



MSMEs and Global Value Chains

This editorial is based on [“Integrating MSMEs into Global Value Chains”](#) which was published in The Hindu BusinessLine on 02/05/2022. It talks about the significance of integrating India’s MSMEs into Global Value Chains.

For Prelims: MSMEs, World Bank, Economic Survey, World Development Report, OECD METRO Model, MSME Samadhan, Industry 4.0

For Mains: MSMEs and Global Value Chains - Integration, Significance, Challenges

The **rapidly expanding [Global Value Chains \(GVCs\)](#) of multinational corporations (MNCs)** are increasingly dominating international trade, which **emerging economies like India can hardly afford to ignore.**

The limited presence of Indian **[micro, small and medium enterprises \(MSMEs\)](#)** in the GVCs is a consequence of the negligible share of internationalised MSMEs, which is primarily due to a **weak innovation base**, owing to **weak networks of MSMEs.**

The integration of Indian MSMEs with GVCs is the need of the hour for MSMEs. **India needs to create a hub for MSMEs** as a market with linkages to various countries by building and strengthening regional innovation systems and by establishing a multipurpose science and technology commission in the clusters of SMEs.

What Role do the MSMEs Play in the Indian Economy?

- The MSMEs play a **fundamental role in India’s economic growth**, contributing **30% to its GDP** and nearly **50% to its exports.**
 - The sector **encompasses over 63 million enterprises** and provides a **livelihood to over 111 million workers.**
- The potential of MSMEs is well recognised by industry bodies, academics, and policymakers.
 - In a recently concluded MSME conclave, the **MSMEs’ potential in building a complete supply chain**, enhancing their global competitiveness was highlighted.

What are the Global Value Chains?

- Global Value Chains (GVCs) refer to **international production sharing**, a phenomenon where production is broken into activities and tasks carried out in different countries.
- In recent decades, international trade is increasingly dominated by global value chains (GVCs) of multinational corporations (MNCs). **More than two-thirds of international trade now takes place within such GVCs.**
- Internationalisation led by the steadily expanding GVCs has been **rapidly reshaping the**

competitive environment of business in the global economy.

- It has **opened national markets to new competitors**, resulting in immense opportunities for both large and small firms.

What is the Significance of Integration of MSMEs in the GVC?

- **Employment Generation:** As the [World Bank's World Development Report 2020 \(WDR 20\)](#) suggests, contingent upon deeper reforms in developing countries and policy continuity in industrial economies, **GVCs can help reduce poverty, and continue to augment growth and employment.**
 - The [Economic Survey of India](#) also highlighted that by participating in GVCs, India's manufacturing sector may witness an **addition of four million jobs by 2025** thus contributing **one-fourth of the total in value-added terms** towards the \$5 trillion economy.
- **Boost in Income:** Cross-country estimates suggest that a **1% increase in GVC participation can boost per-capita income by more than 1%**, particularly when countries engage in limited and advanced manufacturing.
- **Productivity Improvements:** GVC participation can precipitate significant firm-level productivity improvements.
 - WDR 2020 suggests that GVC firms engaged in manufacturing activities show **higher labour productivity than one-way traders or non-traders**, after controlling for firm-level capital intensity.
 - Innovation is one another component of competitiveness, and MSMEs can test advanced technologies in a pilot mode.
- **More Flexibility:** Integration into GVCs can not only support economic growth but might also be a crucial strategy in the post-pandemic recovery.
 - **GVCs enable firms to participate in international markets more flexibly**, as they might contribute only a small component of an overall supply chain rather than a product in its entirety.
- **Shockproofing:** The [OECD's METRO Model](#) shows that localised regimes are more vulnerable to shocks, and result in a significantly lower level of economic activity and fall in national incomes as compared to the interconnected regimes.
 - While interconnected regimes build resilience, stability and flexibility in the production networks, localised regimes offer fewer channels for adjustment to shocks.

What are the Impediments to GVC Integration?

- **Access to Finance:** MSMEs' integration into GVCs depends crucially on access to finance, however, the **credit supply shortage to MSMEs** has been a concerning gap in India's MSME sector.
 - Despite its importance and potential, the **MSME sector is often plagued by a lack of working capital**, affecting its day-to-day operations.
 - Without improved access to finance, the goal of integrating MSMEs into supply chains will remain a challenge.
- **Informalisation:** Given that **95% of the MSMEs in India are in the informal sector**, access to formal finance remains a significant constraint.
 - Studies highlight that MSMEs as a whole **receive less than 6% of bank credit.**
- **Delayed Payments:** The number of applications filed by MSMEs on the delayed payment monitoring system [MSME Samadhan](#) has **crossed the 1-lakh mark, amounting to over ₹26,000 crore.**
- **Lesser Technological Understanding:** Moreover, **MSMEs are often hesitant in adopting digital solutions** due to **limited understanding** and **inadequate training.**
 - The emergence of new technologies of the [Fourth Industrial Revolution](#) (AI, Data Analytics, Robotics and related technologies) is a **bigger challenge for MSMEs than for organised large-scale manufacturing.**
- **Other Challenges:** The **lack of skilled workforce**, knowledge and **adequate physical infrastructure** are some other constraints that inhibit the efficiency of MSMEs and thus their integration into the Global Value Chains.

What can be Done for a Smoother Integration of MSMEs into GVC?

- **Digitisation of MSME:** A recent MSME digital readiness survey by PayPal highlighted that **29% of the MSMEs witnessed an increase in online customers** and **32% experienced better payment solutions.**
 - The digital payment ecosystem holds immense potential for MSMEs by helping them **expand their online customer base** and **enabling faster flow of funds.**
 - The adoption of digitalisation by MSMEs certainly needs to be supported more and leveraged in **providing innovative financial solutions.**
- **Digital and FinTech Literacy:** It becomes essential to **provide training** and generate more **awareness among MSMEs about digitalisation** of banking systems and their operational dynamics to make the digital transformation smoother.
 - Moreover, a **strong impetus towards greater digitalisation in finance** is the need of the hour.
 - Doing so will reduce the dependence of MSMEs on informal sources of finance and reduce their operation cost given the latter's high lending rates.
- **Role of Banks:** Banks could also play other roles to help MSMEs in GVCs - they can **facilitate networking sessions with global companies.**
 - **Regular market updates can be provided** so that the MSMEs can take informed decisions on such markets. This can help them to mitigate risks.
 - **Global banks** also have a role to play here in terms of **connecting clients globally.**
- **Policy Reforms:** Participation in the GVCs necessitates **deeper reforms in labour markets, trade infrastructure,** and improvements in the overall business environment.
 - Policies directed towards **facilitating vertical GVC linkages** between domestic MSMEs and larger foreign and domestic firms can go a long way towards strengthening India's relative position in GVC trade.

Drishti Mains Question

Discuss the significance of integrating India's MSMEs into the Global Value Chains and suggest the measures that can be taken to pursue this objective.