DISCUSSION PAPER

SME Ministerial Conference

22-23 February 2018

Mexico City

Fostering greater SME participation in a globally integrated economy

Plenary session 3

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■ Background information

This paper was prepared as a background document to the OECD Ministerial Conference on Small and Medium-sized Enterprises, taking place on 22-23 February 2018 in Mexico. It sets a basis for reflection and discussion.

■ About the Ministerial Conference

The 2018 OECD Ministerial Conference on Strengthening SMEs and Entrepreneurship for Productivity and Inclusive Growth is part of the OECD Bologna Process on SME and Entrepreneurship Policies. The Conference will provide a platform for a high-level Ministerial dialogue on current key issues related to SMEs and entrepreneurship. It will seek to advance the global agenda on how governments can help strengthen SME contributions to productivity and inclusive growth; how SMEs can help address major trends and challenges in the economy and society; and how the OECD the support governments in designing and implementing effective SME policies.

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2018 SME Ministerial Conference

Fostering greater SME participation in a globally integrated economy

Discussion paper

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Summary

- Stronger participation by SMEs in global markets creates opportunities to scale up, accelerate innovation, facilitate spill-overs of technology and managerial know-how, broaden and deepen the skillset, and enhance productivity.
- Global value chains (GVCs) offer new opportunities for SMEs to integrate the global economy, as exporters, suppliers to large firms that export, and importers of competitively priced foreign inputs and technologies. However, benefits from GVC participation depend on the nature of inter-firm linkages and position in global production networks.
- The digital transformation is reducing trade costs, increasing SME involvement in trade and spawning a new breed of born-global enterprises. Nevertheless, trade costs and restrictions remain which impact SMEs disproportionately. Moreover, the increased number and complexity of digital "border control" may condition the benefits that SMEs gain from digital trade.
- The increasingly complex trading environment requires greater international cooperation to identify global solutions to global challenges, from traditional standards to new regulatory issues in the digital age. It also calls for domestic whole-of-government approaches to address SME constraints in internationalising, including access to information, skills, technology and finance, as well as trade facilitation and connectivity.

Questions for discussion

1. What policy approaches have proven successful to strengthen SMEs' participation in international trade? What new approaches are needed?
2. Which types of firms prove to be most successful in integrating global value chains, and how can policy enable the integration of other SMEs? What aspects of open markets matter most for SME participation in global value chains?
3. How can policy help SMEs harness the potential of digital technologies for international activity?

Better access to global markets is key to strengthening SME contributions to economic development and social well-being

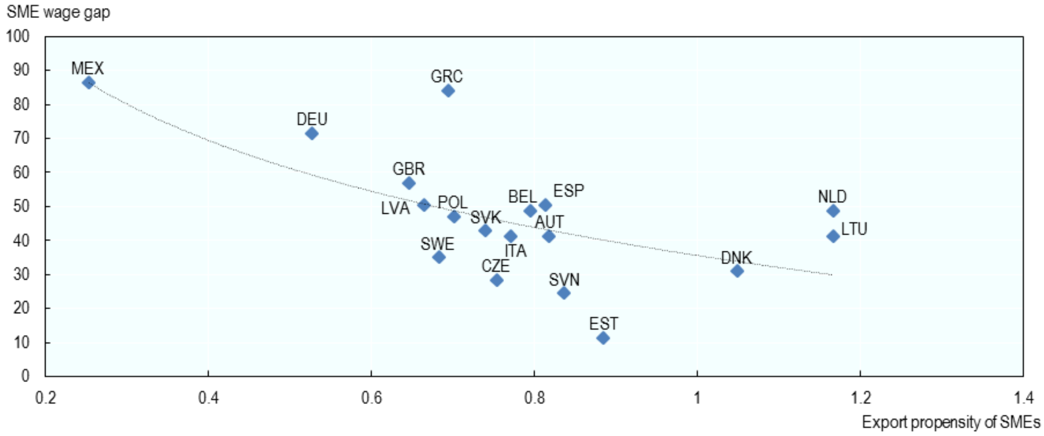
Stronger participation by SMEs in global markets creates opportunities to scale up and enhance productivity, by accelerating innovation, facilitating spill-overs of technology and managerial know-how, and by broadening and deepening the skillset. International exposure, whether through imports, exports, or foreign direct investment (FDI), goes frequently hand in hand with higher productivity, and can be an important driver of employment growth (Wagner, 2012).

In addition, there are growing concerns that the benefits from globalisation have not spread evenly within economies, possibly exacerbating long-standing wage gaps between large and smaller firms. Average compensation per worker across OECD economies is

significantly lower the smaller the firm, with remuneration levels, even in medium-sized firms, around 20% lower than in large firms. This reflects in large part correspondingly lower productivity, but the extent of direct exports by SMEs also appears to play a role. In countries, where SMEs have a relatively high share of exports, for example, differences in average salaries between SMEs and larger firms are smaller (Figure 1).

