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MINISTRY OF
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Department of Commerce
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EEPCINDIA
ENGINEERING THE FUTURE

Knowledge Paper

Integrating Indian MSMEs into Global Value Chains

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Introduction

MSMEs FORM the cornerstone of global economic growth, particularly in developing countries. MSMEs represent about 90 percent of total businesses and more than 50 percent of employment around the world (UNCTAD, 2020).

The integration of MSMEs into Global Value Chains (GVCs) is an opportunity for the advancement of their economic competitiveness and for enhancing global footprints with the rise of the Global Value Chain paradigm.

Value chains become 'global' when their component activities are geographically dispersed across the borders to multiple country locations. Global Value Chains network and connect firms with consumers around the world and often provide a stepping stone for firms and workers in the developing countries to the global economy. In a globalised economy, there is a need for MSMEs to learn and plug into the new market opportunities.

Across the globe, MSMEs are significant drivers of growth, job creators, reason behind increased competition, and innovation. For example, Regionalism in Asia, led by GVCs and free trade agreements (FTAs), have increasingly put the spotlight on MSMEs. Now, more than ever, MSMEs have the opportunity to engage in international trade. Moreover, it also provides them with the opportunity to achieve economies of scale, expand market share, and increase productivity.

The limited presence of Indian small and medium enterprises in the GVCs can be traced back to a negligible share of internationalised MSMEs, which is primarily due to a weak innovation base, owing to weak networks of MSMEs, particularly weak inter-firm linkages.

This paper focuses on the participation of Indian MSMEs into the global value chains and tries to identify challenges and opportunities. The paper will first look into the definition of GVCs, how they are formed, and participation of India and some of its Asian peers in GVCs. This part will also essentially establish why MSMEs are important in a country's GVC participation. Following that, the paper will try to analyse the reason behind Indian MSMEs' low participation in GVCs. The paper will also look into the different government policies that have been taken to increase the potential of Indian MSMEs. Finally the paper will try to make some suggestions so as to increase Indian MSMEs' participation in GVCs.

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Global Value Chains (GVCs)

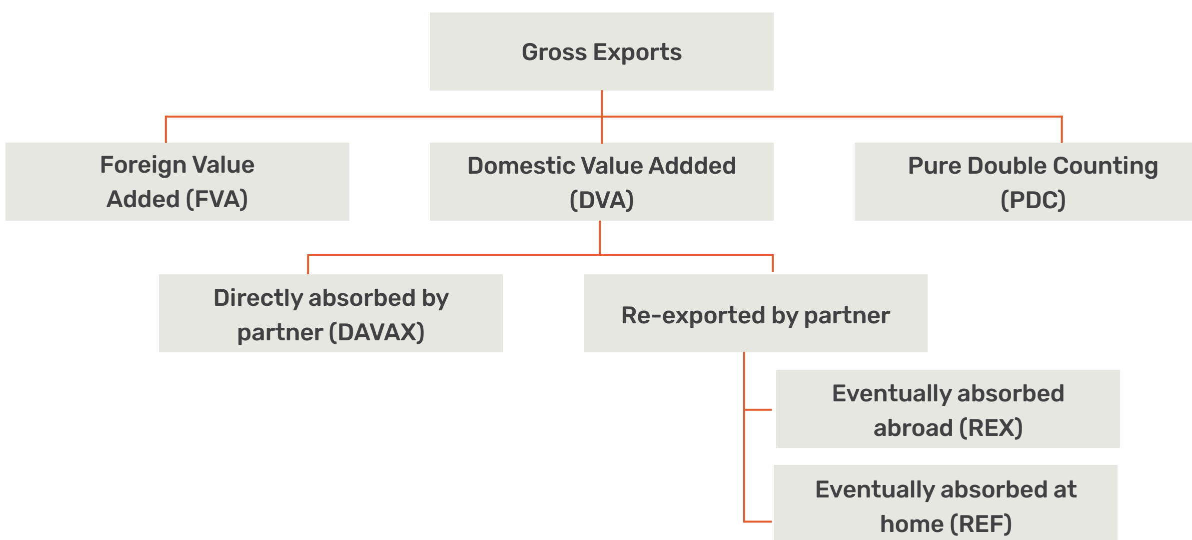
Advancements in the fields of technology have rapidly fuelled the formation of GVCs across the world. Formation of such GVCs have led to fragmentation in the production process which has enabled firms to specialise in particular aspects of production. GVCs have not only fostered job creation and economic growth; they have also enabled countries to exchange technology and knowledge, thereby making the growth more sustainable.

Before proceeding in this paper, there is a need to understand the way a country participates in GVCs. Economies can engage in GVCs in two ways:
Backward integration: GVC exports of Country A include imports from Country B, which is used in the manufacturing process. The product from Country A is then exported to Country C either as a final product or as an intermediate product

Forward integration: GVC exports of Country A include exports of intermediate goods by Country A to Country B, where incremental value is added, and is further exported to Country C, where it is either consumed or again exported. **Figure1** shows the different components of a country's exports.

In all the measures mentioned here, DAVAX where domestic value added is directly absorbed by the importer is 'direct trading' and not taken as an estimate of a country's participation in GVCs. The rest of the parameters, however, indicate border crossing for a number of times before final consumption

Figure1: Schematic representation of the various components of the global exports of a country



Note: *PDC or Pure Double Counting indicates that in a GVC, some goods or services may cross the same border on two or more occasions*
Source: *Compiled from ADB and OECD Trade in Value Added Database*

and these parameters generally specify a country's participation in GVCs. The FVA and the PDC indicate the foreign value content of a country's exports and, therefore, can be taken as an estimate of backward integration. In Figure1, forward integration is indicated by how much of the exports are re-exported (REX).

