

Determinants, challenges, and policy overview for improving SME participation in global value chains

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Abstract:

This research article aims to explore how small and medium enterprises (SMEs) can enhance their participation in the global value chain (GVC) by addressing the challenges they face, proposing policy recommendations, and identifying key determinants of success. The global value chain is vital to modern trade, as it enables businesses to source products and services internationally, yet SMEs often struggle to integrate due to significant barriers. The landscape of GVC participation has been reshaped since the COVID-19 pandemic, which exposed vulnerabilities in traditional supply chains and pushed multinational corporations (MNCs) to explore alternative suppliers, offering new opportunities for SMEs. However, Indian SMEs face substantial challenges in capitalizing on these opportunities. One of the primary hurdles is limited access to finance, which restricts their ability to invest in the necessary technology, infrastructure, and skilled labor required to meet GVC standards. Furthermore, SMEs often face difficulty navigating the complex regulatory environments of international markets, including trade tariffs, customs procedures, and product compliance, which larger corporations can manage more easily due to their resources. Recognizing these challenges, the Indian government has taken several steps to support SME integration into GVCs. Initiatives like the "Make in India" campaign aim to promote industrialization and innovation, with particular focus on sectors such as electronics, textiles, and automotive components, where Indian SMEs have the potential to become significant players in GVCs. Additionally, financial support programs, including credit guarantees, subsidized loans, and tax incentives, have been introduced to ease the financial burden on SMEs, encouraging them to invest in infrastructure upgrades and advanced technologies. These technological advancements, such as digitalization, automation, and artificial intelligence, are critical to improving the competitiveness of SMEs in the global market, yet many firms still struggle to adopt these technologies due to high costs and a lack of skilled workforce. Besides technological adoption, establishing strong international partnerships is crucial for SMEs to access new markets, resources, and expertise, enhancing their ability to compete in GVCs. Building relationships with global buyers, suppliers, and partners can provide SMEs with critical market access and credibility, which is essential for their growth. While the Indian government has made notable progress in implementing policies and reforms to support SMEs, challenges remain in terms of limited access to finance, regulatory burdens, and technology adoption. Addressing these issues is vital to ensuring that Indian SMEs can fully leverage GVC opportunities, increase their global competitiveness, and contribute more significantly to India's economic growth. In conclusion, fostering SME participation in GVCs will require continued government support, investment

in infrastructure and technology, and a focus on building international partnerships that allow SMEs to thrive in the post-pandemic global economy.

Keywords: GVCs, SME participation, small-scale businesses.

I. Introduction:

At the present, the revolution of information and communication technology (ICT) has made immense changes in the global value chains (GVC). As a consequence, there was a change in the process of production. As per the words of Eggers (2020), an SME is referred to as a small and medium-scale enterprise that maintains its business by managing a below certain threshold. Also, a fragmentation of the process of production helped the organisation in integrating the global value chain via specialisation or fragmentation of the production chain. It has been noticed that small and medium-scale enterprises are now participating in international trade by increasing their efficiency in the supply chain. The participation of intermediates has smoothened the way for small-scale businesses to internationalising directly or indirectly through the supply chain (Reddy and Sasidharan, 2021). The present study has shown the key factors, challenges, and policy recommendations to improve the participation of SMEs in the global value chain.

The main objectives of the study are as follow to find the determinants that derive the SMEs of India to participate in the global value chain, to address the challenges of SMEs that poses risk in improving the participation of SMEs in the global value chain and to analyze the policy recommendation for improving SME participation in the global value chain

The paradigm of international trade has increased the participation of SMEs in the GVCs. As per the data, Micro, small and medium-scale enterprises have been playing a vital role in terms of innovation, exports, and the growth of the economy. It has been also reported that 40% of total exports are contributing to the GDP. The manufacturing segment of MSMEs has contributed a total of 7.09% of the GDP (Smechamberofindia, 2022). In addition to this, the total contribution by MSMEs of India to the GDP is 37.54 % (Smechamberofindia, 2022). The exports and the global market integration by MSMEs have encouraged them to participate in the GVC to make further contributions.

