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**Working Paper**

## Obstacles and enablers of internationalization of Philippine SMEs through participation in global value chains

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# Obstacles and Enablers of Internationalization of Philippine SMEs Through Participation in Global Value Chains

*Jamil Paolo Francisco, Tristan Canare,  
and Jean Rebecca Labios*



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# **Obstacles and Enablers of Internationalization of Philippine SMEs Through Participation in Global Value Chains**

Jamil Paolo Francisco  
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## **Abstract**

Small, and medium-sized enterprises (SMEs) are important in many developing countries, including the Philippines. However, this sector remains much less productive than their large counterparts. One factor that can help SMEs achieve higher productivity is internationalization by connecting them to global value chains (GVCs). However, participating in GVCs is not easy for SMEs as they face a host of obstacles in doing so. This paper attempts to determine the challenges and enablers of connecting small and medium businesses to global value chains. It uses data from a survey of SMEs in Metro Manila and a set of key informant interviews of SME owners and of officials of government agencies tasked to assist SMEs. Findings show that Philippine SMEs are weakly linked to GVCs. The challenges and enablers can be grouped into five themes: 1) competition in ASEAN and East Asia; 2) international standards, regulatory requirements, and local institutions; 3) role of the government; 4) international market demand and inputs supply; and 5) entrepreneurial mindset. Based on the results, some policy implications were formulated.

**Keywords:** small and medium enterprises, global value chains, internationalization, exports

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# **Obstacles and Enablers of Internationalization of Philippine SMEs Through Participation in Global Value Chains**

*Jamil Paolo Francisco, Tristan Canare, and Jean Rebecca Labios<sup>1</sup>*

## **1. Background and Objectives**

Small, and medium-sized enterprises (SMEs) are important in many developing countries. In the Philippines, SMEs (including micro firms) account for 99.5 percent of firms and 61.6 percent of employment. These figures are similar to the country's peers in the region. Among members of the Association for Southeast Asian Nations or ASEAN, small and medium firms account for 89 to 99 percent of businesses and 52 to 97 percent of employment (ERIA 2014).

However, despite the large role they have in the economy, SMEs remain far less productive than large firms. Although SMEs account for 61.6 percent of employment, their contribution to Gross Value Added (GVA) is only 35.7 percent. The labor productivity of large businesses is more than twice that of small firms, and around ten times that of micro enterprises. This puts workers employed in SMEs at a disadvantaged position as productivity has been shown to be positively correlated to wages (Downes et al 1990; Millea 2002).

Increasing the productivity of SMEs would not only help boost the overall productivity of the macroeconomy, but also help foster more inclusive growth and shared prosperity as the majority of firms and workers belong to the sector.

The literature identifies several challenges to achieving higher productivity, growth, and development for SMEs. These include access to finance (Harvie et al 2013; Berger and Udell 1998; Chittithaworn et al 2011; Beck and Demirguc-Kunt 2006), access to technology (Thong and Yap 1995; Lee and Runge 2001; ADB 2015), access to markets (Rogerson 2013; Coviello and Munro 1995), disruptive regulations (Klapper et al 2006; World Bank 2012, 2013) and lack of entrepreneurial orientation or human capital of the business owner (ADB 2015; Bates 1990; Wiklund and Shepherd 2005; Wiklund et al 2009).

The literature also identifies factors that can help SMEs achieve higher productivity and growth, one of which is internationalization by linking SMEs to global value chains or GVCs (Botelho and Bourguignon 2011, OECD 2005; ADB 2015). Linking SMEs to GVCs gives them access to an expanded market and can also lead to improvements in technology, human capital, and access to information (ADB 2015; OECD 2008).

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Internationalization by participating in GVCs and trade also provides SMEs with a platform to develop economies of scale and increase productivity (Arudchelvan and Wignaraja 2015).

However, participating in GVCs is not easy for SMEs as they face a host of hindrances in doing so. Most of these challenges are similar to those faced by SMEs in general such as access to finance (Harvie et al., 2013), technical and management know-how (Asasen et al 2003), and access to labor (ADB 2015). The Asian Development Bank identifies two crucial factors in connecting Asia-Pacific SMEs to GVCs – competitiveness of the business and connectivity (ADB 2015). The first refers to the ability of firms to produce products and services that can compete with competitors abroad, both in terms of quality and price. The second refers to the ability of the SME to connect to the value chain, such as supplying larger firms in the domestic market and opening supply links with suppliers and buyers abroad.

The general objective of this study is to identify the factors that hinder Philippine SMEs from participating in GVCs, and to propose policy solutions to address these obstacles. The specific objectives are as follows: 1) to determine the extent to which SMEs in the Philippines participate in GVCs, 2) to identify the obstacles that prevent SMEs from taking part in GVCs, and 3) to propose policy solutions on how Philippine SMEs can better integrate into GVCs.

## **2. Review of Related Literature and Framework**

### *2.1. Challenges to SME Growth and Competitiveness*

The literature has identified many hindrances to SME competitiveness using both theory and empirical analysis of data from various countries. In summary, these include access to finance (Harvie et al 2013; Chittithaworn et al 2011; Beck and Demirguc-Kunt 2006), access to technology (Thong and Yap 1995; Lee and Runge 2001; ADB 2015), access to markets (Rogerson 2013; Coviello and Munro 1995), capacity to compete (OECD 2008), regulatory inefficiencies (Klapper et al 2006; World Bank and 2012, 2013) and lack of entrepreneurial abilities and human capital (Bates 1990; Wiklund and Shepherd 2005; Wiklund et al 2009). Philippine SMEs are also beset by the high cost of doing business, poor business environment, and inadequate knowledge on finance (Philippine MSME Development Plan 2017-2022).

Access to finance is one of the most commonly-cited challenges faced by SMEs worldwide. In the Philippines, SMEs usually lack the collateral required for them to avail of loans, while financial institutions lack credit information that will help them identify credit-worthy SMEs (Philippine MSME Development Plan 2017-2022). Harvie et al (2013) noted that on top of access to credit, SMEs also face difficulties in obtaining other financing sources, such as leasing, particularly in developing countries. Compared to large firms, financial institutions perceive SMEs to be riskier to lend to. Thus, without



proper collateral, SMEs resort to personal savings, internal profits, and informal borrowing (ADB 2015; Harvie et al 2013). In a study of 41 firms from three Latin American countries, Navas-Aleman et al (2012) found evidence that SMEs also face difficulties obtaining loan guarantees, which could be good alternatives to collateral, and that SMEs find bank loan processes complex. Access to capital markets is also limited for SMEs, unlike for publicly-listed large firms that can raise capital through the stock market (Yoshino and Taghizadeh-Hesary 2016).

Access to technology is another challenge faced by SMEs to being competitive. The Philippine MSME Development Plan for 2017-2022 identified lack of knowledge on technologies and innovation as one of the important factors that limit SME productivity. Inadequate ICT infrastructure undermines connectivity to global and regional production networks (ADB 2015). SMEs generally lag behind large firms in using information and communication technology (ICT)-based platforms such as e-commerce (ADB 2015). These platforms would have allowed SMEs to reach wider markets, both locally and abroad.

Market access is another factor in which SMEs are challenged. Rogerson (2013) identifies several issues pertaining to SME access to markets. First is sectoral disadvantage, which occurs when too many SMEs are concentrated in few sectors with low growth potential. Second is location – many SMEs are located in areas that are difficult to reach, reducing market access opportunities. Finally, SMEs need to improve the quality of their products to be able to compete in other markets.

A poor business environment, regulatory inefficiencies, and the difficult and high cost of doing business as reflected by the Philippines' low ranking in the World Bank's Ease of Doing Business Report, further add to these challenges.

While most of these factors are external to the SME, there are also internal factors that affect SME growth and competitiveness. For instance, Wiklund et al (2009) identified owner's human capital as one of the drivers of small business growth. This proposition was empirically analyzed by Bates (1990), who found that the level of owner's human capital as measured by educational attainment affects business longevity. There is also mixed evidence on the effect of entrepreneurial orientation on business growth, with some literature saying that entrepreneurial orientation positively affects growth (Wiklund and Shepherd 2005).

Other factors that undermine SME competitiveness and productivity include limited organization and management competencies, human resource constraints, inadequate entrepreneurial ability, and weak tendency to innovate due to over-reliance on technologies brought in by large multinational enterprises (Asasen, et al. 2003; ADB 2015).

## *2.2. SME Participation in GVCs: Benefits and Challenges*

While the literature provides plenty of studies on the challenges that undermine SME growth and competitiveness, it has also identified the enablers of small and medium business development. These include management skills and human capital (Bates 1990; Lin 1998), business networking and external advice (Schoonjans et al 2013; Robson and Bennett 2000), better regulatory environment (World Bank 2012, 2013), digital platforms or marketplaces such as e-commerce (Poona and Swatmanb 1999), and other programs that assist SMEs in adapting to or countering the effects of the hindrances discussed earlier.

