kheng, 2010; Dickson, 1996; Weber, 1991; Zhang, 2004.

¹⁷ Dickson, 1996.

Lack of availability

The precondition for local sourcing is local availability of the required goods and services. Availability of products and services depends on several factors. One is the cumulative productive knowledge in a country. The higher the cumulative productive knowledge in a country, the “fitter” the country is in terms of the diversity and complexity of products it can produce, and the higher the availability of goods and services.¹⁸

Beyond a lack of cumulative productive knowledge, inputs may not be available because suppliers simply do not find it financially worthwhile or too risky to produce locally. Local production of certain goods requires companies to move into new and unknown business territory; barriers to enter might be high. Finally, an obvious but important factor is geography. Some goods are only available in certain countries due to climatological or geographical circumstances (e.g. diamonds, tuna).

In developing economies, companies requiring complex products and services are more likely to face availability hurdles to local sourcing than companies requiring relatively simple products. Whereas complex products can only be produced in relatively ‘fit’ countries, simple products are likely to be produced by a larger number of countries.

Uncompetitive prices

The net price is often the first selection factor considered by purchasing departments in supplier selection. Price is a function of cost (including costs of raw materials, labour costs, transport costs, and research and development costs), profit margin and market forces.¹⁹

“Price is our key hurdle to local sourcing. If prices would be competitive, we would source our inputs locally.”

Procurement Director Anova

Companies requiring capital intensive products or products that are produced in large quantities are more likely to face price hurdles related to local sourcing in developing economies than companies requiring labour-intensive products. Labour costs are often relatively low in developing economies, which could work in favour of local sourcing of labour-intensive products in these countries. Conversely, capital-intensive products are likely to be relatively expensive due to low capital-productivity (and technology) levels. Furthermore, due to their relatively small economies (in terms of GDP) developing countries often lack the economies of scale which would enable suppliers to divide their fixed costs over a larger number of products.

Low quality

Another key factor often considered by purchasing departments is the quality of the product or service delivered. Quality can generally be defined as “conformance to requirements or fitness to use” and is determined by “the extent to which a product or service successfully serves the purpose of the user during usages”.²⁰ Studies show that quality becomes progressively important in supplier selection as production is governed by a growing number of public and private standards or codes of practice. These help companies avoid ruptures and losses in their production process and deliver consistent quality to their customers. Furthermore, companies increasingly have to implement standard certifications to participate in international trade of goods and services.

Companies requiring products with high quality standards are likely to face quality hurdles related to local sourcing in developing countries. Suppliers in these countries often face difficulties in delivering products that meet all requirements due to a lack of awareness, financial means, skills and/or knowledge.

¹⁸ According to the Theory of Economic Complexity countries will produce all goods and services possible given the productive knowledge in the country; Hausmann, 2011.

¹⁹ This depends on the price setting strategy of companies. For example, when companies use a dynamic price strategy they set flexible prices for products based on current market demand instead of based on production costs; Cheraghi, 2011.

²⁰ Cheraghi, 2011.

Inefficient delivery

The third main factor often considered by purchasing departments is delivery. Delivery is a function of a supplier's efficiency and effectiveness, including on-time delivery, short lead times, reliable delivery methods, good packaging for delivery, and delivery of products in good conditions and without errors in product type and quantity.²¹

As discussed in one of the previous sections, one of the advantages of local sourcing is the lower burden of logistics which positively affects lead times of suppliers. Furthermore, local sourcing enables stronger supplier management, and better control of product conditions and quantities. However, for companies requiring advanced delivery services, the benefits of supplier proximity could be nullified by low supplier efficiency and effectiveness due to low investment levels. In more advanced economies, supplier efficiency and effectiveness is likely to be higher than in developing economies. Hence, despite longer distances, delivery conditions of suppliers abroad might be better than delivery conditions of local suppliers.

3.2 Tackling hurdles to local sourcing

Hurdles to local sourcing can be tackled by either shifting demand and/or improving (the match with) country supply. This will allow local sourcing to grow and unlock the benefits for companies and society.

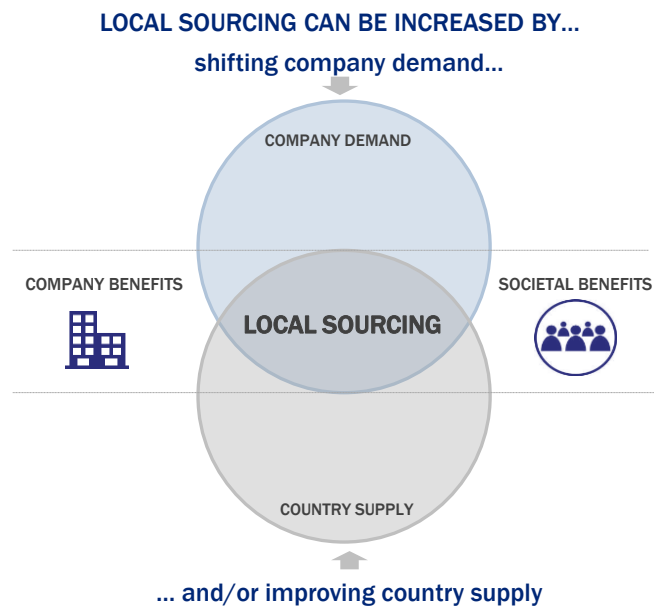


Exhibit 3: Local sourcing links buyer demand and local supply

3.2.1 Company demand

Review supplier selection criteria

Companies should regularly update (the hierarchy of) their supplier criteria to make sure they keep up with the strategical objectives of the company. Over time, consumer demand might change (e.g. conscious consumers are willing to pay more for local products), which could change the relative importance of supplier selection criteria (production origin becomes more important than price). This would open up opportunities for local sourcing.