II. Literature review:

Determinants of SMEs to participate in the global value chain

As per the report of the World Bank Enterprise survey, the associated factors of the firm that help them in participating in the GVCs are the level of employee productivity, foreign ownership, and high technological capabilities. These factors enable firms to enhance their competitiveness and adaptability in a fast-evolving global market. It has increased the level of efficiency for SMEs to participate in the GVCs (Soontornthum et al., 2020). Moreover, firms with strong technological capabilities and skilled labor are better positioned to meet the high standards required in global supply chains. In addition, according to the country-related perspective, inflows of foreign direct investment, openness to trade, governance, and efficient logistics help in increasing the engagement in the network of GVCs. Countries that foster a business-friendly environment with transparent regulations, strong infrastructure, and supportive trade policies tend to attract more SMEs into GVC participation, facilitating smoother integration into international markets.

Firm characteristics :

Productivity

The productivity of a firm is addressed as a significant determinant in participating in GVCs. As per the theory of heterogeneous firms, it is stated that only highly productive organizations can be exporters by managing the sunk costs like advertising costs and market research costs for making an entry into the global market. In other words, productive firms are more likely to succeed in the global market. In India, there is a positive impact on labor productivity that has statistical significance, highlighting the critical role of workforce efficiency in enabling SMEs to compete internationally. This correlation underscores the need for continuous investments in skills development and technological advancements to enhance productivity levels across firms.

Firm size

SMEs have been facing a major constraint to participate in GVCs compared to larger firms. Due to the limited production and sales of SMEs, they face difficulties in exploiting the benefits of scale economies. In addition, the availability of resources, including financial and human resources, is often insufficient to deal with fixed costs like the cost of acquiring market information to participate in GVCs (Biswas and Singh, 2020). As denoted by Urata (2021), the risk of credit for SMEs is higher than for large firms, making it more difficult for them to secure financing and participate in GVCs. Furthermore, SMEs often lack the bargaining power and networks that larger firms possess, which limits their ability to negotiate favorable terms in international markets. These challenges highlight the need for targeted policy interventions to support SME integration into GVCs.

Firm age

It has been found that old firms are more competitive because there is a survival history of facing tough competition. Their accumulated experiences, such as using adequate information about sales destinations and the process of procurement, help in participating in GVCs (Martin et al., 2019). However, the tendency of young firms to adopt new systems of production may be negatively impacted by participating in GVCs. This is often due to their limited operational experience and resources, which can hinder their ability to adapt quickly to the complex demands of global markets. Additionally, young firms may face greater challenges in establishing credibility and trust with potential partners, making it harder for them to gain a foothold in the GVC. Consequently, while older firms leverage their established networks and experience, young firms may require additional support and guidance to navigate the intricacies of global integration effectively.

Foreign ownership

The primary aim of the multinational corporation is to establish a foreign affiliate to construct GVCs. In developing countries like India, products are assembled with imported parts and then they are exported. Thus, foreign ownership can help MSMEs of India in participating GVCs in an efficient way.

Country Characteristics

Openness to trade and FDI

The World Development Report states that the rate of average economic growth depends on the industrialization strategy. The policymakers of the country need to realise the fact that there is a requirement to reduce the restrictions on imports as it makes it difficult to promote an effective procurement process and it decreases the incentives for exports (Urata and Baek, 2020). It has

been noticed that the growth of foreign direct investment and exports is increasing in India as well as Asia which has prompted the participation of the GVCs.