One contributor to SME growth and competitiveness that has been recently popular in the literature is linking SMEs to global value chains (GVCs). A value chain is a set of activities needed to bring a product or service across its life cycle from conception, to production, delivery, and finally disposal (Kaplinsky and Morris, 2001). As value chains globalize, a wide range of business processes from low-value to high-value activities could now be produced in different locations around the globe. SMEs that are able to latch on these global value chains are thus able to access wider markets, better technologies, and positive spillovers from the other actors on the chain.

The literature has emphasized the importance of participating in such global value chains in the growth of SMEs. The OECD (2008) analyzed 20 cases of SMEs in terms of which sectors they supply to; and found evidence that GVC participation promote stability among SMEs and that this can eventually lead to expansion and improvements in technology, human capital, and access to information. Yuhua and Bayhaqi (2013) identified four general benefits of participating in international production networks: improvements in technical capabilities; higher demand for products and services and improved production efficiency; prestige and improved credibility making it easier to access credit and other resources; and internationalization. Furthermore, partnerships with larger firms such as multinational enterprises (MNEs), SMEs can deepen their comparative advantage in the goods and services they specialize in by gaining access to new markets regionally and globally. Competition with other firms can motivate SMEs to improve their processes and systems and can expose them to good business practices, as well as new technology and information. Participation in global markets also leads to increased job opportunities and more foreign reserves when firms export. In general, GVC participation forms a springboard for an economy's growth and human capital development (ADB 2015).

In an empirical study related to Yuhua and Bayhaqi, the Asian Development Bank surveyed almost 200 firms from four Asian countries – Kazakhstan, Papua New Guinea, Philippines, and Sri Lanka – on business (SME and large) participation in GVCs (ADB 2015). The study found evidence that participation in GVCs is associated with improvements in sourcing of supplies, production capacity, technology adoption, business environment, financial condition, access to finance, and employment.

The hindrances faced by SMEs in taking part in GVCs is also well-studied in the foreign literature. The Asian Development Bank identifies two crucial factors in connecting SMEs to GVCs. The first is competitiveness of the business and the second is its connectivity (ADB 2015). Competitiveness allows an SME to compete side-by-side with firms, both foreign and domestic, that are part of the value chain. Connectivity enables an SME to deliver its products to the value chain and its intended market. An SME's product may be competitive, but if it is not connected to the market, then the SME will not be able to realize its benefits.

The same study argues that the hindrances faced by SMEs in participating in global value chains are similar to the hindrances faced by SMEs in growth and development in general. These include resource constraints; lack of access finance, technology, skilled labor, and information; higher transaction costs compared to large businesses; lack of access to business networks, and lack of technical expertise and research and development (ADB 2015).

Participating in global production networks and global value chains is difficult for SMEs and they face many challenges in doing so. The major challenges preventing SMEs from participating in GVCs is their lack of access to finance (Harvie et al., 2013), technical and management know-how (Asasen et al 2003), and access to labor (ADB 2015). Many SMEs also lack resources to invest in research and development and training that is at par with international standards (OECD 2008).

SMEs also face institutional barriers. The international nature of GVC participation requires knowledge of foreign institutional and trade regulations, such as customs procedures (Liu 2012). Knowledge of foreign market conditions is another prerequisite for any SME to engage in international trade or participate in a GVC. In a case study of SMEs in the Czech Republic, firms with CEOs who had greater foreign market knowledge were more successful in international ventures (Musteen et al 2014).

Given these identified hindrances to participating in GVCs, ADB (2015) came up with crucial success factors that help businesses take part in GVCs. These factors were grouped into four: capability and competitiveness, international business, access to resources, and macro conditions. Further statistical analysis provided evidence that among these groups of factors, the international business indicators have the largest effect on firm performance, followed by capability and competitiveness.

During the 2015 Meeting of the Asia-Pacific Economic Cooperation (APEC) Trade Ministers, the organization adopted the Boracay Action Agenda to Globalize SMEs. Working with the knowledge that Small and Medium Enterprises (SMEs) are important contributors of growth and development, APEC agreed to take the following actions: a) facilitate the access of SMEs on free trade agreements and regional trade agreements; b) streamline customs rules and policies and assist SMEs in compliance; c) provide timely information on export and import procedure and requirements; d) widen the base of Authorized Economic Operators and Trusted Traders Program to include SMEs; e) support measures to facilitate SMEs' access to financing; f) expand the internalization

of SMEs through access to ICT and e-commerce; g) strengthen institutional support for SMEs; h) strengthen focus on SMEs led by women (APEC 2015). These actions aim to empower SMEs by helping them penetrate the global market.

### *2.3. Definition and Conceptual Framework*

Gereffi and Fernandez-Stark (2016) defined a value chain as the set of all activities performed by firms and workers from conception to end use of a product or service. It includes such activities as research and development, production, marketing, and distribution to users. Sturgeon (2000) similarly defines a value chain as a series of value-adding activities until the product reaches the end user. Thus, a GVC is a value chain in which one of the steps or actors in the life-cycle of the product from conception to consumption take part in another country.

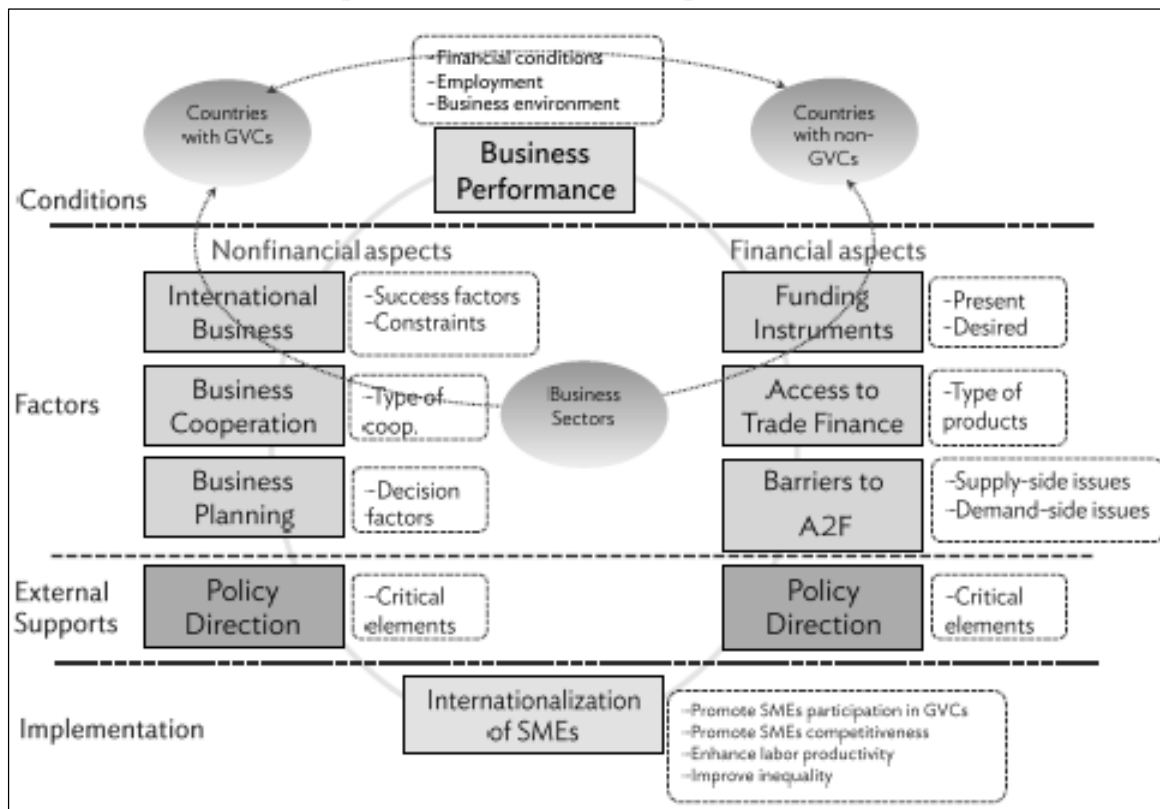
We adopted a conceptual framework developed by ADB (2015) for analyzing SME participation in global value chains (see Figure 1). In this framework, SME participation in GVCs are analyzed on three levels. The first involves an analysis of business conditions. These are factors internal to the firm such as profitability, level of employment, level of technology, managerial skills, liquidity, and the like. The second level of analysis involves the factors that contribute to or constrain the success of SMEs in global value chains. These are a combination of external and internal factors such as access to finance, access to trade finance, and business organizations. Finally, the third level of analysis involves formulating recommendations for policies that can enhance SME capabilities to enable them to participate in GVCs.