²¹ Cheraghi, 2011.

Guerrilla Organics developed a 100% local food box to tap into a new customer base

Guerrilla Organics is a produce-delivery subscription service that provides organic food boxes in the United States. Besides offering a Standard Box for USD 30 with local and imported food, they offer a Local Box for USD 35 with only local food. With the Local Box the company taps into a new strategic market opportunity, which reduces the relevance of price as supplier selection criterion and puts geographic location to the front.

Source: www.guerrillaorganics.com

Explore local alternatives

Companies could explore whether there are local alternatives to the products and services they currently import. If hurdles to local sourcing related to a buyer's current product portfolio cannot be tackled there might be local alternatives available that can replace the imported products.

Bralima replaced a share of imported barley by locally grown Congolese rice in its beer recipes

Barley is one of the key crops used for malt in beer production. However, Bralima, Heineken's subsidiary in the Democratic Republic of Congo (DRC) faced hurdles related to local availability of the product: barley could not be supplied by the Congolese market.

In 2008, together with the Non-Governmental Organizations (NGO) EUCORD, the brewery launched the development initiative known as 'Project Riz'. The aim of the project was to increase the use of locally produced rice in beer recipes, while improving food security and the livelihoods of smallholder farmers in DRC. Since the start of the project, the use of local rice by Bralima has increased from 16% to about 90%.

Source: www.saiplatform.org/projects/64/98/Rice-Project-in-the-Democratic-Republic-of-Congo

Address reputational issues

Issues related to a company's reputation could push companies away from financial and business considerations in procurement. Companies may want to actively source goods and services from local suppliers in an effort to improve their social license to operate. As discussed above, companies need the support of local stakeholders to sustain their operations in the country. Buying inputs from local suppliers helps embed the company into local economic structures. It displays that the company is dedicated to the local economy and seeks to spread the spillovers from their operations. As a result, local stakeholders may look more favourably upon the company, thereby granting it the desired social license to operate.

3.2.2 Country supply

Tailor institutional framework

Companies can discuss with governments how local sourcing can be incentivized by the local institutional framework, i.e. the rules and regulations in a society. Governments can use this institutional framework to regulate and steer sourcing decisions. Examples of policy instruments used by governments to promote local sourcing are:

- *Local content requirements (LCRs)*: policy measures that typically require a certain percentage of intermediate goods used in the production processes to be sourced from domestic manufacturers.
- *Import prohibition and licensing*: policy measures that prohibit or restrict certain goods or services from being imported.
- *Import tariffs*: a tax or duty placed on an imported good or service by a domestic government, making domestic goods cheaper for domestic consumers and producers, and imported goods more expensive.
- *Tax discounts*: lower taxes on products made from local inputs compared to products made from imported inputs.

The use of these policy instruments is much debated. Proponents argue that these help countries (in particular developing countries) to protect and strengthen infant industries that could in the long-run be competitive, support local production and employment, improve the country's trade balance and encourage transfers of technology between local and foreign entities. Opponents assert that these measures lead to economic inefficiencies, discourage foreign investors from investing in a country due to higher costs, raise prices for domestic consumers and incentivize rent seeking because of a lack of competition.

Uganda reduces taxes on beer made from local inputs

In the early 2000s, Nile Breweries in Uganda - a subsidiary of the global brewer SABMiller plc - faced stalling sales. Prices of its products were too high for consumers in the lower-income segments. Most of these consumers were drinking home brews, with potentially severe health consequences. However, the company had a hard time reducing its prices due to high costs of imports, mainly barley, and excise taxes.

The brewery found that imported barley could be reliably replaced by sorghum produced by local farmers. To encourage the company to set up a local sorghum supply chain, the Ugandan government offered a 50% excise tax cut on beer from local inputs. This enabled the company to successfully develop a local beer, Eagle Lager, which could be offered for a reduced price to a new customer segment.

Source: www.stewardredqueen.com/uploads/nieuws/fall_2011_features_sourcing_locally_for_impact.pdf

Develop business platforms/networks

Business platforms and/or networks could help to improve the match between local supply and demand. One of the hurdles to local sourcing is the lack of availability. This could mean the required goods and services are not locally available, but it could also mean they are available, but not found. Business networks and platforms linking suppliers and companies could help to overcome this hurdle.

Invest In Africa (IIA) developed a platform to link corporates and SMEs in Ghana and Kenya

IIA aims to facilitate and increase linkages between large corporations and small local businesses. IIA found that local SMEs often struggle to make themselves visible to big companies looking for suppliers. Therefore they developed an online market place, the African Partner Pool (APP), where buyers and suppliers across Africa can engage, discover new opportunities and grow their business. The APP allows local SMEs to promote the products and services they can deliver and the standards they can deliver to.

Source: www.investinafrica.com/

Improve access to capital

Access to finance is the number one obstacle for businesses around the world.²² Problems include information asymmetries, high transaction costs for banks and a lack of financial skills and knowledge among business owners.²³ Improving access to finance would help companies develop new products (improves availability), increase capacity (drives down price), improve standards (enhances quality) and boost efficiency (improves delivery services).