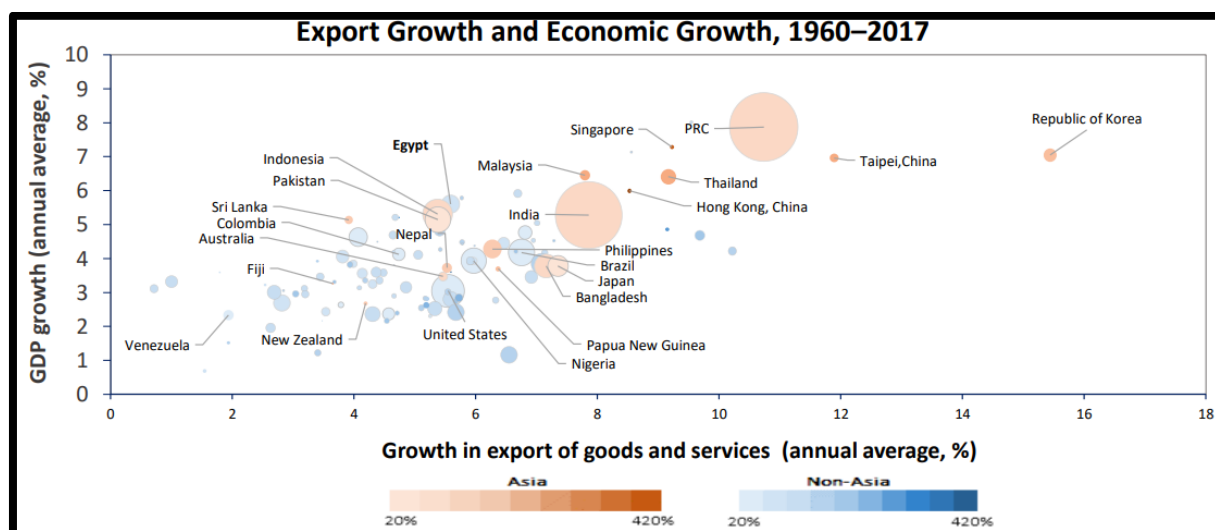


Figure 1: Growth in exports of goods and services
(Sources: Adb.org. 2022)

On the contrary, the openness of a country is also interdependent on the level of the economic integration of that particular country in its regional market and its international market. A country can intensify its economic integration in the global market by liberalizing its trade barrier (Belke and Gros 2017). There are many examples of types of free trade agreements such as free trade market, customs union, economic union, trade common market unions and monetary and customers unions, etc. In such cases, the cost of conducting trade in the global market has been reduced for those countries which are participating in that particular free trade agreement. As a result of it, the small and medium-scale enterprises will be also able to take participation in the global market due to lower costs in trade participation. CECA, FTA, SAFTA, ECTA, etc. are important examples of free trade agreements in India (Pib.gov.in 2022).

Logistics

Efficient and reliable logistics can help SMEs and firms to participate in GVCs as it helps in reducing trade costs. The main significance of a well-developed logistic is associated with maximizing the benefits of firms by saving their delivery timing.

Governance

A fair, transparent, and reliable business environment is addressed as a key factor that helps a business to perform efficiently. According to the words of Dash and Chanda (2021), intellectual property protection and institutional quality play a crucial role in developing countries like India. The rule of laws and enforcement of contracts provides a positive impact on the participation of GVCs.