Why are GVCs important for MSMEs?

The advent of GVCs has also given opportunities to small firms to internationalise their production process. Studies1 have identified the following opportunities for MSMEs in the global production network:
a. increase in technical capability
b. greater utilisation of production capacity and improvement in production efficiency
c. cooperation with enterprises both upstream and downstream provide MSMEs credibility and brand value which helps them to access better finance, new contracts, and foreign investors.

MSMEs on their part often provide better value for money with their low cost of operations. Furthermore, MSME clusters can also provide economies of scale in particular production chains. Therefore, in a way MSMEs form a cornerstone of a country's participation in crucial GVCs.

Studies conducted in the East Asian economies have identified several factors that influence the participation of MSMEs in the global production network. These are: presence of skilled labour; labour productivity; financial stability; access to cheap credit; and ability to meet international standards. MSMEs that have been able to adopt information technology have also been able to expedite their participation in GVCs.

Performance of select Asian countries, including India, in GVCs

The subsequent section looks at India and some of its Asian peers' performance in GVCs based on the measures mentioned here. **Figure2** compares India's value chain participation with some of countries in the Asia-Pacific Region, which have fast emerged as key participants in manufacturing GVCs. These include Vietnam, Taiwan, Cambodia, and Malaysia.

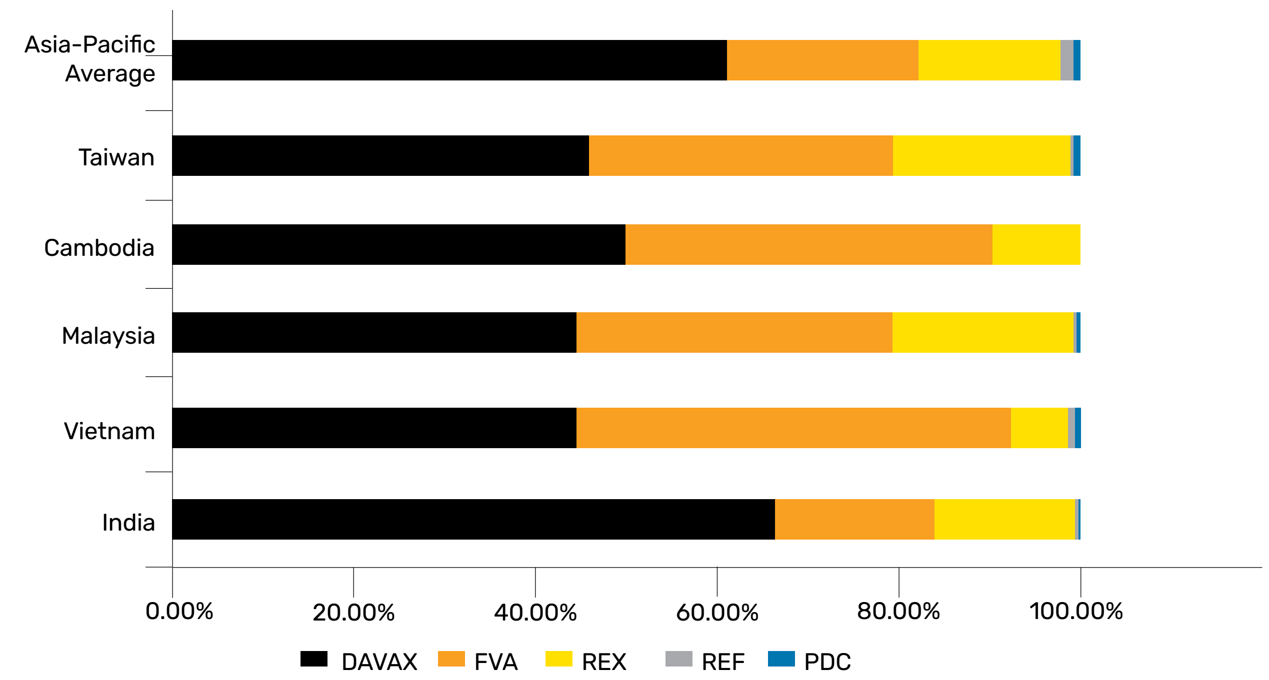
We have not included China in this analysis since China has recently adopted a re-balancing strategy – shifting away from export-led growth towards domestic consumption (McKinsey, 2019). China's shift is also evident in ADB's recent GVC figures. Both forward and backward integration have significantly come down in the case of China. Foreign value-added content (FVA) of China's exports has come down to 14.9 percent whereas re-exports of China's exports (REX) has come down to 13.6 percent, both of which are less than the Asia-Pacific average. This indicates that China is able to source much of its inputs domestically. Furthermore, among all Asia-Pacific countries, China has performed extremely well in the REF indicator (amount of exports eventually re-imported). This is a special type of forward integration and points towards economies which are more upstream in the value chain.

Figure2 clearly shows that in the case of India, direct trading (DAVAX) is much higher (66.6 percent) when compared to similar countries in the Asia-Pacific Group (Vietnam 43.3 percent; Taiwan 46.2 percent; Malaysia 44.7 percent; and Cambodia 50 percent). Infact India's direct trading participation is higher even than the Asia-Pacific Average (61 percent).