Samsung set up a fund to financially support suppliers

Samsung Electronics has established a USD 450m fund, together with commercial banks, to financially support its suppliers. The fund allows Samsung's direct suppliers (tier one suppliers) to borrow a sum of money equal to their monthly payment from Samsung to pay their suppliers (tier two suppliers). They can borrow the money interest-free for up to a year.

Source: www.samsung.com/uk/aboutsamsung/sustainability/supply-chain/

Build capacity of private sector on international standards

Better knowledge, skills, and awareness of international standards could help businesses provide improved quality and delivery services, and offer a wider range of products for a better price. Capacity

²² World Bank Group, Enterprise Surveys.

²³ OECD, 2018.

building programs could include trainings on occupational health and safety, environmental and social risks, and international certifications.

Newmont builds local suppliers' capacity

Newmont Mining Corporation, a multinational gold miner, has developed a "linkages" program with suppliers based in the Ahafo region of Ghana, the Ahafo Linkages Program (ALP), in cooperation with the International Finance Corporation (IFC). The aim was to develop local micro-, small- and medium-size enterprises that provide goods and services to the mine, as well as facilitate the development of non-mining businesses to support a diversified local economy. The first step was to create a database of local suppliers and their skill levels. This helped Newmont to determine the focus of its capacity building program, the second step. Since entering commercial production in 2006, Ahafo has awarded contracts to around 500 local businesses through the ALP and other programs.

Source: www.newmont.com/operations-and-projects/africa/ahafo-ghana/community/default.aspx

4 TWO APPROACHES TO IDENTIFY LOCAL SOURCING OPPORTUNITIES

The previous sections showed that tackling hurdles to local sourcing can unlock significant developmental potential. But where to start? We developed a country-level approach to assist DFIs in identifying clients with whom they could discuss local sourcing and related hurdles within a portfolio of private sector investments. Additionally, after the clients have been identified, DFIs can use the company-level approach in discussions with these clients to explore whether there are opportunities to replace imported products with local substitutes.

4.1 Country-level approach

DFIs often have a large portfolio of investments into private sector clients, and do not have the time and resources to discuss local sourcing opportunities with all of these clients. Furthermore, not all clients might have interest in discussing the topic with DFIs. To assist DFIs in making a first selection, we developed a country-level approach. The approach allows DFIs to identify local sourcing opportunities in all sectors and countries worldwide. As most management in DFIs operates along sectors and countries, this approach would allow for top-down clustering of the portfolio.

4.1.1 Framework

The country-level approach uses a framework which shows for each sector whether local sourcing practices in the country are in line with the country's productive capabilities (also called "fitness", which indicates whether or not the country is able to create a large variety of products). We expect local sourcing to be high in fit countries, as these countries are likely able to produce or develop a large variety of products. In contrast, we expect local sourcing to be low in unfit countries due to their limited ability to produce different products. It follows that if local sourcing is low, while country fitness is high, opportunities to increase local sourcing are likely to be pervasive.

The framework uses the following data sources:

- *Sector sourcing practices*: we use sector data from Input/output (I/O) tables, compiled by the Global Trade Analysis Project (GTAP), the largest database worldwide for this type of data. I/O tables provide information on the share of local versus imported procurement for 140 regions and 57 sectors. This enables us to identify per sector (1) the share of locally sourced versus imported products; and (2) whether the share of locally sourced inputs is more or less than the world/regional average of the sector.²⁴
- *Country fitness*: we use Pietronero's fitness ranking of countries. The ranking is based on the sum of quality and complexity of the products produced and exported in a country.²⁵

Exhibit 4 shows how country fitness and local sourcing practices are combined in a framework to identify local sourcing opportunities worldwide. In this framework all sectors of all countries worldwide can be mapped. The position of sectors in the framework can be interpreted as follows:

1. Sectors in fit countries that source more than average locally, which is in line with expectations.
2. Sectors in unfit countries that source more than average locally. These sectors represent a 'surprise' as we expect local sourcing opportunities in these countries to be limited. Here we see potential to identify best practices in local sourcing.

²⁴ GTAP, 2011. The limitation of using I/O tables is that they reflect sector averages. They are based on an entire sector and do not show the differentiation within a sector. Therefore, sourcing by an individual company can deviate from sector averages.

²⁵ Pietronero, 2015. The limitation of using Pietronero's fitness ranking is that it is based on exports of goods, not on production, and therefore excludes intra-country trade and services.

3. Sectors in unfit countries that source less than average locally, which is according to expectations. Here we see potential to develop local sourcing, but due to the limited capacity in the country, opportunities may be difficult to find.
4. Sectors in fit countries that source less than average locally. The low local sourcing can be considered a 'surprise' as well, as we expect local sourcing opportunities to be prevalent in fit countries. We expect to potential to increase local sourcing to be high in these sectors.