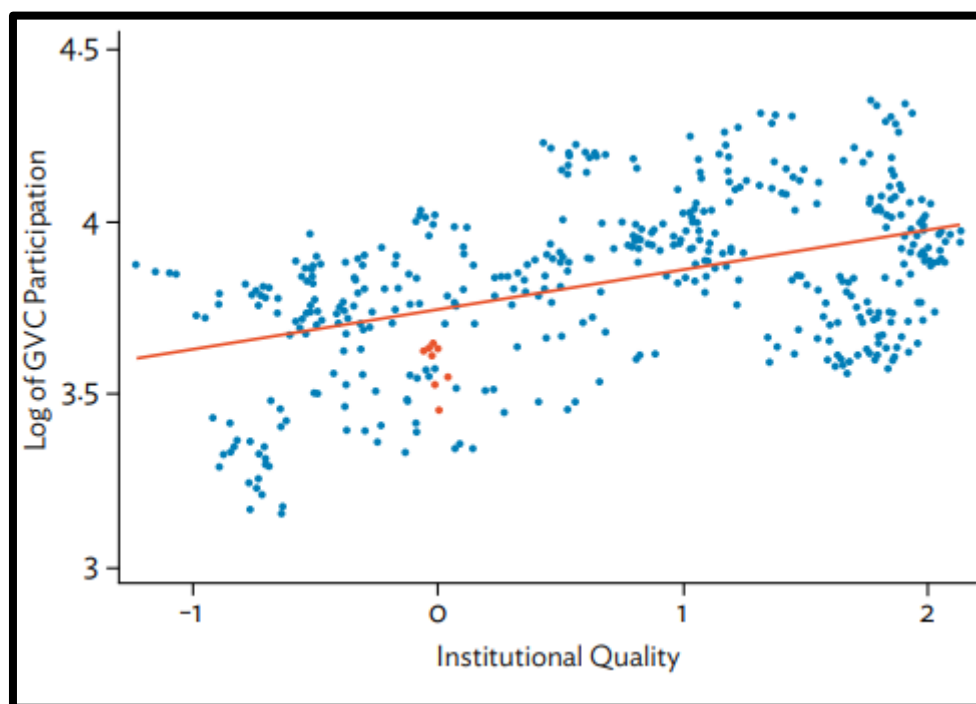


Figure 2: The relationship between institutional quality and participation in the GVC
(Source: Mitra *et al.*, 2020)

The Challenges of SMEs in participating GVCs

Despite the effective contribution of SMEs, small firms are facing various obstacles in participating in the global market. Many researchers have found that the accessibility and the availability of finance have created difficulties to ensure the growth of a small firm. In India, the credit level of loans and the time factors are addressed as the major constraints in accessing formal finance. Furthermore, "The Federation of Indian Chambers of Commerce and Industry (FICCI) and Grant Thornton" have stated in their survey that the higher rate of lending and complications in loan procedures are one of the major key challenges (Mitra *et al.*, 2020).

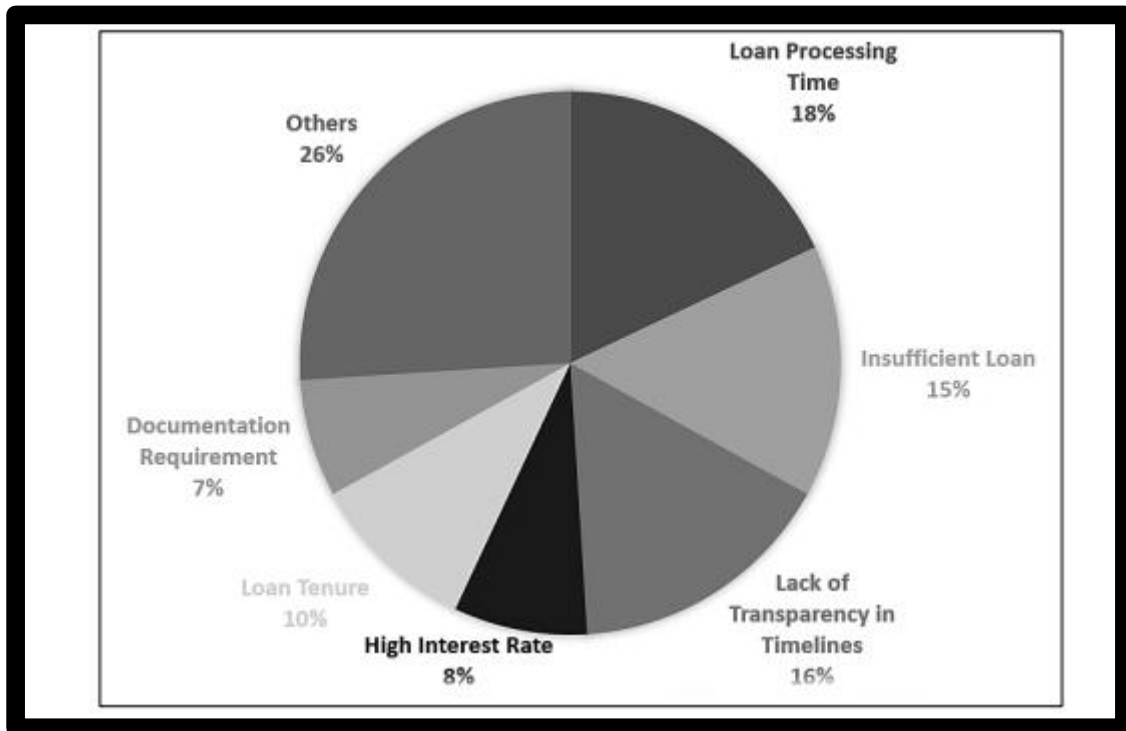


Figure 3: Difficulty in accessing formal Finance by Indian MSMEs
(Source: Urata, 2021)

A report by CII of 2018 has found that the total demand for credit loans by MSMEs is 45 trillion rupees and approximately 44% have been raised through informal channels (Confederation of Indian Industry (CII), 2018). As there is a lack of credit history, SMEs are intended to raise finance from informal sources that restrict the participation of GVCs.