In terms of backward integration, the performance of the manufacturing hubs such as Vietnam, Malaysia, Taiwan, and even the newly-developed Cambodia is significant (more than 30 percent) whereas India's backward integration in global manufacturing GVCs is only around 18 percent. In terms of forward integration, higher value is noted in Malaysia (20 percent) and Taiwan (19.8 percent). However, as per the ADB, Middle Eastern and Central Asian countries such as Brunei Darussalam and Kazakhstan have significant share in these segments, indicating that their exports are further transported in the value chain. Compared to that value of REX, for countries such as Vietnam, Malaysia, and Thailand it is lower, indicating that these economies mostly serve final markets in the GVCs. Interestingly, India's value is low in this segment (15.3 percent) when compared to Vietnam, Cambodia, Malaysia and Taiwan and even the Asia-Pacific average (15.7 percent), indicating India's low participation even in forward integration.

A look into India's performance in manufacturing GVCs in the last decade indicates that India has not been able to expedite its participation in the GVCs compared to many of its peers. For instance between 2000 to 2020, in the middle- and high-technology manufacturing export sector, Vietnam's share in direct trading (DAVAX) came down from 54.57 percent to 31.55 percent. During the same time, Vietnam's share in backward integration of GVCs increased from 29.63 percent to 59.78 percent. On the other hand, for Cambodia, DAVAX came down from 57.04 percent to 41.75 percent between 2000 and 2020 and backward integration increased from 6.26 percent to 22.98 percent indicating the speed at which Cambodia is emerging as a participant in GVCs. In comparison to these figures, India's DAVAX only reduced from 54.86

Figure2: Value-added categories in selected Asia-Pacific countries including India, 2020



Source: Compiled from ADB Global Value Chain Database

percent to 51.95 percent in the last decade while its backward integration only rose to 28.66 percent from 22.26 percent. At the same time, forward integration for India came down in the last decade from 22.88 percent to 19.38 percent. As per a recent study (Mitra *et al.* 2020), India's GVC exports only rose by 0.9 percent between 2000 and 2017 compared to many of its peers such as Vietnam and Cambodia who registered substantial growth, more than 10 percent. India also remains a not very significant player in GVCs with a contribution of only 1.5 percent.

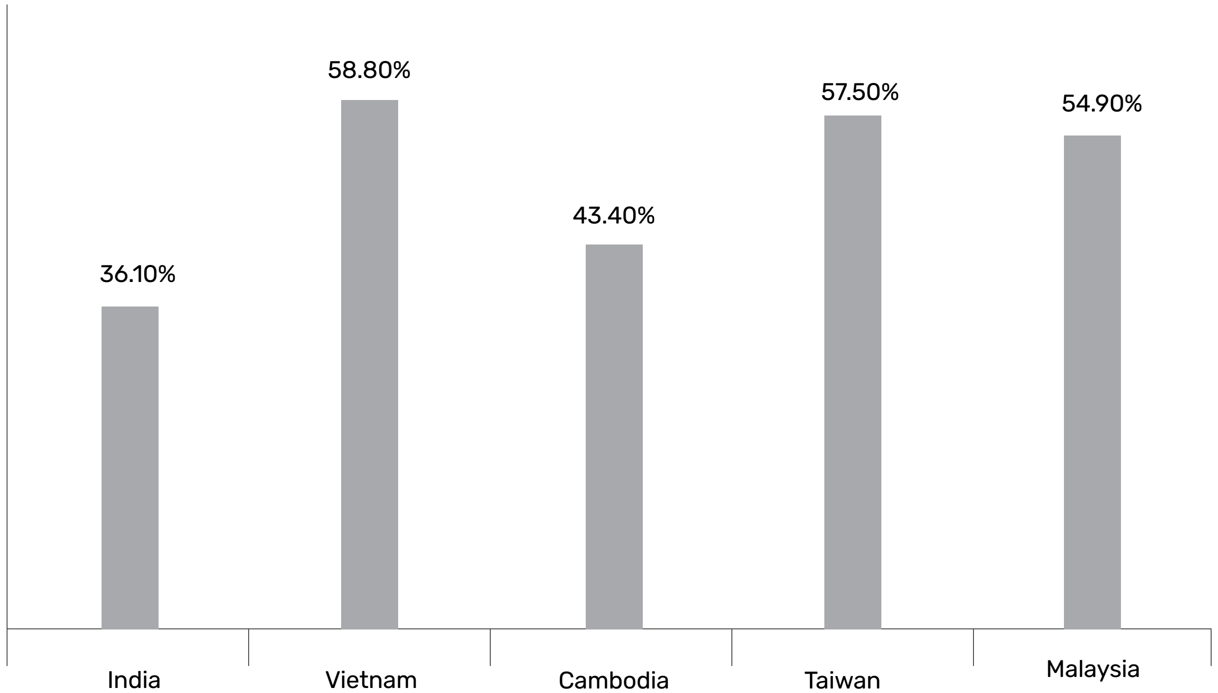
The backward and forward integration together denotes a country's participation in the GVCs. **Figure3** indicates India's GVC participation rate when compared to its peer group of countries. It clearly shows that India's participation rate is much lower.

Opportunities ahead after pandemic-led disruption and slowdown

Disruptions in supply chains due to the recent Covid19 pandemic have revived the policy debate on whether countries with greater participation in GVCs are more vulnerable to such shocks. However, a recent study by OECD[2] indicates that localised regimes with lower participation in GVCs are more prone to such shocks due to greater instability compared to more inter-connected economies. This is also shown somewhat in a recent paper by ADB.[3] The paper, which makes a comparison between the pandemic shock and GVC participation, shows that such external shocks can be associated with larger negative shocks up to a rate of 45 percent. For countries having greater GVC participation, the shock is comparatively smaller (refer to **Table1**).