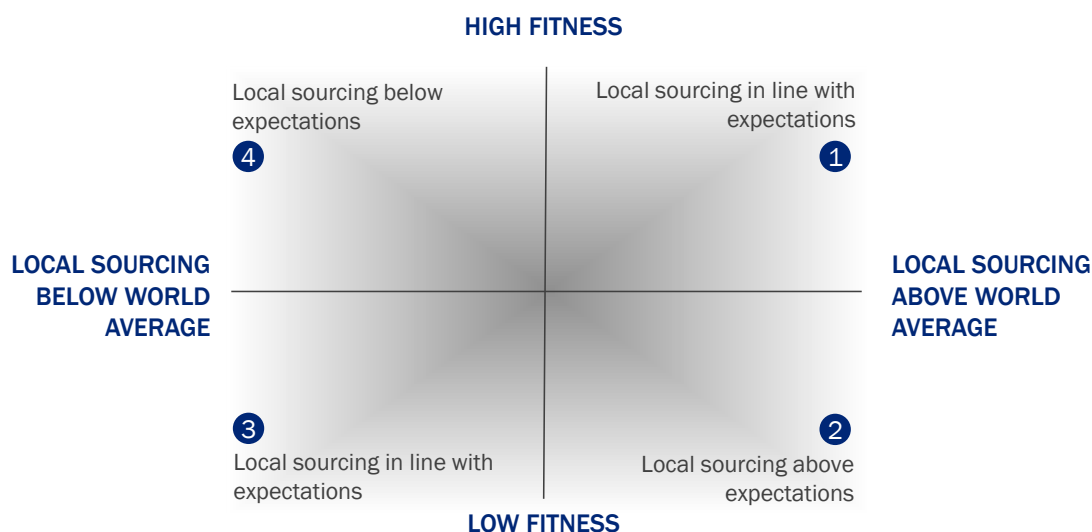


Exhibit 4: Framework to identify local sourcing opportunities

4.1.2 Implementation of approach

Exhibit 5 provides an overview of the country-level approach, showing how the framework can be applied to a portfolio of investments.

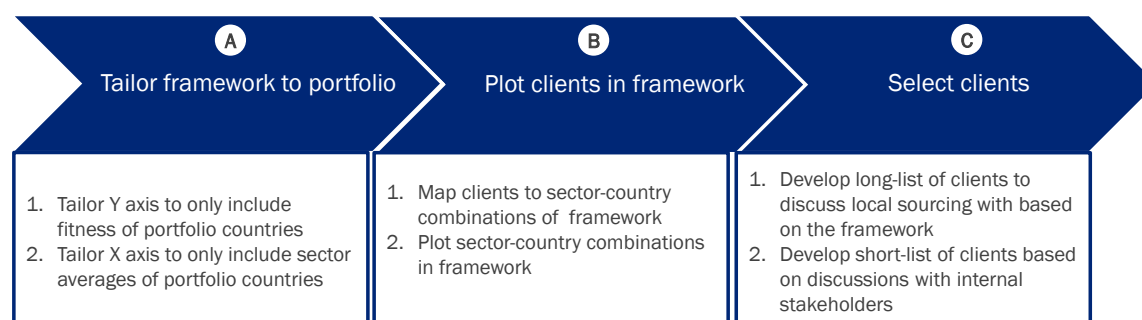


Exhibit 5: Country-level approach

To illustrate how this approach works out in practice, we applied the approach to DEG's corporate clients as of December 31 2016 (selection of DEG client cluster "Corporates", in which DEG has invested or was committed to invest).

Tailor framework to portfolio

The first step is to tailor the framework to the DFI's portfolio of investments, so that the framework reflects opportunities to increase local sourcing within the investment universe of the DFI, instead of worldwide. In order to tailor the framework, the axes should be customized from reflecting all countries worldwide to reflecting the countries within the portfolio.

For DEG we tailored the Y axis so that it would reflect the fitness of the 148 countries in the DEG sample. We ranked the fittest country within the sample (i.e. China) as one, and the least fit country within the sample (i.e. Chad) as 148. For an overview of the highest and lowest ranked countries, see Annex 2. Exhibit 6 shows the average ranking of sample countries per region. The sample countries in Africa are the least fit, whereas the sample countries in Asia are the fittest. The X axis will cut the Y axis at rank 74, which represents the average fitness ranking of the sample.

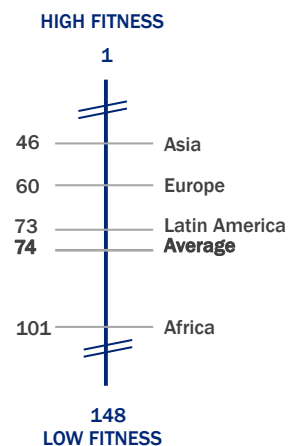


Exhibit 6: Fitness ranking per region

We also tailored the X axis of the framework to reflect the sector sourcing practices of the countries within the DEG sample. Exhibit 7 shows that on average companies in agro processing source the most locally, whereas companies in manufacturing source the most from abroad. The greatest variation in local sourcing between regions can be found in the transport and communication sector. The Y axis will cut the X axis at the sample sector average local sourcing.²⁶

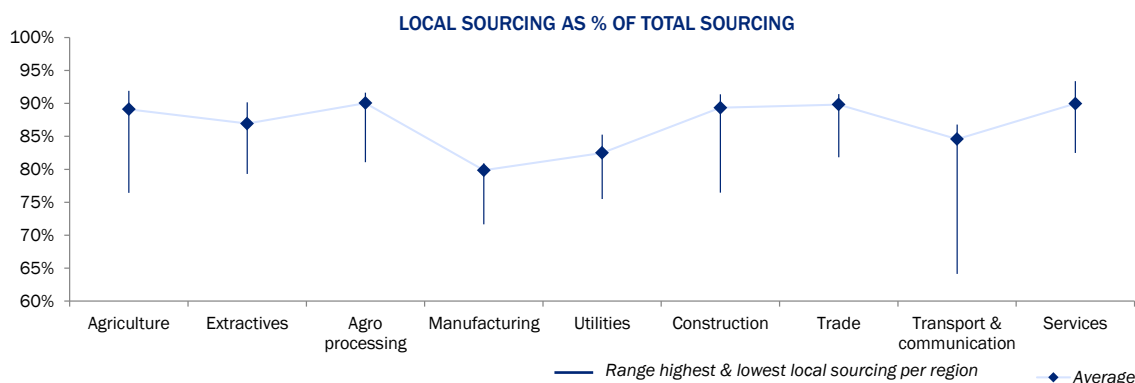


Exhibit 7: Local sourcing shares per sector

Plot clients in framework

The next step is to map the clients of a DFI to the sector-country combinations of the framework. Subsequently these sector-country combinations can be plotted in the customized framework. The bubble size can be tailored to the size of the sector in the country (the larger the bubble, the more important the sector in the country).