Policy Overview

In order to access regional and global markets, SMEs need to gain skills and knowledge about running the business across borders that can foster capacity building. Nevertheless, SMEs should have the ability to increase their standards, conformity requirements, and certification to handle fierce competition in the market. The firms which are intended to expand globally must go for several policy interventions (ADB and ADB, 2016). A well-structured policy and a regulatory framework help to ensure success for SMEs in the global market. Obtaining inclusive growth in the economy is one of the main reasons for the policy agenda in the 21st century.

Ranking	Elements of Public intervention	Group/Sectors/categories
1	Measures for the trade facilitation	GVC players, primary and secondary sector
2	Tax incentives	No particular difference
3	Developing regional infrastructure	The primary sector, medium, and large firms

4	Access to trade finance	No difference
5	Restructuring of ICT, telecommunication, and transport	Small firms
6	Access to non-banking finance	Firms that intended to expand globally
7	Intellectual property protection	Firms that intended to expand globally
8	Developing transport, ICT and logistic	No particular difference

Table 1: Policy intervention to improve SMEs' participation in GVC
(Source: Created by author)

Types of service	Recommended policy intervention
Trade facilitation	Process of trade facilitation like import and export regulation, customs procedures, competitive support service, an integrated transborder system of logistic
Business environment	Fair competition, reducing the threat of hurdles, improved legal and financial nature, well-structured macroeconomic management
Promotion of FDI	Implementation of strategies and policies that can attract and promote FDI to strengthen the regional SME sector
Marketing support	Marketing research, mart intelligence, brand promotion, channel and distribution, the creditworthiness of importers
Liberation of trade and investment	Coordination with regional and national rules, policy framework, and flows in regional and subregional trade investment

Table 2: Recommended policy intervention
(Source: Created by author)

III. Methodology

Research methodology is referred to as a scientific phenomenon that describes the princess of data collection, data analysis, and data evaluation method in a research article (Zangirolami-Raimundo et al., 2018). This research article is based on a secondary data collection method which indicates that data is collected from scholarly articles, journals, and authentic websites. Primary data refers to data that is collected from the field. As denoted by Pandey and Pandey (2021), secondary data is more reliable than primary data as the data cannot be biased. There are other important advantages associated with secondary data, along with the fact that secondary data reduces the chances of biasedness, and it is also more economical than primary data, As it is already mentioned that primary data has to collect directly from the field which is

associated with various cost whereas the secondary data used for this particular paper from different journals, articles, authentic websites are free of cost.

In order to analyze the data empirically, the researchers have used different data representation techniques in their research papers. In statistics, data representation refers to a way of graphical presentation through which the data on a particular fact can be described in a specific manner. Their many tools available in order to represent data such as bar graphs, histograms, frequency polygons, scatter diagrams, pie charts, etc. (Wilson2017). Thus, the researcher has gone through an empirical study to analyze the collected data. A scatter diagram examines the relationship between two variables. It is the most popular way of data representation in the secondary data research procedure. In a particular scatter diagram, there are available two variables such as a dependent variable (which is represented by X) and an independent variable (which is represented by Y). In the vertical axis of a scatter diagram, the dependent variable has been represented. On the other hand, in the horizontal axis of the diagram, the dependent variable has been measured. Another most important characteristic of a scatter diagram is that this particular measure of data representing the nature of the relation between two variables has also been identified. For instance, if the scatter diagram shows an upward sloping curve, then there is a positive relationship between the two variables otherwise an inverse relationship prevails within the variables. The researchers have used scatter diagrams in order to show the relationship between institutional quality and participation in the GVC and the association between export growth and economic growth of various countries. On the contrary, a pie chart, another way of data representation has been also used in this research paper. A pie chart represents data through a circular graph. The pie chart is most used for the categorical variables as well as for the numerical variables also. The different slices of a pie chart represent a comparative size of the data. In this particular research study, a pie chart has been used in order to understand various difficulties in accessing formal Finance by Indian MSMEs.