## **3. Methodology**

### *3.1. Defining and Profiling SMEs*

The Philippine government defines SMEs based on two criteria – employment and asset size excluding land. A business is considered a micro enterprise if it employs less than 10 workers or if it has an asset size of up to PhP 3 million. Small firms are those with 10 to 99 employees or asset size of more than PhP 3 million up to PhP 15 million. Medium firms are those with 100 to 199 employees or asset size amounting to more than PhP 15 million up to PhP 100 million. Finally, large firms are those with at least 200 employees and asset size greater than PhP 100 million.

**Figure 1. Conceptual framework on analyzing SME participation in GVCs**  
(Adopted from the Asian Development Bank).



Note: A2F = access to finance; GVC = global value chain; SME = small and medium enterprise  
Source: ADB (2015), p. 78.

Among the more than 190,000 firms in Metro Manila, 82.1 percent are micro, 16.1 percent are small, 0.85 percent are medium, and 0.93 percent are large. For the entire Philippines, 89.5 percent of businesses are micro, 9.6 percent are small, 0.43 percent are medium, and 0.45 percent are large. In terms of sector composition of Metro Manila SMEs, more than 82 percent are from the Services sector, more than 17 percent are from the Industry sector, and the remaining less than one percent are in Agriculture. This is close to the Philippine-wide shares of 79.5 percent, 18.1 percent, and 2.4 percent, respectively.

### 3.2. Data Sources

We used two primary data sources: (1) a recently-completed SME survey, and (2) a series of key informant interviews. The SME survey was conducted by the Asian Institute of Management R.S.N. Policy Center Competitiveness<sup>2</sup>. The survey, conducted in 2017 among 530 SMEs in Metro Manila, focused on linkages between SMEs and large businesses and on competition. However, the survey instrument also contained questions

<sup>2</sup> The authors would like to thank the Asian Institute of Management R.S.N. Policy Center for Competitiveness and the funder of the survey, the Konrad Adenauer Stiftung, for permitting us to use the survey data for this study.

on exporting, importing, expansion strategies, and obstacles to going global, among others. It also obtained information on the geographical reach of the firm's products and factors that could affect GVC participation such as access to finance, business environment, and owner's characteristics.

The number of SME respondents per city is proportional to the number of firms in each city in Metro Manila. The 530 respondents were comprised of 265 small and 265 medium firms. Although we recognized that this ratio did not reflect the actual ratio of small to medium firms in Metro Manila, we chose to divide the sample equally to gain insight on differences between small and medium businesses in terms of growth, development, and interaction with the business and economic environment (Hsieh and Olken 2014; Tybout 2000; Krueger 2013).

To determine if a business was qualified to be a respondent, both the employment and the asset size definitions were used. A business qualified if it met both of the following conditions: a.) it has ten to 199 employees, and b.) an asset size of more than PhP 3 million up to PhP 100 million. Both employment and asset size definitions were also used in classifying a respondent as small or medium. Additional qualifications were that the firm should have been operating for at least two years and should have been formally registered. Survey respondents were either the owners or managers handling day-to-day operations who had been with the firm for at least one year.

The respondent firms were selected randomly from the list of businesses obtained from the city local governments in Metro Manila. Systematic sampling was used in cities that did not provide the business list. Areas in the city where businesses agglomerate were identified, and prospective respondents were randomly chosen by the enumerators. If unqualified firms were drawn, replacements were selected until the target number of respondents for each city was reached.

Key Informant Interviews were conducted among SME owners and managers who participated in global value chains through exporting. The purpose of the interviews was to obtain a deeper understanding of the challenges to SMEs of participating in GVCs, as well as insights on the kind of support that SMEs need to enhance their capacity to participate. Officials from government agencies that implement programs helping SMEs to participate in GVCs were also interviewed to take the perspective of policymakers.

### *3.3. Profile of Survey and Key Informant Interview Respondents*

The profile of the survey respondents is detailed in Table 1, followed by that of the key informant interviewees. As expected, majority of the respondents were from the Services sector at 91.5 percent, with the remaining 8.5 percent coming from the Industry sector. No respondent was from the Agriculture sector, which was expected because Metro Manila is purely urban. Most respondents from the Services sector are Retail Traders (40 percent) and Hotels and Restaurants (22 percent). Among those from the Industry sector, most are from the Manufacturing sub-sector, with a small percentage coming from Construction and from Publishing.

In terms of age of firm, 70 percent were established from the year 2000 onwards. The average age of the owner or majority owner is 53 years old, 72.3 percent of them are male, and almost 90 percent have college degrees. The average asset size of all respondents is PhP20.7 million and average employment size is 52 workers. Among the small and medium respondents, the mean asset size is PhP5.9 million and PhP35.4 million, respectively.

**Table 1. Characteristics of the respondent firms.**

<b>Size and Other Information</b>	
Average asset size	PhP 20.7 M
Average employment	51.5
Average age of owner or majority owner	53
Share of firms with male owner or majority owner	72.3%
<b>Sector Composition</b>	
Industry	8.5%
Services	91.5%
Retail Trade	36.6%
Hotel and Restaurant	20.1%
Other Services	34.8%
<b>Year of Establishment</b>	
2010's	35.0%
2000's	35.0%
1990s	14.7%
1980s	6.5%
1970s and older	8.8%
<b>Type of Ownership</b>	
Sole proprietorship	47.0%
Partnership	9.1%
Corporation	42.5%
<b>How the Owner/s Acquired the Business</b>	
Started the business	58.5%
Inherited from a family member	16.0%
Acquired the business through purchase	13.6%

Spin-off from another business	9.3%
Others	2.6%

Source: AIM Policy Center Survey on SME-Large Business Linkages and Competition.

There were two sets of respondents for the key informant interviews. The first is institutional – officials of government and private organizations involved in developing SMEs and the country’s capacity to export. The second is a set of owners and managers of SMEs with experience in exporting. The first SME respondent is a food snacks firm founded in 2008. Its exports are different variants of banana chips; and since last year, slightly more than half of their revenues are from exports. The second is a garment manufacturer whose revenues are all from export sales. Established in 1979, it is also connected to the global value chain through its inputs, which are textiles imported from China. The third is a footwear manufacturer that has been operating since 2006. Around 20 percent of its sales are from exports and its inputs are sourced from China, Bangladesh, and the local market.

The fourth respondent is another footwear manufacturer but is much older and has been operating since 1962. It is a former exporter – it stopped when competition became too strong – but still sources its inputs from abroad. The fifth respondent is another former exporter, this time of rattan products. Competition and changes in demand similarly forced it out of the exports market. Established in 2010, it now still produces handicrafts but using another raw material. The next respondent is a producer of upcycled furniture and fixtures established in 2009. It also forayed into exporting in 2013 but shifted back to purely local sales when its attempt at penetrating the international market was not successful. Finally, the stone and marble fixtures manufacturer was established in 1979. About 30 percent of its sales are exports, but this share used to be much larger before competitors took a large part of its market share.

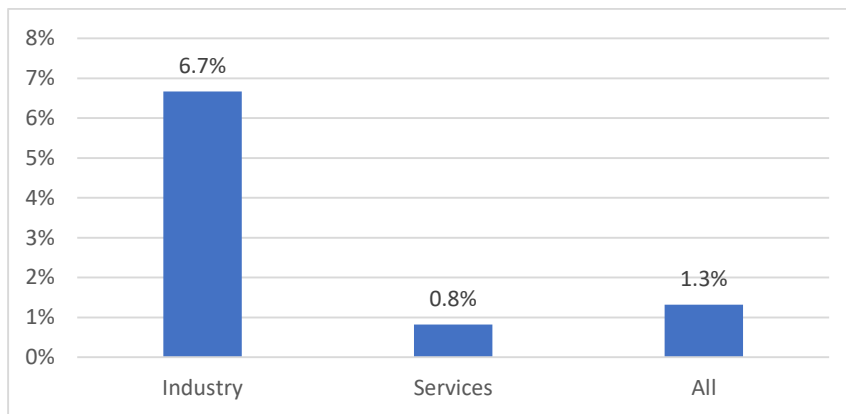
## 4. Results and Discussions

### 4.1. How Connected are Philippine SMEs to GVCs?

A mere 1.3 percent of survey respondents have export revenues in the fiscal year immediately before the survey was conducted. A little more than half (57 percent) of these respondents are from the Services sector and the rest are from the Industry sector, particularly manufacturing. But since only 8.5 percent of the respondents are from the Industry sector, this means that a much greater proportion of Industry compared to Services SMEs are exporters (see Figure 2). For these exporting firms, the share of revenues coming from exports range from 10 to 60 percent, with an average of 33 percent.