To show how this works we mapped DEG’s corporate clients (as of December 31 2016) to the sector-country combinations of the framework, and subsequently plotted these as shown in Exhibit 8. Each bubble represents a county-sector combination in DEG’s portfolio, and links to one or two clients.

²⁶ In the actual model we use data for 57 sectors

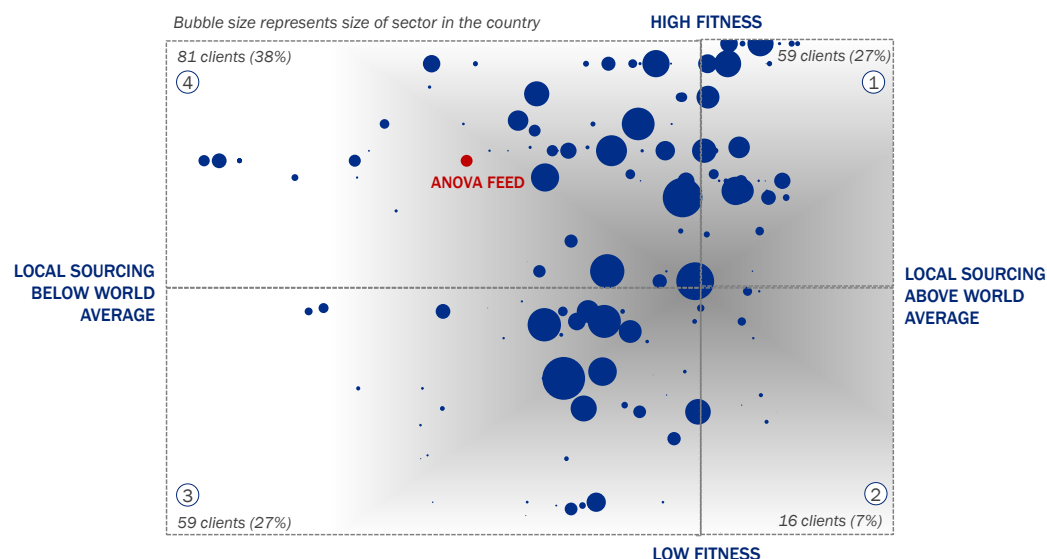


Exhibit 8: DEG clients mapped to framework

Select clients

Finally, a long-list of clients can be selected for discussions on local sourcing, considering the position of the client in the framework and the relevance of the sector in the country. We suggest selecting clients in the top left box (4) of Exhibit 4, as these are expected to have the highest potential to improve their local sourcing. Furthermore, DFIs could consider the size of the sector in the country. Subsequently, we suggest to involve internal stakeholders to short-list clients based on their knowledge of the country, sector and/or client.

Exhibit 4 shows that out of DEG's 215 corporate clients, 81 clients operate in sectors sourcing less locally than is expected considering the relatively high country fitness (box 4, exhibit 8). Out of these 81 long-listed clients we selected Anova Feed ('Anova'), a feed producing company in Vietnam, as a case study. Anova has been selected based on input from DEG's country office in Vietnam and investment officers.

More information on Anova can be found in the full case study, added to this report in Annex 4.

4.1.3 Limitations and learnings

The portfolio-approach is not without limitations. A first key limitation is that the core framework used in the approach is based on statistics instead of real client data. Actual sourcing practices of individual clients could deviate from these statistics. A second important limitation is that the core framework determines opportunities to increase local sourcing based on a sector's sourcing practices compared to a regional average only. There could be multiple other reasons for opportunities to increase local sourcing. Thirdly, a relatively low local sourcing share does not necessarily mean that increasing local sourcing is indeed relevant for an individual client, and the other way around.

The portfolio-approach described above incorporates the learnings from its implementation to DEG's portfolio. We initially did not tailor the framework to DEG's portfolio and only plotted sector-country combinations to the framework when sourcing represented more than 60% of total revenues. However, these decisions filtered out too many clients and have therefore been revised.

4.2 Company-level approach

To help companies and DFIs identify whether there are opportunities for a company to replace imported products with local substitutes, we developed a company-level approach. The approach

consists of a value chain analysis, with a focus on the geographical distribution of supply, and an assessment of the possibilities to substitute imported goods and services by local products.

4.2.1 Implementation of approach

The key steps of the company-level approach are depicted in Exhibit 9 and further described below.