Figure 1. Where export propensity by SMEs is higher, wage gaps vis-à-vis large firms are smaller

Manufacturing wage gaps and SME trade, 2014



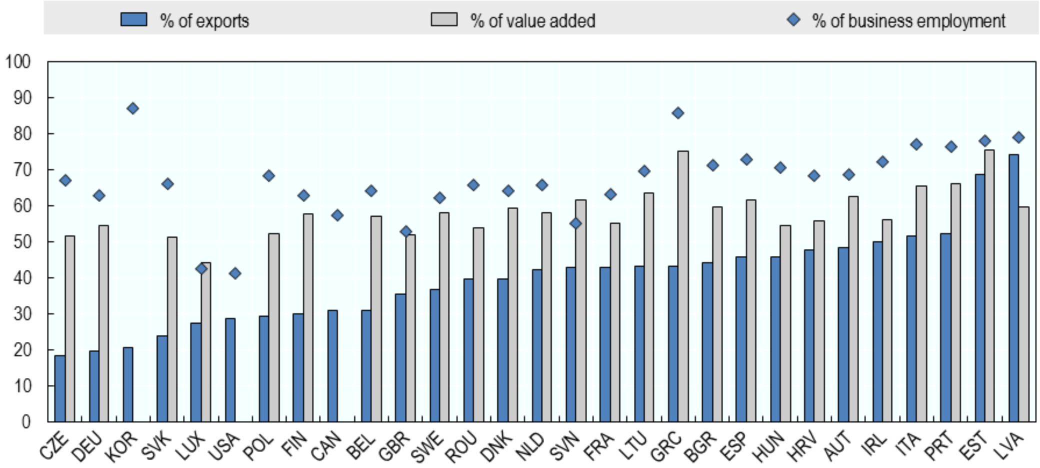
Note: SME wage gaps are measured as the difference between average salaries per employee in large firms and SMEs as a ratio of average salaries in SMEs. Export propensity of SMEs is measured as the share of exports by SMEs divided by the share of output by SMEs.
Source: Based on OECD Structural and Demographic Business Statistics and Trade by Enterprise Characteristics databases.

SMEs tend to be under-represented in international trade

Relative to their share of overall activity and employment, SMEs account for only a small proportion of exports (OECD-WB, 2015). In most OECD economies, for example, SMEs account for upwards of 95% of all firms, around two-thirds of total employment and over half of business sector value-added, but their contribution to overall exports is significantly lower – between 20% to 40% for most OECD economies (Figure 2).

Figure 2. Compared to their contributions to national economies, SMEs are under-represented in global trade

SME export activity, value added and employment shares, as a percentage, 2013

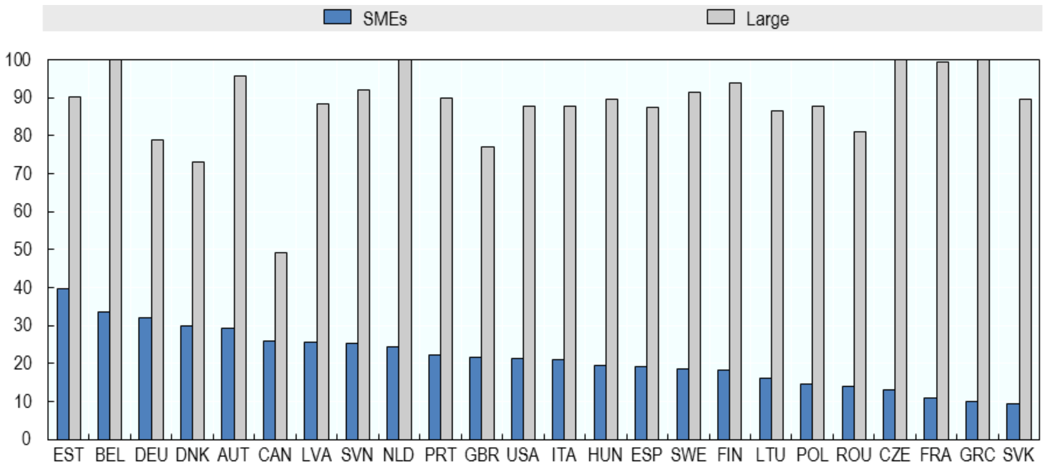


Source: OECD Structural and Demographic Business Statistics and Trade by Enterprise Characteristics databases.

The relatively low contribution of SMEs to overall exports partly reflects their lower contribution to mining and manufacturing (industry), where economies of scale play a role. However, even within the industrial sector, the share of SMEs that export is significantly lower than the corresponding share in large firms. In most economies, more than 90% of large industrial firms export, compared to 10%-25% of SMEs (Figure 3).

Figure 3. The gap in exporting activity in the industrial sector is particularly large

Industrial firms engaged in exports, as a percentage of total firms by size class, 2013



Source: Trade by Enterprise Characteristics database.

Engaging in international markets can be expensive and usually only the most productive firms can afford to do so (Melitz, 2003; Bernard et al., 2007). Lacking economies of scale, trading costs represent a higher share of SMEs' exports – meaning that they are disproportionately affected by tariff and non-tariff barriers to trade (WTO, 2016a). In

turn, SMEs also face considerable challenges in accessing finance for new investment, information, skills and technology, all of which reduce their international competitiveness and their ability to face trade costs. The *Facebook-OECD-World Bank Future of Business Survey* corroborates these findings. In 2017, asked to cite barriers to trade, SMEs with a digital presence named the following factors: finding business partners (63%); market access limitations (41%); different regulations in other countries (38%); customs regulations (35%); language and/or cultural gap (33%); securing export finance (31%); poor online payment alternatives to sell online (29%); large geographical distance from home country (26%); and poor internet connection to sell online (18%).