**Figure 2. Share of respondents with export revenue in the last year, by sector**



Source: AIM Policy Center Survey on SME-Large Business Linkages and Competition, 2017

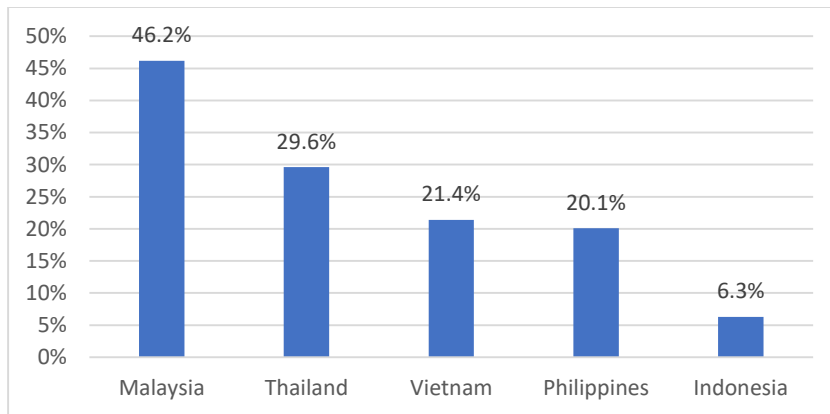
The Department of Trade and Industry estimates that, as of 2006, SMEs (including micro firms) contribute 25 percent of the Philippines' export revenues; and around 60 percent of exporters are SMEs. The 25 percent share is much lower than SMEs' contribution to GVA of 35.7 percent. This means that the contribution of SMEs to total production in the economy is much higher than its contribution to total exports. This is an indication that large firms are more connected to global value chains and international production networks than small and medium businesses are.

Another estimate by Wignaraja (2012) using data from the World Bank Enterprise Surveys shows that, when both direct and indirect exports are included, SMEs account for 33.4 percent of Philippine manufacturing exports. This is one of the highest shares in Southeast Asia, with Thailand having 34.7 percent, Malaysia at 28.1 percent, and Indonesia at 9.3 percent<sup>3</sup>. However, where the Philippines lags behind is on the share of manufacturing SMEs that export, either directly or indirectly. The same Wignaraja paper reported that this proportion is 20.1 percent for the Philippines, lower than 46.2 percent in Malaysia, 29.6 percent in Thailand, and 21.4 percent in Vietnam (see Figure 3). This suggests that SMEs in these neighboring countries are, in general, more connected to international value chains and production networks than Philippine SMEs are.

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<sup>3</sup> The author, though, admitted that the figure computed for the Philippines is surprisingly high; and this can be attributed to the survey respondents being the more productive SMEs.

**Figure 3. Share of manufacturing SMEs that export (direct and indirect), Selected ASEAN countries**



Source: Wignaraja (2012; computed from the World Bank Enterprise Surveys)

Another way in which SMEs can connect to GVCs is through linkages with domestic large firms and with multinational enterprises (ADB, 2015). This is especially true for big businesses that export their products, but it may also be applicable to large firms that only sell domestically. This is because domestic large firms, compared to SMEs, are more likely to be connected to global value chains by supplying their products or services to exporters or to the local offices of foreign enterprises. These linkages could be through supplying these firms with inputs or through subcontracting and outsourcing arrangements. It could also be through formal partnerships such as joint ventures, strategic alliances, and consortiums. A joint venture is an alliance between two firms to establish another enterprise to manufacture or market a product or service. A strategic alliance is similar to a joint venture, but without creating a new firm. A consortium is a group of businesses that partnered to purchase inputs or equipment for the common usage of the group (Hussain 2000).

The survey contains data on sales to large firms and on other linkages with big businesses and foreign enterprises. Among the respondent SMEs, only 23.4 percent sell to large firms, with the remaining respondents selling primarily only to fellow SMEs and to retail clients. Not only is there a small share of firms that sell to large businesses, the average share of revenues from sales to large firms is also small. Among all respondents, the average share of revenues from large firms to total revenues is 6.9 percent. In comparison, the average share of revenues from SMEs is 12.6 percent. Bulk of revenues came from retail sales (78.8 percent), while the rest came from sales to government agencies and from exports.

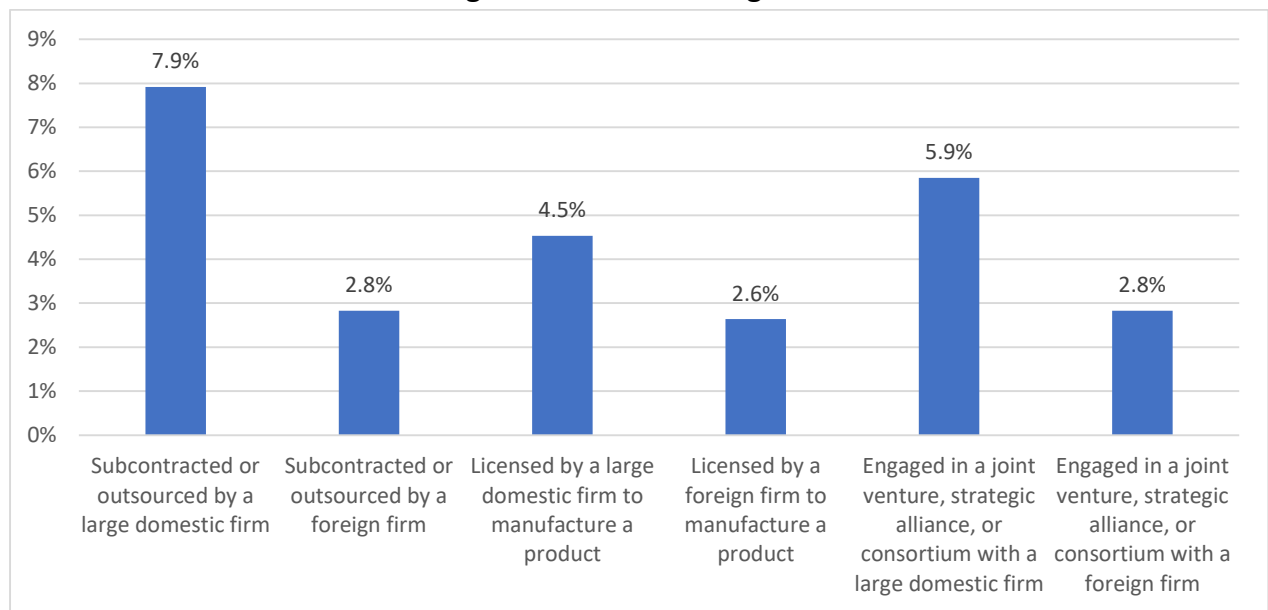
These figures, however, may not be the best gauge of how linked SMEs are to large firms in terms of sales. It must be considered that most respondents are from the Services sector, and SMEs in Services usually concentrate on selling to retail rather than business clients. Services needed by firms such as finance, backroom operations, among others are usually supplied by large firms. If only revenues from firms will be considered, 35.4 percent of such sales go to large businesses and the remaining go to fellow SMEs. Large firms, however, contribute 64.3 percent of GVA. This suggests that large firms

disproportionately purchase their inputs from fellow large firms, and only a small share of SME sales go to big firms.

In terms of the other formal linkages mentioned, 14.5 percent of respondents have been subcontracted, outsourced, licensed to manufacture a product, or engaged in a joint venture, strategic alliance, or consortium with a large domestic business or a foreign firm (see Figure 4). These linkages can help SMEs connect to global value chains through their large firm partners. When a foreign firm or a GVC-connected large domestic business subcontracts to an SME, the latter is directly linked to the value chain where the large firm provides its products. Similarly, the services provided by an outsourced SME are used as inputs by the large firm in producing the product or service that it supplies to the value chain.

Subcontracting or outsourcing for a foreign firm connect SMEs to GVCs by giving them platforms to have their services serve as inputs in producing products that will reach the global market. On the other hand, being licensed to manufacture a product by a foreign business works the opposite way. Some inputs, particularly technology, come from abroad and the manufactured product either stay in the domestic market or is exported.