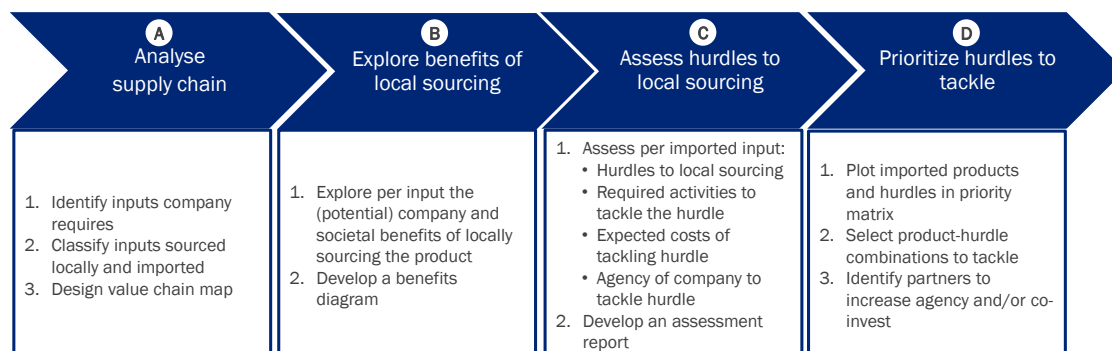


Exhibit 9: Company-approach to identify local sourcing opportunities

To illustrate how the approach can be implemented in practice, we applied it to Anova, which we selected as a case study.

Analyse supply chain

The first step is to analyse a company's supply chain. It requires identifying a company's key inputs, as well as the geographical origin of these inputs. Preferably information on the value of these inputs is added, to calculate the share of procurement expenses that accrue to local versus foreign suppliers. Usually these insights can be provided by a company's Procurement Director. Results can be visualised in a value chain map.

We implemented this approach to Anova, where we discussed the company's supply chain with its Procurement Director during a field visit to Vietnam. We identified the type of inputs the company requires: a mix of raw materials to produce animal feed with the right combination of energy and protein, as well as plastic bags for packaging. Anova could source only 40% of these inputs locally, which is even lower than predictions of our framework (65% local sourcing, compared to a regional average of 90%). Of the inputs used by Anova, rice bran and broken rice, fish oil, premix and the plastic bags are sourced locally. The remaining products are imported. Exhibit 10 shows Anova's value chain map.

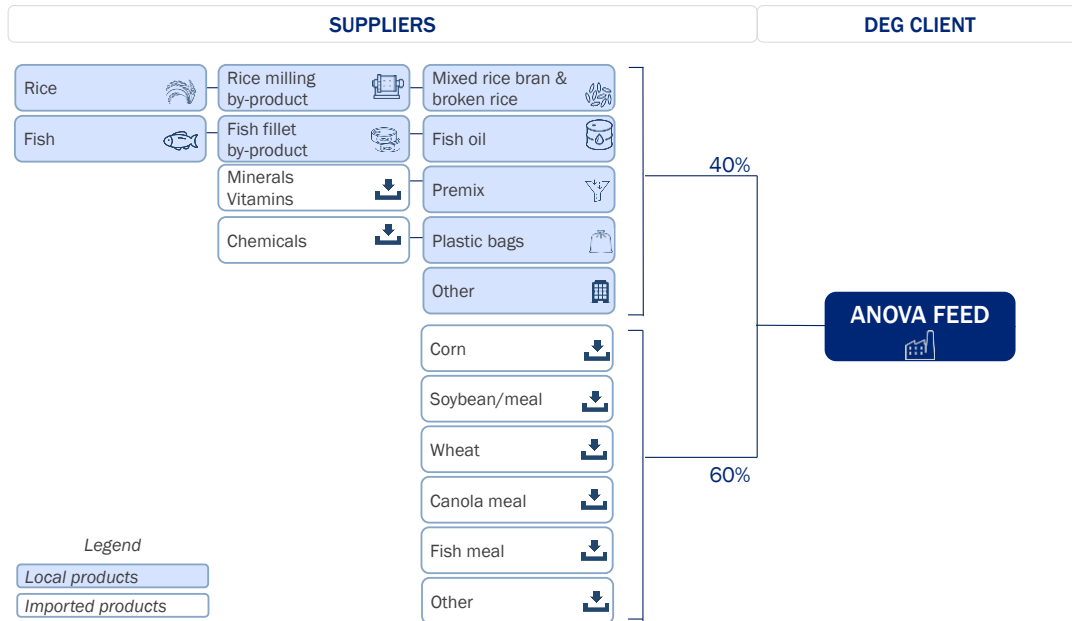


Exhibit 10: Anova value chain map

Explore benefits of local sourcing

The next step is to qualitatively explore the business case of local sourcing for the company, as well as the societal benefits. This exploration is centred on identifying stakeholders that would benefit from local sourcing, rather than precisely quantifying what such benefits would amount to. Usually a company’s Procurement Director can provide good insights into benefits of local sourcing in terms of supply chain management and logistics for the company. He or she can often provide insights into supplier benefits as well. To complement insights on societal benefits, it can be valuable to speak to suppliers themselves, or to other relevant external stakeholders (e.g. government officials). A company’s Sales Director or General Manager could provide additional insights into the strategic benefits for companies of sourcing more locally, e.g. in terms of attracting a new client base or improving the company’s license to operate.

At Anova, the company’s Procurement Director provided insights into benefits of local sourcing for the company in terms of supplier management, logistics and reaching out to specific consumer segments. Furthermore, we discussed expected benefits for society of Anova’s local sourcing. Subsequently, we organized meetings with Anova’s main local suppliers to obtain additional insights. We presented our findings in the benefits diagram depicted in Exhibit 11.