In many countries, women entrepreneurs face heightened challenges to participate in international markets. Businesses run by women are less likely to be involved in international trade, whether as exporters or importers, than male-run enterprises. In addition, among exporters, women-led businesses tend to be more focused on individual consumers and less engaged in business-to-business trade than male-run enterprises, which reflects, in part, gender differences in the sectors of activity (OECD, 2017a).

Changes in the global trading environment offer new opportunities for SMEs

Recent changes in the global trading landscape, such as the rise of global value chains (GVCs) and the digital transformation, offer new opportunities for SMEs to integrate into the global economy. Greater flexibility and capacity to customise and differentiate products can give SMEs a competitive advantage in global markets relative to larger firms, as they are able to respond rapidly to changing market conditions and increasingly shorter product life cycles.

Some niche international markets are dominated by SMEs, and innovative small enterprises are often key partners of larger multinationals in developing new products or serving new markets. For example, in Germany small- and mid-size companies hold between 70% and 90% of global market shares in some specialised manufacturing segments, and account for the bulk of the German international trade surplus. In 2015, across twelve OECD countries, the share of SME merchandise export in textile, apparel and wood manufacturing represented respectively 66%, 64% and 61% of the total (OECD, 2016a).

At the same time, SMEs comprise a very heterogeneous group of firms and opportunities to internationalise will depend on the activities undertaken, as well as on whether SMEs operate in tradable or non-tradable sectors.

….through GVCs…

GVCs allow SMEs to specialise in specific segments of production, rather than having to master all processes required to produce finished goods and thus integrate into segments of global production chains. In turn this can be a pathway towards economic development through productivity growth, exporting more sophisticated products, and a less concentrated export basket (Kowalski et al., 2015).

This integration can occur on the ‘output’ side, through direct cross-border exports and also indirectly, through upstream supplies to larger firms, which provides a vehicle to overcome trade related costs and challenges. But SMEs can also benefit on the ‘input’ side, through access to cheaper inputs and capital goods as well as through better sourcing or use of foreign technologies, products or knowhow (Lopez-Gonzalez, 2017).

Outward FDIs can also allow SMEs to access international markets and integrate in GVCs, often indirectly, as upstream suppliers to exporters (OECD-WB, 2015). In fact, survey evidence indicates that proximity to global enterprises, as suppliers, is one of the main drivers of outward FDIs by small businesses, although this form of internationalisation is relatively uncommon among SMEs: in a 2009 survey of European SMEs, only 2% indicated direct investment abroad (European Commission, 2010). In this regard, empirical evidence suggests that public measures to support outward FDIs by SMEs are effective in enhancing firm performance in terms of domestic turnover and productivity growth, especially for smaller and younger firms (Bannò et al., 2014).

… as exporters…

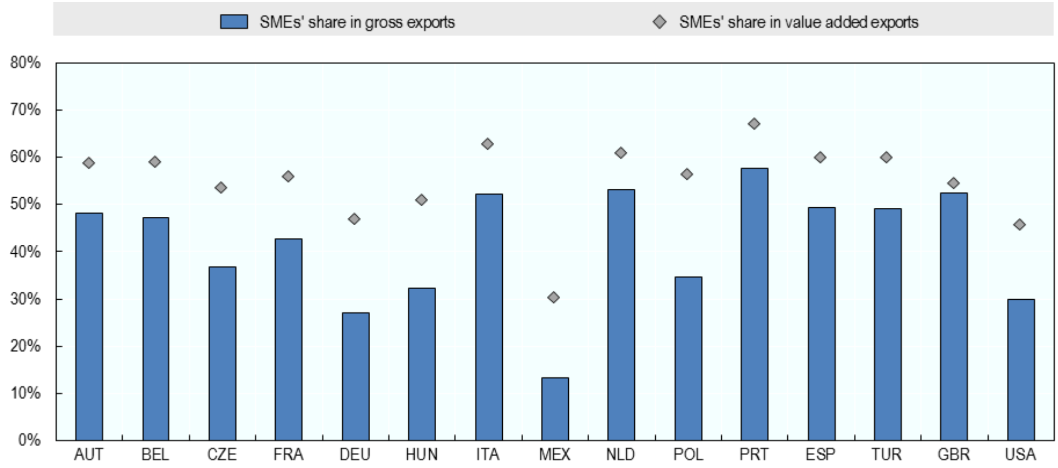
Direct participation in GVCs takes place when SMEs export intermediate goods and services for further processing. Evidence for Southeast Asian countries shows that selling inputs is particularly important: manufacturing SMEs in these countries have a higher tendency than larger firms to export goods and services that are sold directly into GVCs. In Thailand, for example, 16% of the value added in the exports of manufacturing SMEs is sold directly to firms abroad for further processing, versus only 6% for larger manufacturing firms. Opportunities for SMEs operating in service sectors might be even bigger. In Viet Nam, the share of exports by SME used by other countries to produce exports jumps from 5% (manufacturing only) to 26% when service firms are included (Lopez-Gonzalez, 2017).