**Figure 4. Share of respondents that have engaged in selected partnerships with a domestic large business or a foreign firm**



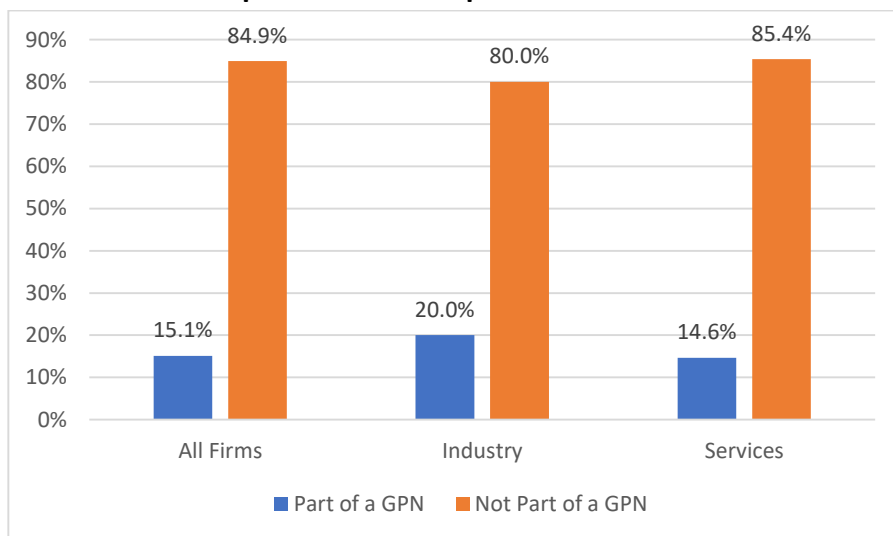
Source: AIM Policy Center Survey on SME-Large Business Linkages and Competition, 2017

Another indicator of GVC linkage available from the survey data is participation in Global Production Networks (GPN). Respondents were asked if they are part of a Global Production Network after reading the definition of a GPN to them. Sturgeon (2000) provides a simple definition of a production network – at least two value chains with at least one common actor. From this definition, being part of a GPN implies being part of

at least one GVC. More formally, Coe et al (2008) define a production network as the set of interconnected functions and transactions used to produce, distribute, and consume the product or service. A production network is a GPN if one of the interconnections extends across countries.

Like the previous indicators, only a small share of respondents – 15.1 percent – identified themselves to be part of a GPN. Disaggregating between sectors shows a slight difference. For respondents from the Industry sector, this share is 20.0 percent, slightly higher than the 14.6 percent for Services (see Figure 5).

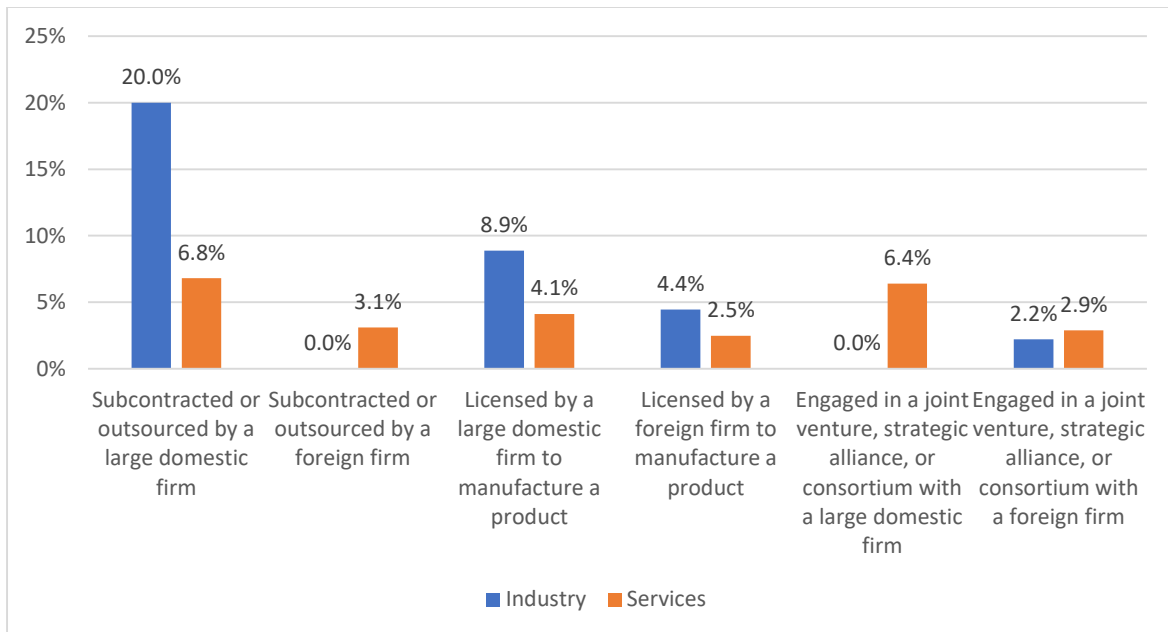
**Figure 5. Share of respondents that is part of a Global Production Network**



Source: AIM Policy Center Survey on SME-Large Business Linkages and Competition, 2017

Although the statistics presented in this sub-section suggest that SMEs in general are not well-connected to GVCs, disaggregation would show that this trend varies across sectors. To begin with, as shown in Figure 2, SMEs from the Industry sector are much more likely to export than those from the Services. In addition to this, 44.4 percent of respondents from the Industry sector sells to large firms, compared to only 21.4 percent from Services. Industry SMEs are also generally more likely to engage in formal partnerships with large and foreign firms and slightly more likely to be part of a Global Production Network (see Figures 5 and 6).

**Figure 6. Share of respondents that have engaged in selected partnerships with a domestic large business or a foreign firm, by sector**



Source: AIM Policy Center Survey on SME-Large Business Linkages and Competition, 2017

The foregoing discussion suggests that Industry SMEs are more connected to GVCs than those from the Services sector. This could imply that either there are more GVC linkage opportunities for SMEs in the Industry sector or they encounter fewer and/or easier to overcome obstacles than those in Services. Either way, this trend could suggest important implications for policy makers and SME owners and managers.

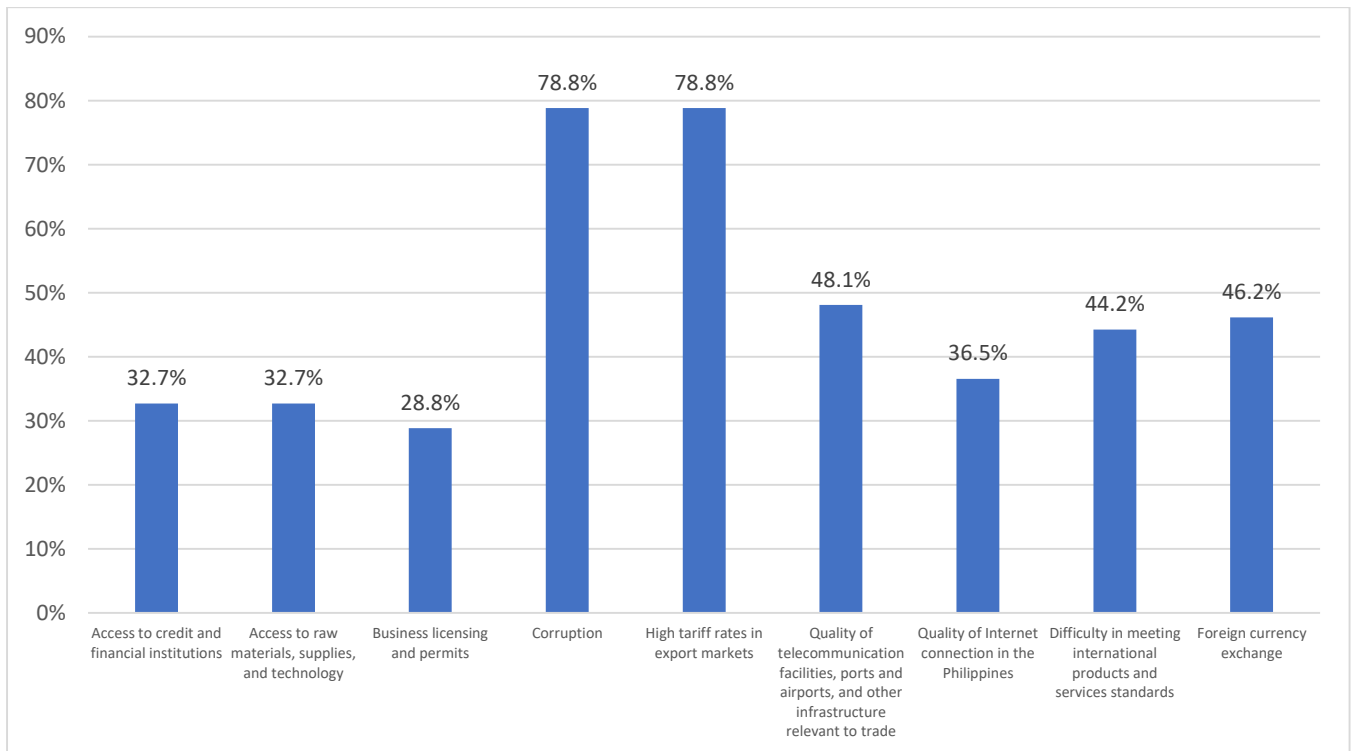
#### 4.2. Challenges to SME Participation in GVCs

Although only 1.3 percent of respondents have export revenues in the previous fiscal year, an additional 8.5 percent said that they are planning to export in the next two years. The difference in the number of respondents that are exporting and those that are only planning to export could suggest that many SMEs that are looking to penetrate the global market encounter prohibitive difficulties in doing so. Many of the respondents who said that they are planning to export but is currently not exporting are not new firms, with an average age of 15 years and a median age of 10. This could suggest that being in the early stage of development is not a primary reason why these firms are still planning and not currently exporting. Among those currently and planning to export, the primary motivations for doing so are to increase its revenues and to create new markets for their products and services.