We found that local sourcing generates benefits for Anova in terms of enhanced control and increased flexibility. Other potential benefits of local sourcing, such as reducing the company’s environmental footprint and improving the company’s customer base (e.g. license to operate, sales) were less relevant. Furthermore, Anova’s local sourcing contributes to societal benefits, such as incomes for households, business income, government income and employment. However, we did not find a strong connection between Anova’s local sourcing and economic growth. Anova uses only basic products

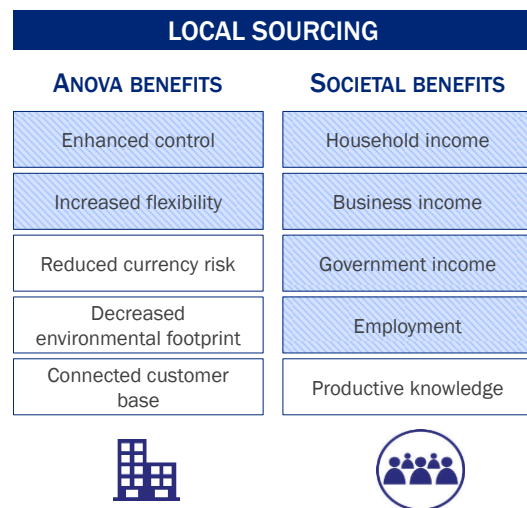


Exhibit 11: Benefits diagram






requiring few skills and/or knowledge to produce. The company can therefore easily switch between suppliers and has little incentive to invest into its supplier relationships.

Assess hurdles to local sourcing

Companies have no reason not to source their inputs locally, unless local supply does not meet a company's requirements. In practice, the latter is often the case for at least a part of the inputs required by a company. In this third step we assess what hurdles companies face related to locally sourcing per imported product. Furthermore, we assess whether it makes sense to invest time and/or money into tackling these hurdles. Insights can be obtained by discussing these topics with a company's Procurement Director. Furthermore, external stakeholders such as industry associations and government officials could provide additional background information on key hurdles to doing business in a country. Results of such an assessment can be reported in a hurdle assessment report.

At Anova we spoke with the company's Procurement Director, who provided insights into the hurdles related to local sourcing per imported product. We also discussed drivers of these hurdles and activities necessary to tackle these hurdles both with Anova's Procurement Director, and government officials in Vietnam. Moreover we touched upon the influence of Anova to tackle these hurdles and expected costs. Besides these interviews we also studied literature to obtain more insights into hurdles to local sourcing in Vietnam, in particular of the (agricultural) products required by Anova. We presented the results in an assessment report.

Table 1: Hurdle assessment report

Imported product	Key hurdles	Driver of hurdle	Activity	Cost	Buyer's influence
Corn 	Price	Economies of scale local competitiveness	Investment in better seeds capacity building	High	Low
Soybean/meal 	Price	Economies of scale local competitiveness	Investment in better seeds capacity building	High	Low
Wheat 	Availability	Climate	n/a		
Canola meal 	Availability	Climate	n/a		
Fish meal 	Availability	Climate	n/a		

As Table 1 shows, the key hurdle to sourcing corn and soybean/meal locally is price, driven by little economies of scale in Vietnam and a lack of local competitiveness. Notwithstanding limited scale in Vietnam, competitiveness could be enhanced by using higher yield varieties and setting up skill development programs focused on improving production techniques of farmers. Costs of these activities would be high, especially since new varieties have not yet been tested in Vietnam. Furthermore, we found Anova's influence to be relatively low as the company has a small market share (2%) and is not among the market leaders.

The key hurdle to sourcing other crops locally is availability, related to unfavourable climatological circumstances. Although Anova might adjust its formula, nutritious contents must remain the same. According to Anova's Procurement Director, local alternatives that can provide the same nutritious contents are not available. We therefore do not foresee any further activities related to these products and hurdles.

Prioritize hurdles to tackle

The final step of the company-level approach is to prioritize hurdles to tackle. Imported products can be plotted in a priority matrix. Such a matrix helps to determine whether there is a business case for companies to tackle these hurdles. If there is a business case, companies could explore potential stakeholders to partner up with (e.g. DFIs).

Exhibit 12 shows such a priority matrix. The vertical axis measures the expected benefits for companies of sourcing the product locally, while the horizontal axis indicates the size of a company's demand and its related influence on the market.