However, there are certain factors that need to be looked into. OECD cautions that countries with low diversification in suppliers and buyers are prone to such external shocks. Innovative solutions such as e-commerce may also be more helpful and digitalisation may provide

Figure3: India's participation rate in GVCs, 2020



Source: Compiled from ADB Global Value Chain Database

Table1: Correlation between pandemic shock and GVC participation

Country	Pandemic shock	GVC participation rate (%)
India	-15	36.1
Vietnam	-3.6	58.8
Malaysia	-10	54.9
Cambodia	-10.3	43.4
Taiwan	1.2	57.5

Note: Pandemic shock is determined by the difference between forecasted and actual growth rates
Source: Compiled from ADB Global Value Chain Database

MSMEs with more cost-effective revenue. It is important to note that beyond the pandemic, GVCs also face other external shocks such as geopolitical tensions between countries. Countries, therefore, need to diversify their supply and export bases and adopt more digitalisation to avoid the impacts of such future shocks.

The discussion clearly establishes why GVCs are essential for fostering the growth of MSMEs. It also clearly establishes India's low participation rate in GVCs indicating lower involvement of Indian MSMEs in GVCs. In the next section we look at the current situation of MSMEs in India and why their participation in GVCs has remained low.

India's MSME sector

IN ORDER TO KNOW the status of the Indian MSME sector and its performance in recent years, it is essential have an idea of which industrial units are treated as Micro, Small and Medium Enterprises in India. The Revised Classification of MSMEs defined by the government and applicable with effect from 1 July 2020 is depicted in **Table2**.

Importance and contribution in economic development

According to the latest information by the Ministry of MSME, Government of India, the contribution of MSMEs in India's GDP was around 30 percent in 2018-19 while the share of manufacturing MSMEs in the country's total manufacturing GVO (gross value of output) at current prices remained constant at around 33 percent during the period from 2014-15 to 2018-19. Information provided by the National Investment Promotion and Facilitation Agency, 'Investindia,' showed that the share of MSME-related products in total exports from India during 2018-19 was 48 percent; the estimated number of workers in unincorporated non-agriculture MSMEs in the country was 11 crore; and the MSME sector accounted for 95 percent of India's industrial units. At present, the number of estimated MSME units in India is 633.88 lakh (63.388 million).

These statistics are probably enough to realise why the MSME sector has emerged as a highly vibrant and dynamic sector of the Indian economy over the last five decades and what potential this sector has in developing the economy going forward. In a large developing country like India, MSMEs are complementary to large industries as ancillary units and hence make significant contribution in the socioeconomic development of the country by fostering entrepreneurship and generating large employment opportunities at comparatively lower capital cost. Over the years, this key sector of the economy has widened its domain across several new and unexplored sectors of the economy, producing diverse range of products to meet the demand for indigenous as well as global markets.

Increasing importance of MSMEs in engineering

As stated earlier, the significance of MSMEs has been recognised and this sector has becoming increasingly important for the development of the Indian economy. In the

Table2: Revised MSME criteria: Composite – investment in plant and machinery/equipment and annual turnover

Classification	Micro	Small	Medium
Manufacturing enterprises and enterprises rendering services	**Investment in plant and machinery or equipment:** Not more than Rs1 crore($0.14 million) **Annual turnover:** Not more than Rs5 crore ($0.68 million)	**Investment in plant and machinery or equipment:** Not more than Rs10 crore ($1.35 million) **Annual turnover:** Not more than Rs50 crore ($6.76 million)	**Investment in plant and machinery or equipment:** Not more than Rs50 crore ($6.76 million) **Annual turnover:** Not more than Rs250 crore ($33.81million)

National Manufacturing Policy, manufacturing output has been targeted to increase to 25 percent of GDP and the MSME sector is anticipated to play a major role in achieving the target. In terms of market size and employment, MSME is the largest sector of India after agriculture. Engineering is a major component of manufacturing and the engineering sector also relies a lot on the MSME units for its overall growth and enhancing contribution to the development of the Indian economy.

Initiatives taken by the government as discussed earlier clearly indicate that the government is well aware of the potential of this sector and has full confidence that this sector will continue to add significant value in the growth and development of the Indian economy.

Now the major drawbacks of this sector, other than financial problems, are technological backwardness and scarcity of skilled labour at reasonable cost. The previous discussion has shown that the government has taken adequate measures to address these two issues. A slew of schemes and initiatives are in force that induces skill development and fosters technological upgradation. Moreover, the Make in India scheme launched by the Prime Minister that invited leading global players from selected manufacturing segments to set up their production units in India, has also created a lot of opportunities for the manufacturing as well as engineering MSMEs to work with global leaders and get access to the updated technologies being used in the production process. MSMEs in the manufacturing sector have started reaping the benefits of Make in India and also of all the schemes and initiatives implemented by the government. Slowly but steadily, manufacturing MSMEs that include engineering MSMEs as a prominent segment, have been upgrading themselves up to the global standard and their recognition in the international market has also been increasing with time and the combined effect of the government schemes and unique initiatives.

Despite a sudden downturn in the MSME sector caused by the unprecedented medical crisis, the number of working MSMEs, employment generated by the MSME sector, investments in fixed assets in the MSME sector, and gross output of the sector has been continuously increasing for the last two decades or so before the pandemic. At the same time, this sector has opted for product diversification and added many new products in its production basket. They have also entered in many new sectors. The engineering sector also has seen increase in the presence of MSMEs in many new segments. This widening as well as deepening of the presence of MSME units across the industry speaks for the vibrancy of this sector and also signifies the inevitability of this sector in the process of economic development of India.