The survey asked the SME respondents what the obstacles are in penetrating the international market, particularly through exports. Among respondents who are exporting or planning to export, the top answers are corruption and high tariff rates in

export markets, each with 79 percent of respondents saying that these are indeed obstacles to exporting. The next are quality of infrastructure relevant to trade (48 percent), foreign currency exchange rate (46 percent), and difficulty in meeting international products and services standards (44 percent) (see Figure 7).

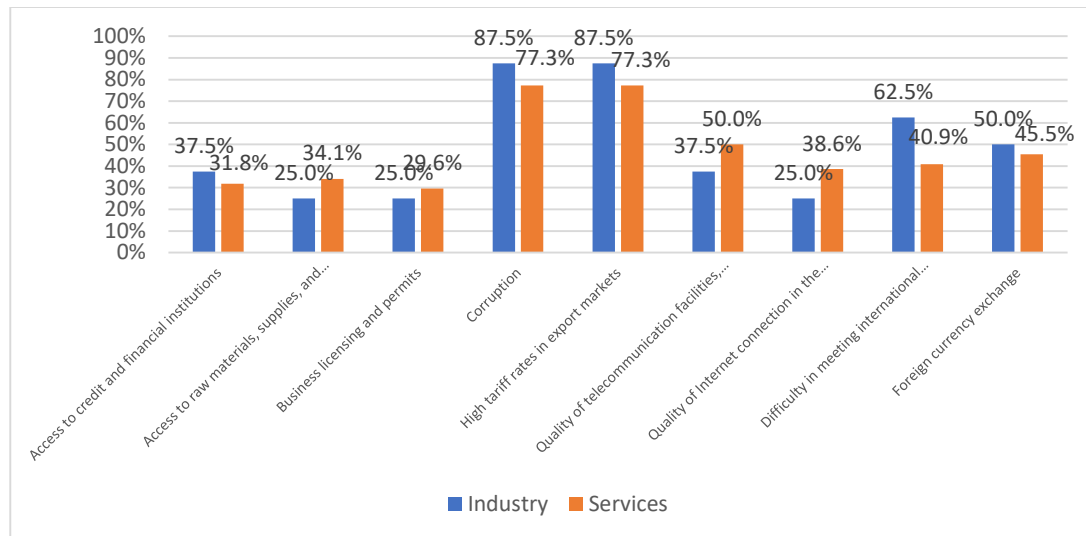
**Figure 7. Perceived obstacles of SMEs to participating in global value chains such as exporting, importing, and partnering with foreign firms**



Source: AIM Policy Center Survey on SME-Large Business Linkages and Competition, 2017

Following the earlier discussion that SMEs from different sectors could be facing different challenges in connecting to GVC, Figure 8 modifies Figure 7 by disaggregating the respondents into Industry and Services. Indeed, there are factors that are identified as obstacle by a significantly greater share of one sector compared to the other. Difficulty in meeting international product and service standards appear to be a much stronger obstacle for Industry SMEs; while infrastructure and telecommunications seem to be a more significant hindrance for those in Services.

**Figure 8. Perceived obstacles of SMEs to participating in global value chains such as exporting, importing, and partnering with foreign firms; by sector**



Source: AIM Policy Center Survey on SME-Large Business Linkages and Competition, 2017

The survey also asked respondents that do not or have no plan to export the reasons for their lack of interest to attempt entering the international market; and this also provides indications on challenges faced by exporters. The primary reason given by respondents is the high tariffs in export markets (65.5 percent), followed by lack of market for their product or service abroad (51.5 percent), lack of access to technology (38.3 percent), lack of access to finance (37.4 percent), and the high standards required for products or services for export (32.8 percent).

In another survey of SMEs, this time in four Asian countries that includes the Philippines, the ADB (2015) identifies five primary impediments in connecting small and medium firms to global value chains – access to finance, availability of skilled labor, labor market rigidity, weak institutional support, and disadvantages of the sector. The latter is considered the most critical, which implies that the sector as a whole is not competitive enough to compete with products abroad.

While these surveys provide evidence on what the challenges are to linking SMEs to GVC, they do not show how these factors affect the capability of small and medium firms to link to value chains. The key informant interviews allow us to dig deeper into the results, explaining how these challenges impede SMEs’ ability to participate in GVCs, how these hindrances can be overcome, and identify other challenges faced by SMEs in connecting to value chains.

Five themes emerged from the key informant interviews, from which challenges can be identified, and enablers can be suggested, for SMEs to connect to global value chains. The five themes are 1) competition in ASEAN and East Asia; 2) international standards, regulatory requirements, and local institutions; 3) role of the government; 4) international market demand and inputs supply; and 5) entrepreneurial mindset. Most of

the perceived obstacles to participating in global value chains identified in Figure 7 are related to these five themes. For instance, corruption and business licensing and permits fall under institutions. Difficulty in meeting international standards not only falls under the second theme, it is also one of the reasons why Philippine SMEs find it hard to compete abroad, the central idea of the first theme.

**1. Competition in ASEAN and East Asia.** There are two primary levels of participation in GVCs – volume and value. Volume refers to the quantity contributed by the firm to the GVC; value refers to the value of this contribution. While there are players that are integrated into the higher-value parts of the chain, most Philippine SMEs are in the lower-end and are only able to provide raw materials. The electronics and automotive industries, according to the resource persons, are those that are fully integrated in the high-value segment of GVCs. These sectors are competing well because foreign direct investments (FDIs) support them. Other industries, like the food and beverage sector, also manage to thrive in the international market but their ability to do so is because they are self-made. It seems that for most domestic SMEs that are already linked to GVCs, moving up the value chain is one of the major challenges. What makes Philippine SMEs less competitive is the lack of capacity to increase value-added. When they do export, it is mostly just raw materials rather than processed products.

However, even for SMEs in the high-value section of the chain, majority of the respondents shared how the competition in ASEAN, particularly against Vietnam and Thailand, including China, makes it difficult to participate in the global market. Often, it is because these competitors abroad can offer products and services at lower prices.

For instance, a respondent from the stone and marble fixtures sector used to generate more income from exporting back in the 1990s and early 2000s. The massive orders coming from abroad were instrumental in the growth and expansion of their company. But since 2011, their exports declined with the emergence of competitors from China that produce tiles at a lower cost that are made to look like marble. This is then exported to other countries, including to the Philippines. This innovative capacity of producers in competitor countries is one factor for their cost competitiveness compared to Philippine exporters.

Some materials used to make this ‘synthetic’ marbles are in fact raw marbles imported from the Philippines. Exporters of these raw marbles are examples of Philippine firms that are in the lower-value section of the GVC. If these exporters can find ways to develop the raw marbles into processed products, as those producers in China do, they would be able to sell at a price higher than what they charge for the raw marble.

Another source of the cost disadvantage of Philippine SMEs is the lack of capacity to mass produce. This means that they lose out on the ability to meet large market demands abroad and on the crucial economies of scale that could allow them to price their products lower. Many exporters abroad have the technology to mass produce and are mechanized, allowing them to produce in bulk and more efficiently. This is not prevalent among Philippine SMEs. One respondent from the handicrafts sector is having difficulties



competing with Vietnamese counterparts mostly because they cannot take bulk orders. This is due to lack of skilled workers and their non-mechanized production process. While it is easy for countries like Vietnam to mass produce and meet tight deadlines, many sectors in the Philippines are yet to acquire the technology for faster mass production. This respondent along with the one from the garments sector also pointed to cheaper labor abroad as one of the factors why they find it difficult to compete.

While competition is a problem for most respondents, one of them was able to adapt to it by looking for certain market niches that are not yet highly competitive and in the higher-value section of the chain. This SME from the food and beverage sector concentrated on food products for health-conscious consumers, taking advantage of rising trend on health and wellness in the recent years.

Another contributor to the lack of competitiveness of Philippine SMEs in the export market is the lack of a national quality infrastructure (NQI). In addition, there are too many regulatory bodies that are not housed under one unit making it confusing and difficult for SMEs. Another critical factor is the lack of established mutual recognition agreements (MRAs).

**2. International standards, regulatory requirements, and local institutions.** Another main challenge for SMEs in linking to GVCs is complying with regulatory requirements and quality standards, both in the Philippine and in potential export destination countries. Resource persons from government agencies that handle SME development argue that complying just to local quality standards set by the government is a challenge for many small and medium businesses. Compliance to these standards is the first step if an SME wants to participate in global value chains. These includes certifications on the use of certain production processes and inputs that improve the product's quality and makes it compliant to regulations in export destination countries.