It can be stated that a research philosophy is a belief by which a researcher can describe the way of gathering data, used and evaluated. In this particular, the researcher has used a positivism research philosophy to gather and analyze data. The reason behind choosing the positivism philosophy is that the data is collected in an objective way. In positivism philosophy, the part of a researcher is limited in the collection of data and the interpretation of that collected data. On the other way, it can be said that in this specific type of research philosophy, researchers are the object analyst, and here that particular researcher has to be indifferent to their personal judgments, values, and instincts at the time of the study (Research-Methodology.net2022). There is no scope to implement human interest in the research in the case of positivism philosophy. Therefore, one of the most important advantages of the positivism philosophy is that this particular research philosophy can restrict any personal interest biasedness within the research, here all the decisions are data-driven.

In a systematic research methodology, research strategy enables the researcher to conduct the research in an efficient way to provide an effective outcome (Mohajan, 2018). The research strategy gives a researcher a step-by-step plan through which the research objectives taken by the researchers would be fulfilled. An appropriate research strategy should be selected on the basis of some significant components such as research-based questions, the objective associated with a particular research study, the time span available for that particular research work, the level of resources available to the researchers, and the philosophical foundation by the research for specific research work. By implementing an appropriate research strategy, the researcher

was able to choose the right procedure for data collection and a perfect process of data analysis and data interpretation. There are mainly three basic research strategies available in research such as qualitative strategies, quantitative strategies, and mixed methods.

In the context of the present research study, the researcher has used a qualitative secondary research strategy to draw the conclusion of this research study. This procedure is used to examine and find out the answers to the different research questions through the existing secondary data given that the data is qualitative in nature.

IV. Discussion

Over the last two centuries, industrialization has become one of the last noteworthy concerns to participate in the GVCs (Dilyard et al., 2021). Enabling a free flow of capital, and a large base of labour has allowed various developing countries to participate in the GVCs. However, in the FDI scheme, India has taken a negative approach which is not effective at this moment. It has only allowed those sectors whose names are in the FDI policy framework (Barik and Tripathy, 2022). The introduction of the PLI schemes, liberalisation of the FDI regime helps SMEs in enabling an effective business environment to participate in the GVCs. It is expected that in the next decades MSMEs would contribute a total of 25% of the GDP and participation in the GVCs would lead to an increment in employment. It has a chance to create 4 million jobs by 2025 (Estate et al., 2022). In addition to this, it would contribute to innovation and technologies by increasing its flexibility and lowering costs of trade.

Different Macroeconomic factors

(i) GDP growth rate

Other than the foreign direct investment within a country, other macro-economic indicators are directly correlated with the performance of the SMEs in a country. Economic growth is the one of most significant drivers which can easily impact the performance of the existing SMEs in the global value chain. The economic growth of a country has been measured by the GDP rate of that particular economy. A relatively greater GDP or a higher economic growth in a country causes a better standard of living in the country hence an expansion of affordability among the country's people has a positive impact on the SMEs in that country (Mitchell, Wray and Watts 2019). An economic expansion can help these small and medium-sized enterprises directly as economic growth is associated with a relatively greater aggregate demand within the country (Brancaccio, Garbellini, and Giammetti 2018). For instance, the real economic growth of 8.7% in the year 2021 to 2022 in India will try to boost the condition of SMEs in India in the upcoming years by creating various economic positives (ibef.org 2022).

(ii) Formal credit access

In order to the expansion of a small-sized or medium-sized firm, one of the important factors is credit accessibility by that firm. Credit accessibility has also been associated with other different economic indicators, including the interest rate. Here interest rate of that country plays a significant role (Nguyen et al. 2022). If a country took an expansionary monetary policy on the basis of the country's requirement, the rate of interest if that country has been decreased. A comparatively lower interest rate is equivalent to a relatively lower borrowing rate for the existing firms in the country. As a result of it, the small and medium domestic firms can borrow money at a lower cost in that situation which would help those firms to enhance their productivity and efficiency and leads participants in the international market. On the other hand, if a contractionary monetary policy persists within the economy, resulting in a relatively higher

interest rate in the monetary market. As a consequence of that, the firms have to bear a relatively greater credit cost within the country. In India, CGTMSE, or "Credit Guarantee Fund Trust for Micro and Small Enterprises" is one of the greatest initiatives by the Indian market to support SMEs. With this particular scheme, up to 100 lakh rupee loans are available with a lower interest rate (Mund2020).