MSMEs in exports – focus on engineering

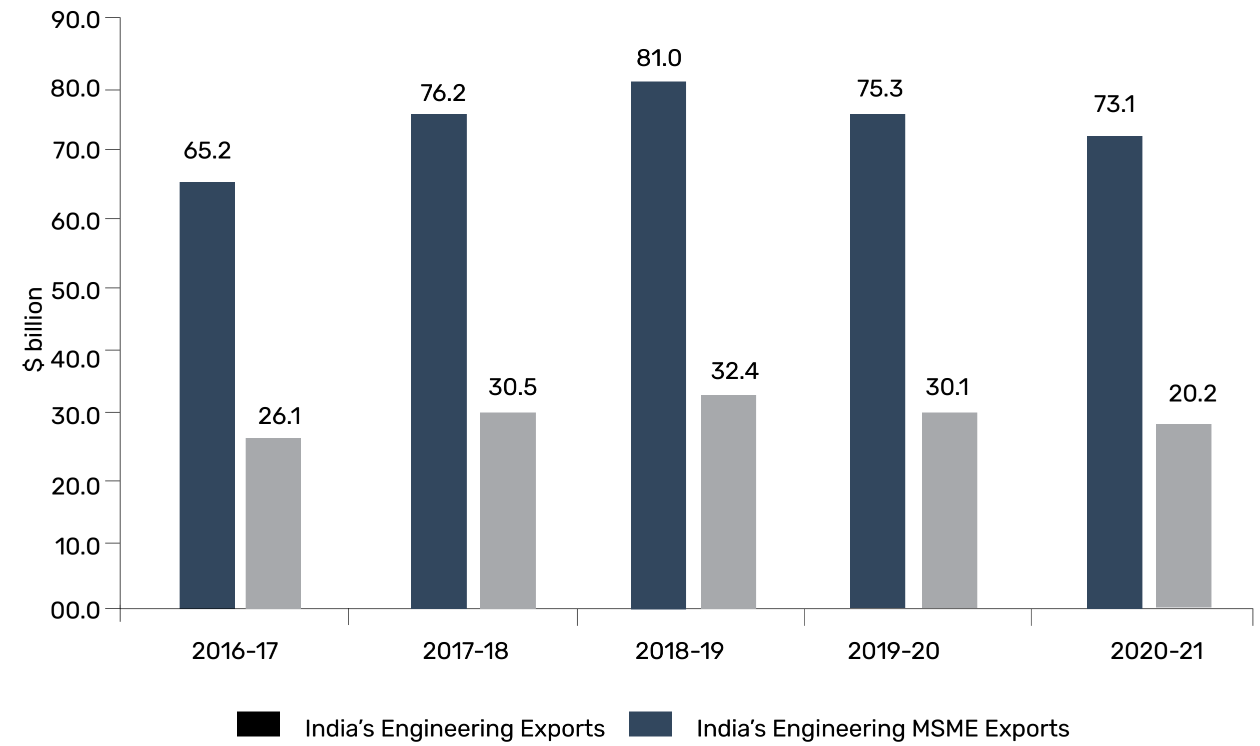
The role of the MSME sector in India's concept of 'inclusive growth' is critical. MSMEs not only play a crucial role in providing large employment opportunities at comparatively lower capital cost than large industries but also help in industrialisation of rural and backward areas, thereby reducing regional imbalances and assuring more equitable distribution of national income and wealth. In India, MSMEs play a pivotal role in the overall industrial landscape.

The share of MSMEs in total exports is spread across different product segments. In case of engineering the role of MSMEs is immense. Out of 13,000 members of EEPC India, more than 60 percent are MSMEs. In terms of exports, the MSME units contribute in the range of 30-40 percent of total engineering exports from India.

Role of MSME sector in achieving India's $1 trillion export target by 2027-28 and $5 trillion GDP target by 2024-25

So far as international trade is concerned, it is increasingly being dominated by the GVCs of large-scale global multinational companies.

Figure4: Total engineering exports vis-à-vis MSME exports



Source: *DGCI&S*

The contribution of the GVCs in total global trade reportedly accounts for 60-80 percent. These multinationals are largely from the developed countries. However, economies from the emerging and developing world like China, Malaysia, Thailand, etc, along with the newly industrialised economies, have started finding their place in GVC increasingly with time. Joining the GVC has brought immense benefit for those economies leading to their dramatic advances in living standards and economic growth. These developments have implications in the form of challenges as well as opportunities for the Indian economy, particularly for its small and medium enterprises.

Entering the global value chain provides the MSMEs the right opportunity to enhance productivity, make them accessible to updated global technology, enable them to improve managerial efficiency, and facilitate in accelerating innovation. By penetrating global trade or by linking with the global trade through GVCs, MSMEs can take up a first step ladder, which through technology and knowledge transfers can often lead them to increase productivity, enhance production, and make well-informed choices about the market.

In this context, the 'Make in India' initiatives of the incumbent government need a special mention. As discussed earlier, this unique brainchild of our Prime Minister aimed at making India a global manufacturing hub and to enhance India's manufacturing export, in turn, has certainly brought new opportunities for Indian MSMEs. They get ample scope to work with the large-scale manufacturing companies from across the globe and subsequently get access to upgraded technology and marketing techniques. Participating as well as adding value to the production process of leading global players will lead to enhance India's integration into the global value chain of manufacturing while MSMEs in the engineering sector will also grasp the benefits as engineering is a major segment of manufacturing. Make in India, therefore, acts as a ladder for the manufacturing MSMEs to move up in the global value chain.