These standards have two benefits; first, it improves the quality of the product making them more likely to be able to penetrate the international market. Related to this, some countries also have regulations on the use of certain inputs, and imported products require certifications that they are compliant to these laws. Second, compliance to certain non-regulatory standards, e.g. organic production, allows the producer to participate in the higher-value part of the GVC. One of the more successful respondents was able to reach markets abroad by improving their packaging and improving product features such that they appeal to more health-conscious consumers. Complying to these standards allowed them to produce higher-value products that would earn them more revenues.

There are several reasons why many Philippine SMEs find it difficult to comply with international standards and regulations – and some of these reasons are presented as separate themes in this section. One is access to finance. Meeting international standards sometimes require certain equipment, and many SMEs do not have the financial capital to purchase this equipment. Credit is one solution to this. But as a large number of literature says, SMEs face problems in accessing credit because of lack of collateral and difficulty in proving their credit-worthiness (Harvie et al 2013; Berger and Udell 1998;

Chittithaworn et al 2011). Even when credit is available, as will be discussed later, many SMEs are averse to obtaining them due to risk aversion, lack of entrepreneurial orientation, and lack of willingness to expand and invest. Other reasons that are discussed in separate themes are access to skilled labor and lack of entrepreneurial mindset.

Complying to policies set by local institutions also pose challenges to SMEs in linking to global value chains. Respondents point to the slow and inefficient processing of permits from government agencies. Inefficiencies in Customs and ports operations makes it more difficult and costlier to export. Some SME exporters that are willing and able to spend more engage the services of so-called forwarders – outsourced service providers that handle the administrative processes of exporting such as dealing with customs, port procedures, and other related activities. However, these are unnecessary costs that could have been avoided if Customs and ports processes are efficient.

**3. Role of the government.** Another important theme that arose from the interviews is the role of the government in helping SMEs connect to global value chains. While many exporter respondents argue that government support to SMEs is greater in competitor countries, various government agencies in the Philippines has implemented programs that can help SMEs connect to GVCs. Examples of these are mentoring programs that teach the basics of entrepreneurship and trade fairs that help connect SMEs to markets, suppliers, and service providers.

In addition to programs and other interventions that directly impact SMEs' ability to participate in global value chains, the government can also implement policy reforms that will create an enabling environment for small and medium firms. As discussed in the previous theme, the inefficiency of some government institutions that are involved in regulating trade unnecessarily increases the costs of exporting and importing. Streamlining and automating ports and customs processes would help promote connecting to GVCs by simplifying and lowering the cost of trading.

**4. International market demand and inputs supply.** Another set of obstacles to GVC participation of SMEs that emerged from the interviews are factors pertaining to international market demand and supply of production inputs. One of these challenges is the SMEs' ability to adapt to changing market conditions and changing consumer preferences in export markets. Examples of this are the respondents from the shoe and the garment industries. The shoe manufacturer used to have robust export sales. But changes in footwear fashion trends, particularly the emergence of fast fashion, greatly reduced their sales; and they have not been able to adapt, mostly because it is expensive to produce new designs and they are not willing to take the risk of expanding production. Consumers have been drawn to new and cheaper shoe products that has flooded the market while the respondent maintained its line of product and did not attempt to find new market niche nor follow new footwear fashion trends. Meanwhile, the garment manufacturer used to export specialized clothing products to large buyers in the United States. When these buyers stopped importing from them due to a weak economy and cheaper alternatives, its export sales plunged. In spite of the presence of a market for other types of garments and their ability to produce these, the respondent has not been

able to adjust its products. A related case is the marble manufacturer. When market for marbles declined with consumers preferring the cheaper ‘synthetic’ marbles than the real, more expensive ones, it has not been able to adapt by changing their product line. This is despite the producers of synthetic marble importing their raw materials here.

On the other hand, respondents who have been able to adapt to changing market conditions and preferences have been more successful in their export sales. The food snack manufacturer shifted to a product line that is targeted to health-conscious consumers when consciousness about one’s health became a trend. Another shoe manufacturer respondent adapted to the changing market conditions by continuously looking for buyers and exploring and developing new products that is at par with current trends.

There are other market-related problems to participating in GVCs, particularly exporting, that mostly affect smaller SMEs and those without much experience in the international markets. One of which, already mentioned earlier, is mass production. Smaller SMEs do not have the capacity to produce in bulk quantities, thus failing to serve international markets as exporting requires a certain quantity to be profitable. Their inability to mass produce thus limits their access to export markets. Another challenge is access to market information in terms of preferences, tastes, and capacity to pay of consumers. This information tells SMEs what countries are potential export destinations and what products to sell.

One solution to these problems is indirect exporting through the use of a middleman. More formally known as consolidators, these service providers buy products from potential Philippine exporters and sell these in the international market. The value added of services provided by consolidators is mainly helping address the just discussed market access problems of SMEs. By pooling similar products before exporting them, consolidators provide a venue for SMEs that cannot produce large quantities to export and connect to global value chains. One respondent used this service and eventually became a direct exporter when they gained the ability to do so. These service providers also have market information on preferences and capacity to pay of consumers in potential export destinations. This helps address the problem of lack of information of SMEs on possible export markets.

Another obstacle to exporting is access to inputs, particularly skilled labor and supplies. Sourcing of skilled labor can be a problem especially for newly-developed products and industries. A respondent also expressed concern about the difficulty and cost of sourcing raw materials that are imported.

**5. Entrepreneurial mindset and skills.** The Department of Trade and Industry identifies ‘7 Ms’ of entrepreneurial success – mindset, mastery, mentoring, money, machine, market access, and models of business. Resource persons from the government identify mindset as the first driver of entrepreneurial success. To stress the importance of mindset, we will use the case of two respondents. These two SMEs belong to the same industry, produce the same products, and are located in the same province. This means that they

face almost the same constraints, challenges, and potential markets. The industry they belong to used to be a booming one including in the exports market, but the influx of imported items and changes in consumer tastes and preferences severely affected it with firm closures and a big drop in production. While one of the respondents responded to this situation by keeping their line of products unchanged, ceasing its export operations, and focusing on the small market left to it mostly in its home province, the other responded by altering their products line to suit changing preferences and actively seeking new markets both locally and abroad through networking and attending industry events. While the former took a passive mindset in response to changing conditions, the other took an active one. This active mindset kept it connected to global value chains through exports.

While the literature has identified some of the obstacles to linking SMEs to GVCs such as lack of access to finance (Harvie et al., 2013), technical and management know-how (Asasen et al 2003), difficulties accessing skilled labor (ADB 2015), and lack of resources to invest in research, development, and training (OECD 2008), the importance of mindset cannot be undermined. According to resource persons from the government, SMEs have an adverse reaction to endeavors that require substantial capital. This risk aversion of small and medium businesses, particularly those that are owner-managed, under single proprietorship, or family owned, is documented in the literature (Fernandez and Nieto 2006; Thomsen and Pedersen 2000; Fama and Jensen 1985). With smaller asset size and lack of safety nets, these firms have no fallback in case an investment does not produce positive returns. If the mindset of Philippine entrepreneurs is to change, the underlying cause of their risk aversion should be tackled.

Lack of entrepreneurial skills is another obstacle for SMEs' participation in global value chains. Resource persons from the government that conduct mentoring activities reported that majority of SME owners have low entrepreneurial and management skills. Most of these small business owners do not have business plans, are too afraid to shell out money and make investments, and are easily disenchanted when the process starts getting complex. Because of these, many of them would opt not to expand and stay in the status quo, or in some extreme cases, decide to close shop. A respondent SME owner and exporter who used to act as a lecturer for the government's mentoring program for small businesses also observed the lack of entrepreneurial mindset among entrepreneurs.