… as suppliers to larger firms that export

Another way for SMEs to benefit from GVCs is through indirect exports, or by supplying intermediate goods and services to typically larger firms – domestic or foreign-owned – which then export. Recent evidence suggests that, in OECD countries, looking only at direct exports by SMEs under-represents the actual engagement of small firms in a country’s gross exports (Figure 4). In Mexico, for example, SMEs account for less than 15% of gross exports, but for 30% of the total value added in the country's exports. In other terms, when the role of SMEs as suppliers of inputs to larger direct exporters is taken into account, the importance of SMEs as exporters doubles.

Figure 4. SMEs account for a larger share of value added in international trade when indirect exports are taken into account

Direct and indirect exporting activity of SMEs in OECD countries, as a percentage of gross exports, 2009

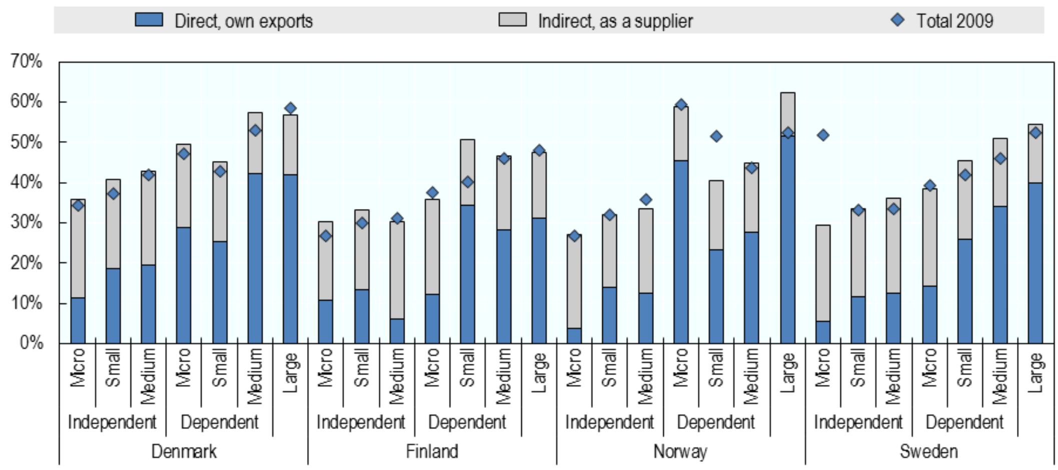


Source: OECD Trade by Enterprise Characteristics (TEC), Structural and Demographic Business Statistics (SDBS) and Intercountry Input-Output Trade in Value Added (ICIO/TiVA) Databases.

The significance of indirect channels is especially important for independent SMEs (i.e. those not owned by a larger domestic firm or foreign firm). For example, while only 3% of total value added generated by independent micro SMEs in Sweden is exported directly, an additional 18% of their value added is indirectly embodied in exports (Figure 5).

Figure 5. Indirect export contributions to value added are particularly relevant among independent SMEs

Direct and indirect exporting activity of SMEs in Nordic countries, as a percentage of total value-added, 2013



Source: Nordic countries in Global Value Chains (2016), OECD-Statistics Denmark.

Indirect exports by SMEs are particularly large in sectors where GVCs are important and where scale matters. In the transport equipment sector, for example, SMEs account for over 40% of total US value-added exported, with nearly all of that contribution reflecting

upstream component and services suppliers to the transport equipment industry. This indirect mode of internationalisation provides SMEs access to foreign markets and new sources of growth, but without incurring trade-related costs.

SMEs can strengthen and upgrade supply linkages by establishing specific contractual arrangements with Multinational Enterprises (MNEs), such as supply/manufacturing agreements, licensing, R&D agreements, technology transfer and quality support, as well as by receiving inward FDI. The existence of industry clusters at the local level represents an important location factor for many MNEs.

… and as importers of competitively priced foreign inputs and technologies

Imports matter for export competitiveness and SMEs may also benefit from GVCs on the input, or buying, side (Lopez-Gonzalez, 2016 and 2017). Firms which use more imported goods and services are more productive, and are better able to face the costs of exporting (Bas and Strauss-Kahn, 2014 and 2015).

SMEs, including non-exporters, can increase their productivity by drawing on cheaper and more sophisticated imports; by exploiting new technologies embodied in new and cheaper capital products; as well as through improved access to new technologies from engagement with internationally-oriented firms, including through linkages arising from foreign investment. All of these channels can also help to target specialisation in parts of the value-chain, where SMEs have comparative advantages and can in turn foster upgrading.

Existing potential remains untapped, however. In Nordic economies, for example, SMEs consistently source a lower share of foreign goods and services to produce exports than larger firms. In addition, the evidence highlights that dependent SMEs also have higher integration from an input (import) perspective than independent SMEs, and so are able to leverage on those links to overcome import trade barriers. This underscores the importance of policies that address constraints not only to exporting, but also to importing for small firms.

… but these gains may vary by position as well participation in GVCs

The benefits from GVC participation depend not only on the degree of integration or participation, but also on the position within global production networks and on the characteristics of other participants in the value chain. Firms and industries positioned at the centre of complex production networks have access to a greater variety of foreign inputs, and potentially a broader range of technologies, compared to those at the periphery. Smaller firms display faster productivity growth in those sectors that have become more central to global production, than those on the periphery, and also in sectors with stronger linkages to more productive foreign buyers/suppliers (Criscuolo and Timmis, forthcoming).