Prime Minister Narendra Modi set an export target of $1 trillion by 2027-28 while also envisioning to make India a $5 trillion economy by 2024-25. The MSME sector, with around 30 percent share in India's GDP, is obvious to be a trendsetter to help India achieve this feat. Higher integration to the global value chain will help MSMEs to grow by enhancing their productivity. At the same time, higher growth of MSMEs will raise the overall size of the economy and hence exports. It is the MSME sector that is likely to play a pivotal role in fulfilling the GDP and export targets going forward.

Challenges faced by India's MSME sector

Despite being termed as the 'backbone of the Indian economy' for playing a vital role in building the Indian economy by creating 1.3 million jobs every year and producing more than 8000 quality products for the Indian and international markets, the MSME sector has been facing several hardships to growth for years. Major problems of the sector that has been proved as deterrent to its smooth growth are as follows:

- Absence of adequate and timely banking finance
- Limited capital and knowledge
- Technological backwardness –non-availability of suitable technology and lack of capacity to adopt updated technology
- Low production capacity
- Ineffective marketing strategy
- Constraints on modernisation and expansions
- Non-availability of skilled labour at affordable cost
- Follow up with various government agencies to resolve problems due to lack of manpower and knowledge etc.

Among all these issues mentioned here, scarcity of finance, absence of upgraded technology in the production process and lack of information about the product market due to lack of efficient management, are the three issues that are mostly damaging the prospect of this sector. However, the government has been trying its level best to address these issues of MSMEs in order to ensure smooth growth and maximum participation of this sector in economic activities.

The best way to boost MSME exports is to improve the manufacturing ability of the MSME sector which in turn is expected to improve the competitiveness of their products. Higher value addition, skill development and training, thrust on standardisation and quality, access to affordable credit, impetus for innovation, etc, would be essential elements of the strategy.

Key areas of the strategy include Skill development and training, Infrastructure development, Access to affordable credit, Technology upgradation and innovation, Providing marketing support and brand building with adequate institutional structure, and Special support for MSMEs.

Government initiatives in strengthening the MSME sector

RECOGNISING the importance of the MSME sector, the Government of India has been working to address the challenges faced by the sector in order to enhance the global competitiveness of Indian MSMEs and to enable them match global standards as well. During the period of the socioeconomic lockdown in 2020, the government under Prime Minister Narendra Modi, came out with the first-of-its-kind 'Atmanirbhar Bharat Abhiyaan' package of around Rs30 lakh crore in three phases, focusing mainly on support to the MSME sector as it was the worst-affected sector during the pandemic. Major schemes initiated by the government for the MSME sector are discussed here.

Credit and financial assistance to MSMEs

• ***Prime Minister's Employment Generation Programme (PMEGP):*** The scheme aims at providing financial assistance to self-employment ventures, in order to generate employment opportunities for unemployed youth and traditional artisans.
• ***Credit Linked Capital Subsidy Scheme for Technology Upgradation (CLCSS):*** The objective is to facilitate technology to Micro and Small Enterprises (MSEs) through institutional finance for induction of well-established and proven technologies in the specific subsector/products approved under the scheme.
• ***Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE):*** Ministry of Micro, Small and Medium Enterprises and Small Industries Development Bank of India (SIDBI) jointly established this trust in order to implement the Credit Guarantee Scheme for MSMEs.
• ***Interest Subvention Scheme:*** The scheme aims at encouraging both manufacturing and service enterprises to increase productivity. Additional 2 percent interest subvention has been provided to MSMEs.

Skill development and training to MSMEs

Entrepreneurship and Skill Development Programme (ESDP): The ultimate objective is to promote new enterprises, capacity building of existing MSMEs and inculcating entrepreneurial culture in the country.

Infrastructure support to MSMEs

• ***Scheme of Fund for Regeneration of Traditional Industries (SFURTI):*** Main objective of the scheme is to organise the traditional industries and artisans into clusters to make them competitive and provide support for their long-term sustainability.
• ***MSE Cluster Development Programme (MSE-CDP):*** The scheme aims at the growth of MSEs by addressing advancements in sustainable and green manufacturing technology, market access, skills and quality, etc. Creating infrastructural facilities in existing Clusters of MSEs and Industrial Areas.

Technology upgradation and competitiveness scheme for MSMEs

• ***Design Clinic Scheme:*** The objective is to enhance industry understanding and application to design and innovation, and to promote design as a value adding activity and integrate it into mainstream business and industrial process of MSMEs
• ***Lean Manufacturing Competitiveness Scheme (LMCS):*** The objective of the scheme is to enhance the manufacturing competitiveness in MSMEs through the application of various Lean Techniques by reducing waste, increase productivity, imbibing a culture of continuous improvements, etc.
• ***Digital MSME Scheme:*** The objective of the scheme is to make MSMEs digitally empowered by adopting ICT tools and applications in their production and business processes to improve their global competitiveness.
• ***Financial support to MSMEs in ZED certification scheme:*** The scheme envisages promotion of Zero Defect and Zero Effect (ZED) manufacturing among MSMEs so as to promote adaptation of quality tools/systems and energy efficient manufacturing, encourage MSMEs to constantly upgrade their quality standards in products and processes, to drive manufacturing with adoption of Zero Defect production processes and without impacting the environment.
• ***Support for MSME entrepreneurial and managerial development through incubators:*** The objective is to promote emerging technological and knowledge based innovative ventures that seek the nurturing of ideas from professionals beyond the traditional activities of MSMEs.
• ***Building awareness on intellectual property rights (IPRs):*** The aim of the scheme is to enhance awareness of MSMEs about intellectual property rights and to take measures for the protection of their ideas and business strategies.

• ***Tool rooms and MSME technology centres:*** The scheme aims to facilitate an integrated development of MSMEs by providing quality tools, industry-ready manpower, consultancy in tooling and related areas and processes and products development in several product groups.