#### *4.3. A Framework on Linking SMEs to GVCs*

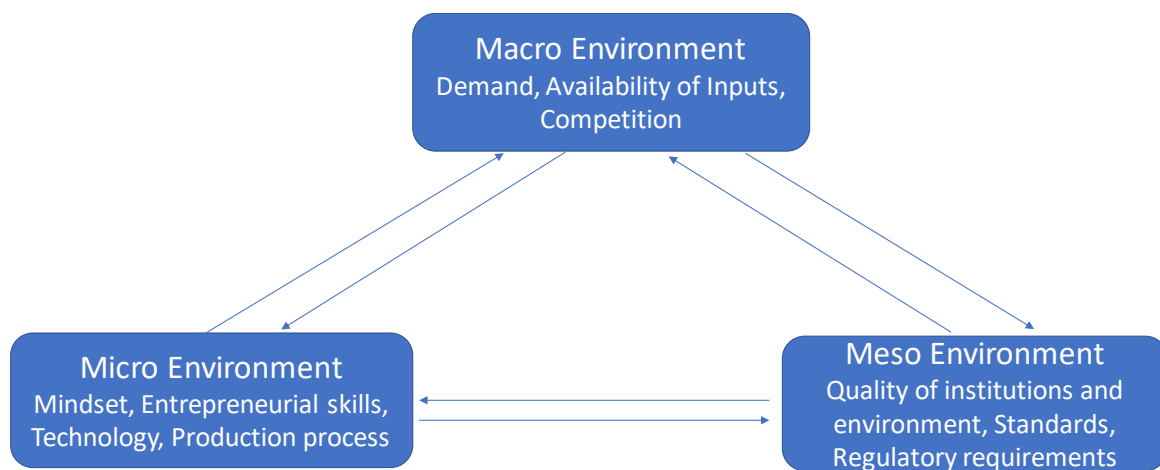
The foregoing sub-section discusses the challenges faced by SMEs in connecting to global value chains. Analysis of these challenges suggests a framework on how to promote the connection of SMEs to GVCs. The ADB (2015) framework presented in Figure 1 shows three levels of crucial factors that affect the ability of SMEs to connect to GVCs – conditions, factors, and external support.

Using the analysis herein, we also propose three levels of factors affecting Philippine SMEs' capacity to connect to global value chains (see Figure 9). First is the macro environment of the firm. This includes the level of demand in international markets,

availability of inputs including capital, and competition. Second is the firm’s meso-environment, which includes institutional and governance quality, standards, and regulatory requirements. Finally, the third level is the micro-factors or those that are internal to the firm. This includes the mindset and entrepreneurial skills of the owner, the technology that it employs, and its production processes.

Factors in one level can affect how the firm can respond or adapt to factors in another. For instance, the technology and production process that the SME employ can determine if it will be able to deal with competition abroad. Technology and production process can also determine if the firm will be able to meet regulatory standards.

**Figure 9. Factors that affect SME competitiveness in Global Value Chains**



Source: Authors’ illustration.

## 5. Policy Implications

This section discusses some policy implications that can help overcome the identified challenges of SMEs in connecting to global value chains. These implications are not only for policy makers but also for SME owners and managers. For policy makers, the implications are the following.

**1. Enhance the efficiency of ports and Customs operations.** Inefficiencies in ports and Customs processes unnecessarily increases the cost of trading. Simplifying processes and reducing the incentives for corruption such as automation would help in exporting and importing.

**2. Improve credit terms of SME loans.** Many SMEs are reluctant to invest and take out a loan because of risk aversion brought by absence of fallback and safety nets in case the investment produce negative returns. One way to encourage SMEs to access credit is to improve the terms such as longer repayments.

**3. Incentivize exporting of higher-value products compared to raw materials.** One way to do this is to provide incentives on the purchase of equipment that processes raw materials into higher-value products. This could be in the form of tax breaks for purchase of equipment or for equipment financing. In addition, for industries big enough such that there are multiple SME exporters, the formation of a consortium among these firms may be facilitated. This consortium can pool funds from its members for the purchase of an equipment that they can use jointly.

**4. Implement programs that promote linkages between SMEs and foreign or large firms.** Connecting SMEs to GVCs is not only through exporting. It can also be by providing supplies or services to firms that are already connected to the value chain (ADB 2015). Because only a small share of SMEs are connected to large or foreign firms this way, policy makers may explore establishing an information-exchange platform, where large and foreign firms can post their outsourcing and subcontracting requirements, while SMEs can post their qualifications, capabilities, and services that they can offer.

**5. Reduce the cost of participating in trade fairs.** The trade fairs regularly conducted by the government are ways to link SMEs to markets abroad. However, many SMEs are reluctant to join because they see it as an expense with no guaranteed return. One way to encourage SMEs to join is to waive or reduce the entrance fee but charge a transaction fee if it is successful in contracting with a buyer during the fair.

**6. Expand entrepreneurial skills training.** There is probably no proven way to improve entrepreneurial mindset. It is determined by culture, socio-economic background, personality, and risk aversion. However, it is too important in connecting SMEs to GVCs to ignore. The government should continue its mentoring programs encouraging entrepreneurs to pursue their goals but at the same time helping them realize that expansion and success inevitably comes with some degree of risk taking.

**7. No one-size-fits-all solution.** Survey findings suggest that SMEs from different sectors could be facing different obstacles in connecting to GVCs. Thus, a more efficient and more effective program is one that is finely targeted depending on needs and challenges faced by the firm.

**8. Monitor progress through statistics.** To monitor progress and help design policies, the government should maintain reliable statistics on MSME participation on GVCs. This includes trade data disaggregated by firm size such as export and import volume, value, and price, among others.

The following are the policy implications for SMEs.

**1. Find new market niches where competition is not yet too tough.** Philippine SMEs cannot do anything about the lower cost of labor in competitor countries, neither on the bigger support of the government on SMEs in these countries. What domestic SMEs can do is to target the right market where they can establish early mover advantages.

**2. Avoid purchasing equipment with high asset specificity.** With a fluid international market, tastes, preferences, and market conditions quickly change; and a firm should be ready to adapt to these changes. Thus, when purchasing equipment, avoid acquiring machines that can produce only one product. A footwear manufacturer, for instance, should avoid acquiring a machine that can only produce one type of shoe. Similarly, a clothing producer should avoid buying equipment that cannot manufacture several types of clothes.

**3. Consider indirect exporting.** Many potential exporters do not have the capacity to produce in quantities that would make exporting profitable. Moreover, many potential exporters do not have access to market information in export destination countries. Indirect exporting can help address these obstacles in connecting to global value chains. Indirect exporting may be done through consolidators – a third party that buys export-quality products from local producers and selling them in countries where there is demand. Indirect exporting may also be done by providing inputs to firms that export such as foreign companies or large businesses. These inputs may be in the form of supplies or services such as outsourcing or subcontracting arrangement.

**4. Take advantage of government support and network.** SMEs should not shy away from engaging in available platforms like *Negosyo* Centers and the *Kapatid* Mentor Me Program to improve their entrepreneurial abilities.

## **6. Summary, Conclusions, and Recommendations**

This paper attempts to determine the challenges and enablers of connecting SMEs to global value chains. It uses data from a survey of SMEs in Metro Manila and a set of key informant interviews of SME owners and of government officials tasked to assist SMEs. Data from the survey and from related literature shows that Philippine SMEs are not well connected GVCs; and most indicators of connectivity suggest that Industry SMEs are more linked to GVCs than Services SMEs are. There are five main themes that explain the challenges, and thus suggest the enablers, of connecting Philippine SMEs to global value chains. These are 1) competition in ASEAN and East Asia; 2) international standards, regulatory requirements, and local institutions; 3) role of the government; 4) international market demand and inputs supply; and 5) entrepreneurial mindset and skills. The specific obstacles under these themes can also be grouped into the firm's macro-environment, its meso-environment, and its micro conditions or individual characteristics.

Philippine SMEs are finding it hard to compete with competitors from Southeast and East Asia because they lack the ability to scale up production, thus missing out on economies of scale and raising per unit cost relative to their competitors. In addition, most Philippine SME exporters are at the low value part of the chain, i.e. they export raw materials rather than processed, higher-value products. Another challenge is many SMEs in the country cannot meet international standards and regulatory requirements. Lack or

shortage of access to finance, skilled labor, and entrepreneurial mindset and skills are the main reasons for this. In addition, inefficiencies in ports and customs unnecessarily increases the cost of exporting and importing.

The next challenge is reaching international markets, which is constrained by lack of information and inability to mass produce. To address this, some SMEs resort to indirect exporting. One way of doing this is coursing their products through consolidators that buy export-quality products from firms that cannot produce in large amounts; and then export these in countries where there is demand. It may also be done by providing supplies or services to foreign or large firms that are already connected to GVCs. Finally, many SME owners lack the entrepreneurial mindset or skills to effectively navigate the international market. This includes not only management skills, but the mindset to pursue new markets despite the challenges, including the willingness to take some risks.

Nonetheless, the risk aversion of SMEs is not entirely irrational. Because SMEs have fewer assets, they often do not have a fallback or a safety net in case an investment produces negative returns.

This paper looked at the internationalization of SMEs through GVC participation in general. However, differences in processes, markets, competitiveness, cost structure, and access to inputs of different sectors imply that there could be heterogeneities in the obstacles and enablers of internationalization and GVC participation across industries. Different sectors also have different ways of connecting to GVCs. For instance, Services SMEs usually connect to GVCs by being outsourced by foreign firms; while Manufacturing firms may provide supplies to exporters or directly export their products. It would therefore be useful if more in-depth studies focused on specific sectors will be conducted.



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