In addition, certain risks may arise for SMEs that participate in GVCs, due to their typically weaker bargaining power vis-à-vis larger firms. In this respect, due diligence requirements and their implementation matter for creating a level playing field. The OECD Guidelines for Multinational Enterprises, which cover also relationships with sub-contractors and suppliers, represent an important reference[1].

[1] http://mneguidelines.oecd.org

A range of internal and external factors influence SMEs' ability to participate in global markets

While the global fragmentation and specialization of economic activities provide a number of economic opportunities for SMEs, challenges for tapping into these remain due to a number of internal and external factors.

Internal factors

Innovation

SMEs that innovate are more likely to engage in global markets than non-innovative firms. Process and organisational innovation, for example, can increase firm productivity by reducing production costs and allowing SMEs to achieve the minimum level of efficiency required to cover the fixed costs of exporting. Through product innovation, marketing innovation and innovative branding strategies, SMEs differentiate their products from those of their competitors, which enables them to gain market shares in global markets.

Technology adoption

The use of emerging technologies can enhance firm productivity, making it easier for them to access foreign markets and compete. However, new technologies tend to require considerable upfront costs, as well as a reorganisation of the firm to adopt and effectively implement them, making the investment often too expensive for SMEs and larger firms more likely to adopt advanced technologies, including digital ones. Small firms are, for instance, less likely to adopt a range of hardware and software technologies, including servers, Enterprise Resource Planning (ERPs), database management systems, and innovation software (DeStefano et al., 2017).

In addition, unlike large firms, SMEs have considerably less knowledge-based capital and accumulated technology, making it harder for them to adopt emerging technologies (Gibbs and Kraemer 2004). In fact, certain technologies may actually favour large multinational firms, as advances in information and communication technology enable large multinationals to coordinate and profit from complex and fragmented production networks (OECD-WB, 2015).

Management and human capital

SMEs, particularly in emerging markets, generally have weaker managerial skills and less efficient organisational practices than large firms, which can be a barrier to effective participation in global markets. Poor management skills are usually correlated with low levels of productivity, an inefficient use of the workforce, higher frequencies of wastage and damaging of tools, machinery, materials and inputs, and overall ineffective use of the manufacturing floor (Bloom et al., 2012; Iacovone and Qasim, 2013). In this regard, management can be considered as a type of technology which, if used effectively, can enhance the competitiveness of a firm (Bloom et al, 2012; Bloom et al, 2013), and significantly raise their productivity (Andrews and Criscuolo, 2013). Workers with higher levels of human capital are more adaptable to technological change, making it easier for firms to adopt and reorganise around emerging technologies (Bartel and Lichtenberg, 1987; Bresnahan et al, 2002). However, developing or acquiring the right mix of skills, ideas and talents is a challenge for SMEs, especially in markets where the required skills

are scarce or expensive. Worker skills in SMEs are also an important factor in their relation with MNEs and link with Foreign Direct Investments (FDIs). However, evidence shows that workers in smaller firms tend to have lower cognitive skills (including literacy, numeracy and problem solving skills) than those in larger firms, putting SMEs at a higher risk of not meeting the skills requirements of multinationals. Relationships between MNEs and affiliates (or local suppliers) – and their respective bargaining powers – may also influence the diffusion of knowledge and technology, and thereby firms' ability to gain a larger share of the value generated within GVCs. Having the skills capacity to absorb new technologies can help SMEs to develop the types of relationships that foster the diffusion of knowledge (OECD, 2017b).

External factors

Access to finance

Many of the internal factors of SME participation in GVCs are dependent upon finance. For example, both product and process innovation require considerable up-front investments that may not be at reach of many SMEs. Moreover, emerging technologies tend to be expensive and therefore require considerable investment. Financial barriers are found to hamper R&D and investment (Hall, 2002; Lerner and Hall, 2010) and to substantially hinder technological investment, which is the main reason for the gap in productivity and innovation between domestic and foreign-owned firms (Gorodnichenko and Schnitzer, 2013).

Specific challenges limit access to finance by SMEs. These are largely related to the greater difficulties that lenders encounter in assessing and monitoring SMEs relative to large firms, leading to higher transactional and informational costs. This is especially the case for traditional bank lending, which represents the main source of external finance for SMEs. However, increasingly complex and interconnected financial markets offer opportunities to serve the needs of SMEs that seek to integrate global markets (OECD, 2015a). In particular, trade finance instruments (e.g. factoring, letters of credit, guarantees, export credit and credit insurance) have become increasingly important to mitigate risk related to cross-border transactions. Supply chain finance has gained particular importance, also as a result of the increased complexity of supply chains and progress in digital technologies. However, globally, over half of trade finance requests by SMEs are rejected, against 7% for MNEs. Gaps are highest in countries that are experiencing rapid growth in trade opportunities, as global production patterns evolve (WTO, 2016b).

Access to information

SME engagement in international activities may be hindered by limited information and understanding about target foreign markets. This limits the ability to customise products to the diverse needs of consumers and to meet product requirements and standards under local regulatory environments.

In comparison to larger firms, SMEs also lack established contacts with suppliers and business partners abroad. While advances in telecommunication technology may help to alleviate some of the knowledge gap, foreign contacts are essential for overcoming information barriers particularly for SMEs.