Procurement and marketing support to MSMEs

• ***Procurement and Marketing Support (PMS) Scheme:*** The objective is to promote new market access initiatives, create awareness, and educate MSMEs about various marketing relevant topics and development of marketability.
• ***Procurement from Micro and Small Enterprises:*** The Public Procurement Policy for MSEs has mandated that every Central Ministry/Department/PSU shall set an annual goal of minimum 25 per cent of the total annual purchases from the products or services produced or rendered by MSEs.

Other initiatives

• ***MSE SAMADHAAN Portal:*** The portal has been launched to monitor the progress of procurement from MSEs including MSEs owned by SC/ST and women.
• ***Udyog Aadhaar Memorandum (UAM):*** A one-page simple registration form for online filing of UAM has been introduced, which replaces the filing of Entrepreneur's Memorandum Part I and II.

MSME Schemes under Aatmanirbhar Bharat

Almost all the MSMEs have been deeply impacted by the Covid-led pandemic and subsequent lockdowns. Many of them could not even survive and had to shut down their units. They were badly in need of financial and other support from the government to survive as well as recover. At this juncture, the government came out with an exemplary rescue plan called Aatmanirbhar Bharat with MSMEs as one of the prime focuses. A number of supportive measures were announced in three phases during the year 2020 with an aim to revive and boost this sector. The major schemes were:
• Rs3 lakh crore collateral free automatic loans for businesses, including MSMEs leading to business recovery and safeguarding jobs for around 45 lakh MSME units.
• Rs20,000 crore subordinate debt for stressed MSMEs – unprecedented equity support for around two lakh stressed MSMEs.
• Rs50,000 crore equity infusion for MSMEs through Fund of Funds.
• Global tenders to be disallowed upto Rs200 crore.
• Addressing the delay in payment of dues.
• ***Product-link incentive scheme for selected sectors:*** The objective is to boost the competitiveness of strategically important sectors.

Government's collaboration with export promotion councils for MSME advancement

Export promotion councils have played key role in advancing the MSME exporters of India. Recognising their importance, the government has collaborated with these organisations on many occasions to further the cause of MSME exporters. In the following section, an example of EEPC India's technology initiatives for MSMEs in collaboration with the Ministry of Commerce is mentioned.

EEPC India has been the face of Indian engineering exports over 67 years when India grew from a nation exporting just $10 million of engineering goods in 1955 to $72.7 billion (2020-21) and is regarded as a model Export Promotion Council in India by the Union Ministry of Commerce and Industry. EEPC India had played an instrumental role in the successful export performance of India's engineering sector. Promoting the MSME sector is one of the main objectives of EEPC India which is reflected in the policy orientation of the latter which is entirely based on the requirement of the businesses belonging to the MSME sector.

One of the major reasons behind Indian MSMEs' low participation in GVCs is lack of technological upgradation. Recognising this, the Ministry of Commerce and Industry implemented an initiative of technological upgradation for boosting engineering manufacturing and exports through EEPC India as the lead implementing agency. EEPC India Technology Centres were born out of this objective to handhold, assist, and enable the MSMEs to internationalise their production methods. The centres at Bengaluru and Kolkata are aimed to increase the awareness of advanced technologies and help them to upgrade from their existing technology, mainly on knowhow in manufacturing. This is an initiative to increase the quality and quantities of the products manufactured in India and eventually boost engineering exports.

Indian MSMEs need to move up the value chain by making a gradual shift to R&D, innovation, development of new products and services, and expansion of facilities for achieving the engineering product export target of $200 billion by 2025. It is only through technological upgradation that we can switch to Industry 4.0 which is the mantra of the engineering world.

Focus on cluster development

In a recent study conducted by the ADB[4], Integrated Cluster Development (ICD) is identified as one of the key factors that will help MSMEs improve their competitiveness. The study identifies four elements of ICD:
a. Strengthening backward and forward linkages among key cluster stakeholders, including banks, industry associations, skilling and educational institutions, and buyer groups
b. Establishing platforms and governance frameworks for stakeholders to coordinate actions and pool resources
c. Ensuring adequate investment incentives for both common use cluster infrastructure, as well as utility and connectivity
d. Promoting investment in sustainable manufacturing processes and infrastructure facilities.

The Government of India already has a dedicated Cluster Development Programme (CDP) which focuses on enhancing the MSME capacity in the country by creating common infrastructure and facility centres. Under this 20 projects in total have been completed in 2020-21. However, studies have identified a number of lacunae in this scheme. Some of the issues include:
a. Lack of knowledge of scheme and understanding of the process on behalf of MSMEs
b. Cumbersome application process and time-taking approval process
c. Lack of mentoring and guidance
d. Lack of skilled human resources
e. Lack of raw materials at affordable prices
f. Lack of support from local regulators.

It is believed that if the government can address these factors, Indian MSMEs can surely increase their competitiveness and participation in GVCs.

Leveraging FTAs to increase Indian MSMEs' participation in GVCs

IN THE LAST TWO decades, global production has become increasingly fragmented and organised around global value chains. Enhancing participation in GVCs has been found to facilitate a wide range of development outcomes that a country strives to achieve including generating productive employment opportunities, increasing labour productivity, and gaining a larger share of global exports.

A firm no longer has to produce a product in its entirety with the advent of GVCs. Rather, small firms can now internationalise and enhance their efficiency by participating in supply chains via specialising in facets of the supply chain in which the firms enjoy a comparative advantage. In the present-day paradigm of international trade, participation in GVCs is no longer a large-firm story. Trading in tasks and intermediates has paved the way for small firms to internationalise directly or indirectly into the supply chains. Hence, through GVCs, MSMEs can now act as suppliers of parts and components to lead firms. The buyer-supplier relationships with lead firms allow MSMEs to further specialise in a specific set of activities, while at the same time gaining access to large regional and global markets through new niches for the supply of new products and services to these lead firms.