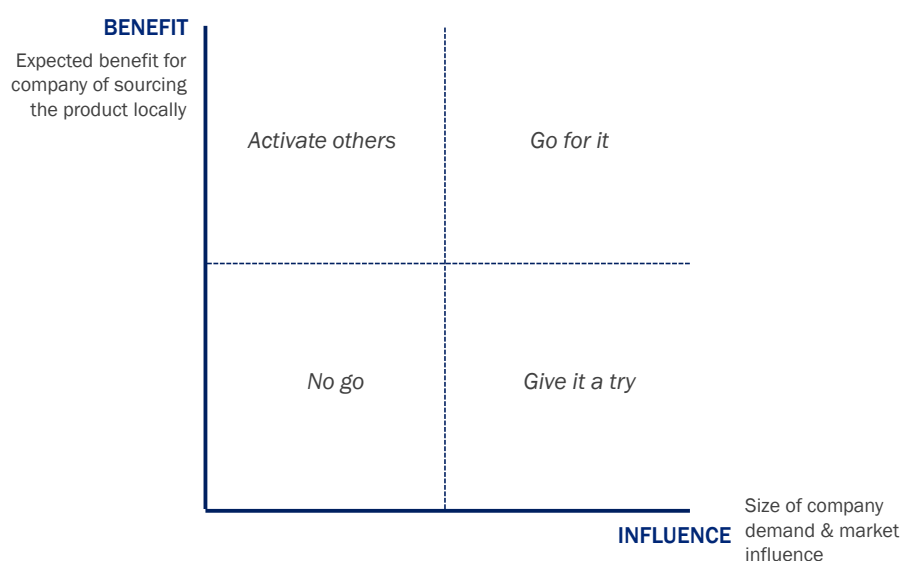


Exhibit 12: Priority matrix

If expected benefits are high, and a company has strong influence on reducing the magnitude of the hurdles, there is an imperative to tackle hurdles for local sourcing (upper right quadrant). High benefits but low influence highlights a potential to partner up with organisations to increase agency in tackling hurdles (upper left quadrant). In case a company has a high ability to tackle hurdles it can do so, even if its benefits are expected to be low, for the sake of contributing to the local society (lower right quadrant). Naturally, if expected benefits and actual influence are both regarded as low, there is no sufficient reason to tackle hurdles to local sourcing (lower left quadrant).

We have not developed a priority matrix for Anova as the hurdle assessment report showed little opportunity to improve local sourcing for Anova. Significant investments are needed to produce soybeans and corn in a competitive way, while Anova has little agency. From our conversations with Anova it became clear that to the extent possible, the company already sources its inputs locally.

4.2.2 Limitations and learnings

A key limitation of the company-approach is that it strongly relies on cooperation of a DFI client. Clients should be willing to share their procurement information, and invest time to discuss this with a DFI. Our experience with Anova showed that most information can be derived from investment proposals, or is readily available at a company's procurement department. Furthermore, external stakeholders such as suppliers and Ministries considered local sourcing and related hurdles a relevant topic and were willing to cooperate as well.

The Anova case-study learned us that the framework of the portfolio-approach rightly pointed us to a client with a relatively low local sourcing share, for which local sourcing was in indeed an interesting topic to discuss. However, in contrast to what the framework predicted, opportunities to enhance Anova's local sourcing turned out to be limited. This underlines that a business case to increase local sourcing is a prerequisite, and hurdles to local sourcing cannot always be tackled.

5 CONCLUSIONS

Based on our research regarding the benefits of local sourcing for companies and society, and the possibilities to increase local sourcing, we come to the following conclusions:

1. **It is relevant for DFIs to assess opportunities to increase local sourcing in their portfolio as it enables them to maximise the developmental effects of their investments.** Local sourcing generates key benefits for companies and society. DFIs, through their mission and their close linkages with the companies they finance, can provide an important impetus to tackling the hurdles to local sourcing.
2. **To identify opportunities to tackle hurdles and increase local sourcing within their portfolio DFIs can use the country-level approach explained in this paper.** DFIs often have portfolios of hundreds of investments, which makes it hard for them to discuss local sourcing with all of these clients individually. The country-level approach allows them to make an initial screening of clients on opportunities to increase local sourcing. As the framework used in the country-level approach is based on statistics, it should always be complemented with insights from investment officers and specialists who know their clients and markets best.
3. **To identify opportunities to tackle hurdles to local sourcing together with their clients, DFIs can use the company-level approach of this paper.** In theory, companies would source the inputs they need from local suppliers. However, in practice, they face several hurdles to local sourcing and often source part of their inputs from abroad. The company-level approach enables DFIs to structurally assess bottlenecks to local sourcing with their clients. It could be used to guide the discussion between DFIs and their clients (not as a straitjacket), with a business case for clients as prerequisite. In implementing this approach a client's willingness to cooperate is key.
4. **DFIs can deploy their networks, finance and knowledge to help tackle hurdles to local sourcing.**
 - *Networks:* DFIs could create an informal network of their corporate clients, facilitate international network opportunities between local businesses and international businesses, or partner with funds/financial institutions (FIs) to create networks among their clients. These networks could improve the match between local demand and supply, and increase local businesses' access to global supply chains and world markets. Furthermore, they could facilitate bundling of demand of smaller companies, which could make procurement processes more efficient.

"DEG should invest in complex industries. With its German background, a country with high-quality manufacturing and a strong Mittelstand DEG is well positioned to do this."

Managing Director, VI Group
 - *Finance:* DFIs could discuss with its corporate clients whether there are opportunities to strengthen the corporate's local value chain by investing in local suppliers. They could consider either direct investments (if local suppliers are large corporates themselves) or indirect investments (if local suppliers are relatively small). DFIs could for example partner with a local FI and develop supply chain finance products that could be offered to a supplier (local FI's client) and buyer (DFI client). A local FI can likely better assess SME specific risks, and can provide smaller loans. The local FI will benefit from better risk mitigation through the security of a procurement contract with a larger client that is financed by a DFI.
 - *Knowledge:* DFIs could leverage the business knowledge in their home country as well as Technical Assistance services towards their corporate clients:
 - Organise trainings on international standards (e.g. on food safety) to improve access to global value chains;

- Build corporate capacity on financial and business management to improve local competitiveness and access to capital;
- Provide advice on production processes (e.g. supply chain management) and product development to improve local efficiency and product variety;

Furthermore DFIs could leverage their financial expertise and financial intermediaries' access to smaller businesses:

- Deliver capacity building on product validation and risk assessments to unlock more finance from these FIs for local businesses;
- Develop train-the-trainer programs for local FIs, so that they can provide training to SMEs in financial and business management in order to meet banking requirements.