Bottlenecks in infrastructure and distance

In addition, a number of more general barriers affect the integration of small businesses into GVCs. The geographic location of a firm, for instance, is an important determinant for joining GVCs (Kowalski et. al. 2015). While the geographical distance between trading partners matters, the ability of firms to access foreign markets and participate in GVCs is greatly affected by the quality of physical infrastructure, such as roads, ports, and airports, as well as the efficiency of the procedures followed in the operation of those facilities (Bernhofen et al., 2016). In particular, in Low-Income Developing Countries (LIDCs), the ability of firms and industries to engage in trade is determined much more by the quality of their port facilities (sea and air), than by the types of preferential access that they might enjoy in major industrialised markets (OECD-WB, 2015).

Telecommunications infrastructure is another important component which supports the value chains of physical goods and enables the creation and trade of digital services, which account for a growing share of total international trade. Access to such infrastructure can therefore be important for SMEs that seek to participate in global markets.

Logistics infrastructure reduces the time, cost, and uncertainty involved in importing and exporting for all types of firms. However, improving the overall efficiency of a country's logistics infrastructure is more important for small businesses than for large firms, since costs of trade are fixed regardless of the size or revenue of the firm.

Intellectual property

Intellectual property rights (IPRs) are useful tools for SMEs to protect their innovations and intellectual property, particularly if the product is easily replicated by others. Moreover, IPRs can increase the perceived value of the firm, which can be leveraged to access external sources of finance, as well as attract knowledge and commercial partners.

SMEs encounter a unique set of challenges using IPRs when operating internationally. These relate mainly to cost, in particular legal overheads; multiple filings, regulatory and technical differences across countries, which often meet with expertise deficiencies; and the robustness of local IP enforcement. Streamlining procedures and reducing application costs and time, particularly in industries where innovation occurs at a rapid rate, and improving litigation and enforcement mechanisms are important to SMEs looking to operate in GVCs and international markets. Likewise, improving cross-border IP information, coordination and enforcement, including access to protection mechanisms provided by international treaties, can ease SME participation in GVCs and export markets (OECD, 2011). In this regard, the European Union has created the European IPR Helpdesk, which provides free-of-charge, first-line support on IP matters to beneficiaries of EU-funded research projects and SMEs engaged in transnational partnership agreements.

SMEs are adapting their internationalisation strategies for the 21st century

The digital transformation is changing what and how we trade (Lopez-Gonzalez and Jouanjean, 2017) and SMEs are both facing new challenges and adopting new internationalisation strategies.

Digital platforms reduce trade costs and increase SME involvement in trade

Access to digital technologies have considerably lowered the barriers of entry into global markets, enabling SMEs to internationalise at a fraction of the cost, and making it easier to participate in international production networks, find customers abroad and make international payments. Many crucial ICTs needed to sell goods abroad can be accessed cheaply, as long as a firm has access to the internet. For example, online platforms reduce the cost and speed of finding buyers of their products and services, and sellers of intermediate inputs at home and abroad, thus connecting supply and demand globally. Many of these digital platforms offer services that facilitate payments and provide warehousing and logistics services, all of which further reduce trade-related costs. Taken together, this has contributed to a greater participation of SMEs in trade, as well as a rising number of small packages crossing international borders (Lopez-Gonzalez and Jouanjean, 2017).

However, while some trade costs fall, others remain. Goods still incur considerable to-the-border, at-the-border and behind-the-border costs, underscoring the need for continued efforts to streamline trade facilitation. Reform of slow or cumbersome border procedures can cut costs of trading by 12%-18%, depending on a country's level of development (OECD, 2015b). Trade costs faced by SMEs also depend on the applied de minimis thresholds, that is, the value threshold, under which no tariffs or taxes are collected. Above this threshold, not only will a tariff have to be paid, but packages might also be delayed at the border for inspection, increasing delivery time.

Some countries do not have a de minimis provision, so their customs inspect and collect duties, if applicable, on all arriving packages. But among those that do, there is a wide variation in thresholds. This matters for SMEs for two reasons. First, because low de minimis thresholds can lead to higher trade costs through longer clearance times and tariffs – which disproportionately affect low or small value trade flows. And, second, because different de minimis thresholds make it difficult to estimate costs when selling products to different markets.

… but services restrictions hit SMEs harder than larger firms

The digital transformation is also giving rise to new 'information industries', such as big-data analytics, cyber security solutions or at-a-distance quantum computing, and presents new opportunities for SMEs. However, services restrictions may mean that these opportunities remain untapped, especially by small firms.

For cross-border exports of services by SMEs, an average level of services trade-restrictiveness represents the equivalent of an additional 12% tariff relative to large firms. Establishing an affiliate abroad involves an even wider range of sunk and fixed costs. For a medium-sized firm of EUR 5 million in turnover, selling specialised services through foreign affiliates, the average level of services trade-restrictiveness can be equivalent to an additional 19% tariff compared to large firms.

Opening up services markets would primarily benefit SMEs. Not just through greater market access, but also by reducing the costs of service inputs which are essential for the international operations of SMEs.