However, these benefits are not preordained, and countries have to surmount several bottlenecks to participate in GVCs and move to more sophisticated sectors and activities.

Given the gains associated with GVC participation for MSMEs, it becomes pivotal to examine the factors that restrict the GVC participation of these MSMEs. One such factor shaping the participation of MSMEs along the value chain is the role of finance. In this context, the various sunk costs that dissuades firms from participating in foreign markets includes expenditure on research and development, market research, advertising, rent for land, and wage bills. This is a severe problem, especially for MSMEs from developing economies where capital markets are still underdeveloped, and there exists a problem of information asymmetry. A recent ADBI survey of four countries highlights access to finance as a crucial factor in the successful integration of MSMEs in the GVC (ADB and ADBI 2016). Further, a study by the World Bank shows that 70 percent of micro, small, and medium-sized enterprises in emerging economies lack access to credit markets.

In this regard, free trade agreements are good for the nation and India must look to leverage these pacts with countries having transparent trading mechanisms and business systems. India should focus its energy on FTAs initially with developed countries that are looking for market access in the large Indian market and which can open their doors to domestic goods as well. We need to engage from a position of strength for certain products and involve our MSMEs in gaining market access across the world. We need to focus our energies for future FTAs with countries with whom we have reciprocal and equitable relations, where we can expand our domestic manufacturing abilities. We also need to be cautious while engaging in FTA with countries where we can get the advantage of a level playing field or reciprocal access or where there is minimal risk of predatory pricing or risk of circumvention of country of origin rules. Hence proper trade policy and agreements aimed at enabling these MSMEs to become direct beneficiaries of GVC participation would reap greater benefits enhancing the economic and financial sustainability of MSMEs.

Post-Covid opportunities to integrate with GVCs

THE PANDEMIC launched by the outbreak of the corona virus shook the entire global economy. As a result of disruptions in supply chain due to imposition of lockdowns to arrest the spread of corona virus, all the leading, emerging, and less developed economies observed substantial slowdown in economic activities leading to decline in GDP and subsequent recession. Economic activities were virtually stalled in some economies. India, as no exception to the global economic trend, experienced its highest decline in GDP on record since the New Economic Policy came into force in early-90s. Supply chain disruption also caused international trade to drop noticeably and that was the starting point of domestic economic downturn.

Indian MSMEs that were already facing several problems including scarcity of finance, were the worst-hit by the pandemic. Several studies and surveys yielded that over 90 percent of the MSME firms were adversely impacted. Even after the progressive unlocking, a large chunk of them were in trouble while some were forced to exit businesses. Reports said that on an average, 11 percent decline in business volume of Indian MSMEs were recorded because of the lockdown in 2021 compared to the 46 percent decline during the nationwide lockdown in 2020.

Every crisis brings an opportunity and especially when it is supported by a well-thought-out roadmap of the government. The incumbent domestic government has left no stone unturned to restore this sector by addressing each and every issue being faced by the firms through a number of exemplary measures as a part of Aatmanirbhar Bharat. While the measures have already been discussed in detail earlier, we will now look for how MSMEs can turn this pandemic-led disruption into opportunities.

It can be said that almost all economies have virtually started afresh after the pandemic shock. The pandemic has given them the lesson of diversifying their trade, rather than relying on only a few. As India has already developed a brand value in global businesses with a reformist and business-friendly government in place, the developed world may look India as an alternative destination for trade and investment. Indian MSMEs, with nearly 30 percent contribution in India's GDP, have the scope to grasp this opportunity and be a part of the global companies as ancillary or subcontracting units. Manufacturing companies from developed markets can see the Indian MSMEs as their linkage units as Indian market is relatively untapped in comparison to China and other markets of Southeast Asia. While the government is on its toes to support the restoration of its MSME sector as the economy starts reviving led by exports, MSMEs are also well-equipped to capture the invitations from the global players and participate in the global value chain much intensely than before.

The way forward

RECENTLY THE Government of India has announced 'Vision 2047' which aims to make a vision plan for a 'future-ready' India, a tribute to country's 100th year of Independence. Exports and India's position in global trade will be a crucial aspect in this vision. Given the importance of MSMEs in India, taking on the opportunities presented by the post-pandemic shocks, increasing MSME participation in future GVCs will be essential in dictating India's global trade position. Therefore, the government should provide all necessary assistance and incentives to the MSME sectors especially in terms of technology upgradation, innovation, R&D, and skill development. Apart from that, India will need more certifying bodies (both quality and technical) in Tier II and Tier III cities. Greater harmonisation of Indian and international standards will also be important.

FTAs/CEPA/CECA with GCC, SACU, North African countries, Latin American countries, and CIS are the need of the hour. India should also sign more mutual recognition agreements (MRAs) with its FTA partners. India's trade regime should promote value addition in the country. Hence, the general tariff structure should be low on raw and primary goods, slightly higher on intermediaries and the highest on final products.

Both the direct and indirect tax structure should be neutral and non-discriminatory between the nature of firms. Banks and financial institutions should be more willing to discern genuine exporters and demand less of collaterals. Finally, stability in policy measures with less of intervention and emphasis on neutrality on behalf of the government will be necessary. While the above are only broad pointers, concerted efforts in these lines can actually enhance Indian MSMEs' participation in GVCs and be a game-changer in India's industrial journey.

Notes

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