V. Conclusion

From the above study, it can be concluded that several critical determinants play a decisive role in shaping the participation of small and medium enterprises (SMEs) in global value chains (GVCs). The main factors include firm size, firm age, infrastructure, governance, and sunk costs. These elements collectively influence how effectively SMEs can integrate into GVCs, access international markets, and maintain competitiveness. Firm size and age are crucial, as larger and more established firms typically have greater access to resources, including capital, technology, and skilled labor, which are essential for engaging in GVCs. Younger and smaller firms often lack these resources, making it difficult for them to scale up and meet the demands of global markets. In the case of Indian SMEs, these factors have been particularly challenging, especially in the context of accessing finance and dealing with inadequate infrastructure.

A major issue that Indian SMEs face is the difficulty in obtaining the necessary finance to participate in the global market. Financial constraints limit their ability to invest in technology, expand production capacity, and meet international quality standards, all of which are critical for GVC participation. Many SMEs in India rely heavily on traditional banking channels, which are often reluctant to lend to smaller businesses due to perceived risks, lack of collateral, or limited credit histories. This financial exclusion not only restricts their ability to grow but also hinders their capacity to innovate and compete on the global stage. Moreover, the absence of a well-developed non-banking financial sector further exacerbates the challenges, as alternative financing options such as venture capital, trade finance, and private equity remain underdeveloped for SMEs in India.

However, despite these challenges, it is an undeniable fact that Indian SMEs have made a significant contribution to the national economy. They account for a substantial share of the country's manufacturing output, employment, and exports. Indian SMEs have displayed resilience and adaptability in a highly competitive global environment, contributing to sectors such as textiles, automotive components, information technology, and food processing. Their ability to innovate, leverage local resources, and produce high-quality goods at competitive prices has positioned them as vital contributors to India's economic growth. The government's initiatives, such as "Make in India" and various sectoral incentive schemes, have been instrumental in boosting SME growth and facilitating their entry into GVCs, albeit more work remains to be done to enhance their participation further.

Looking ahead, the future participation of Indian SMEs in GVCs can be significantly improved by developing a more conducive business environment and enhancing market infrastructure. Creating a business ecosystem that supports innovation, reduces bureaucratic red tape, and facilitates easier access to finance is key. Strengthening digital infrastructure and improving logistics and transportation networks would also play a critical role in helping SMEs integrate into GVCs. Additionally, access to trade finance needs to be expanded through policy reforms that encourage financial institutions to extend credit to SMEs, while developing non-banking

financial services, such as microfinance, factoring, and leasing, can provide alternative avenues of funding.

Furthermore, government interventions to support capacity building and skill development for SME workers will be crucial. Programs that enhance the technical capabilities of SMEs, foster entrepreneurship, and provide access to global best practices will help them meet international standards and enhance their competitiveness. In this regard, the Indian government's focus on vocational training and upskilling through initiatives like Skill India can be pivotal. SMEs will also need to improve their ability to form strategic partnerships with multinational corporations and other firms in GVCs to gain access to global markets, knowledge, and technology. Collaborations between SMEs and larger enterprises can enable them to scale up more effectively and adopt innovations that enhance their global competitiveness.

In conclusion, while Indian SMEs face significant challenges in accessing finance, overcoming infrastructure deficits, and navigating the complex regulatory landscape, their contribution to the economy is undeniable. With the right policy support, improved market infrastructure, and expanded access to finance, their participation in GVCs can be greatly enhanced. By fostering a more favorable business environment, developing non-banking finance options, and enhancing digital and physical infrastructure, the future of Indian SMEs in GVCs holds immense promise. Such measures will not only benefit the SMEs themselves but will also strengthen India's position in the global economy.

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