… and 21st century trade requires digital connectivity

Firms are increasingly relying on digital solutions, not just in the production stages and the delivery of goods and services but also as a means of connecting different, and

geographically dispersed, customers or suppliers, including as part of GVCs. Digitalisation also allows firms to draw on data from users to better respond to consumer preferences, better target services, as well as to connect and customise production processes.

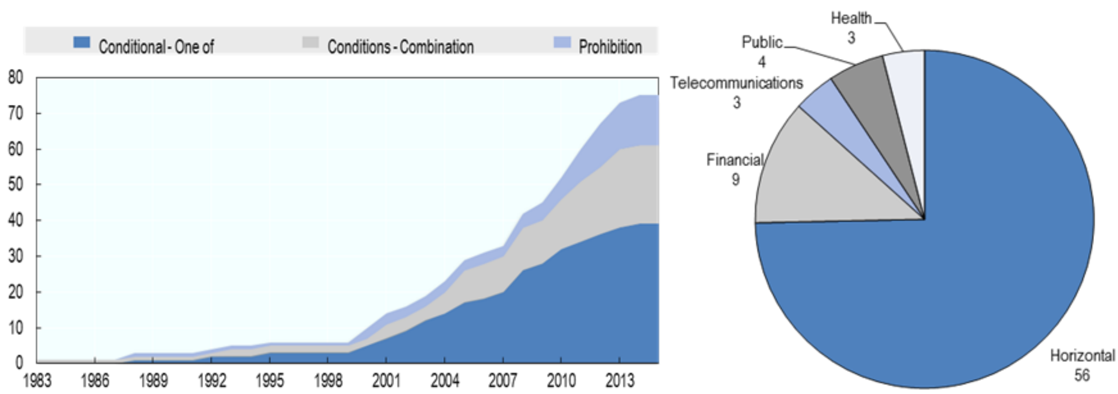
SMEs seeking to engage in digital trade require cheap and reliable access to digital networks. This means good physical infrastructure and appropriate regulatory frameworks. Here, restrictions on trade telecommunications services can inflate costs of access to digital networks, disproportionately affecting SMEs' ability to benefit from the new opportunities offered by digital trade.

The digital trade environment has spawned a new breed of 'micro-multinationals' that are 'born global' (Lund and Manyika, 2016). Access to online inputs contribute to SME competitiveness and help SMEs operate across distant markets to overcome trading costs. For example, cloud computing helps SMEs access IT services with little upfront investment and scale up their IT functions in response to changes in demand. Better and faster access to critical knowledge and information can also help SMEs overcome informational disadvantages, notably with respect to larger firms, and compete on a more even footing. The Internet and international data transfers help SMEs better connect, improve their ability to secure and fulfil global contracts and access global supply chains. As a result, SMEs are increasingly becoming lead firms within GVCs and connecting with other SMEs (including micro companies) as providers of inputs.

However, the ubiquitous exchange of data has led to the emergence of 'data localisation' measures seeking to address concerns ranging from security and protection of individual privacy, to regulatory and audit reach. These introduce digital 'border controls' through restrictions on cross-border data transfers and/or local storage requirements. They are growing in number and complexity (Figure 6) and may condition the benefits that SMEs draw from engaging in digital trade. Finding balance between meeting key public policy objectives in a way that preserves the benefits of an open internet will be key.

Figure 6. The number and complexity of cross-border data transfer restrictions are rising

a. Stock of cross-border data measures - b. Affected sectors



Note: Cross-border data flow restrictions are differentiated between "One of" (at least one of a set of conditions must be met)"Combination" (a combination of restrictions must be met).
Source: OECD (2016b).

Policies can enable SMEs to integrate into global markets

Policy plays a key role in overcoming the barriers to SME integration into global markets. The complex web of global production highlights that a broad range of policies can matter, from services trade to efficient domestic markets.

Global value chains amplify the importance of both goods and services trade policies. Modern production networks rely on two-way flows of imports and exports of goods and services. These intermediate inputs often cross borders multiple times, each time accumulating additional trade costs, and these trade costs disproportionately affect SMEs, given their lower revenue base. Although tariffs for many goods are low in advanced economies, substantial barriers to trade in services remain. OECD work on Service Trade Restrictiveness Indicators reveals restrictions on foreign ownership, restrictions on the movement of people (e.g. quotas, stay duration limits) and barriers to competition even amongst advanced economies (OECD, 2017c).

Competitive domestic markets foster GVC participation, but there is scope for further services liberalisation. Lifting product market regulations encourages innovation and growth of the most efficient SMEs through increased competition, enhancing their GVC participation. In addition, by providing easier and cheaper access to inputs, reductions in red tape can also lead to gains in downstream firms using these inputs (Abe, 2013). Reducing barriers to entrepreneurship in services sectors, such as telecommunications, transport and logistics, and professional services, are particularly important for broader GVC participation.

The diversity of regulatory standards can be a major barrier for SME integration into GVCs. Technical barriers to trade cover 30% of international trade and more than 60% of agricultural products are affected by sanitary and phytosanitary measures (Nicita and Gourdon, 2013). However, standards are far from harmonised across countries and complying with each final destination market's regulations and standards can require firms to make costly investments in adapting production processes, specific packaging and labelling or undertake multiple certification processes for the same product (OECD, 2013). Mutual recognition and convergence of regulatory standards would reduce the burden of compliance for small-scale exporters in particular (OECD-WB, 2015).

GVC participation often requires investment in product and process innovation to upgrade technology and working capital to finance exports. However, access to finance is a particular challenge for SMEs and calls for policies that address credit market imperfections and support the broadening of financing instruments available to SMEs, in line with the G20/OECD High-level Principles on SME Financing. This includes export credit guarantees and measures to develop supply chain finance (OECD-WB, 2015; BIAC et al., 2016). For instance, in Mexico, the Production Chains Programme, launched by NAFIN, the state-owned development bank, allows small suppliers to use their receivables from large buyers to access working capital financing; provides financial training an assistance to SMEs; and eases the interaction of large buyers, SMEs and financial institutions through an electronic platform (OECD, 2015a).

The complexity of customs procedures and quality of transport infrastructure affect the cost of accessing export markets and importing intermediates. This raises compliance costs and causes delays, the latter requiring firms to hold larger inventories and working capital, which is a particular hurdle for SMEs. Promoting policies that streamline border procedures, simplify trade documents and automate border processes is likely to help (OECD, 2015b). There is no one-size-fits-all institutional arrangement for countries to

implement logistics-related reforms. However, a collective framework that includes the private sector is important for consistent implementation. Canada, China, Finland, Germany, Malaysia, and Morocco have all introduced councils or similar coordination mechanisms for this purpose (OECD-WB, 2015).

Public support can help overcome information barriers related to business opportunities, foreign product standards, trade procedures and how to contact potential buyers/suppliers, for example, through providing information on rules and regulations, disseminating market information, international trade fairs or identifying foreign business partners (European Commission, 2010). In addition, spillovers can occur from nearby firms within the same industry and exporting to the same market and hiring workers with experience of that export market (Choquette and Meinen, 2015). However, many SMEs are not aware of the support available, even amongst those SMEs that are internationally active (European Commission, 2010). This is despite evidence suggesting export promotion agencies (which often provide a range of these information services) have a larger impact on exports of SMEs than larger firms (Cruz, 2014). For instance, in Korea, the Export Capacity Enhancing Project, implemented by the Small and Medium Business Administration (SMBA), offers SMEs a broad range of services, such as education, global market information supply, marketing, market research, strategy consulting and global brand development. (Kyung-ho, 2017).

Upgrading technology and scaling-up production requires skills and organisational capital. In this regard, supporting investment in skills is critical, such as through policies that combine high-quality initial education with vocational education and lifelong learning opportunities, as well as initiatives that support SMEs in attracting talent and appropriate skills to undertake international activity (OECD-WB, 2015). In Portugal, for instance, the “INOV Contacto” programme matches young graduates with companies that seek high-potential human resources aiming for an international career.

Programmes that support internal capabilities through training and skills development can also form a key element of the internationalisation process of SMEs (OECD, 2008). A comprehensive approach to improve SME expertise and strategic capabilities for navigating international markets can be found in programmes that combine training with coaching by a consultant or export adviser. This is the case of Denmark’s Vitus programme, launched in 2010, which targets SMEs with a particularly high international growth potential, offering counselling and one-year intensive coaching for developing and executing an export strategy. On the other hand, policies that impede labour market flexibility and limit immigration might restrict the ability of SMEs to hire the skilled workers needed to reorganise and scale-up production.

Policies that support investment in local innovation, such as through intellectual property protection, R&D fiscal incentives and university-industry collaborations, can play a role in developing SMEs’ capacity to absorb new technologies. Policies that encourage stronger links between firms and research, educational and training institutions can facilitate the knowledge transfers required for upgrading in GVCs. In addition, policies that promote partnerships between SMEs and foreign firms can help to develop or transfer technology, products, processes or management practices (OECD, 2008). For instance, in Turkey, in 2017, following the decision by the Ministry of Economy to provide support to the membership of e-commerce websites, the Turkish Exporters’ Assembly signed an agreement with the e-commerce platforms Alibaba and Kompass, which is expected to foster SMEs participation in global e-commerce markets and create opportunities for new entrants.

Creating a supportive domestic and international operating environment for SMEs takes a whole-of-government approach

The increasingly complex trading environment requires a greater focus on domestic whole-of-the-government approaches. Many of the constraints that SMEs face in internationalising relate to access to information, skills, technology or finance, underscoring the importance of continued action to address them. In terms of trade policy, reducing the costs of importing, through continued liberalisation of goods and services and sustained support for trade facilitation and connectivity, will particularly help SMEs to better exploit new opportunities. Improved export competitiveness can be achieved through broader policy measures that recognise the important upstream role played by SMEs. Policies should thus be adapted to reflect the holistic view of production, especially in sectors which require scale.

Programmes that provide greater information to SMEs on new opportunities and help promote linkages and partnerships with larger firms, domestically and internationally, can enable SMEs to better exploit their comparative advantage in the production of intermediate goods and services.

Promoting digital connectivity, by increasing the quality of digital infrastructure and decreasing the cost of access, will empower smaller firms to take full advantage of the digital trade revolution. In this regard, it will also be critical for policy-makers to explore ways to meet key public policy objectives in a way that is least trade distorting and preserves the benefits of a free and open internet. This means engaging in greater international dialogue, involving different stakeholders, including firms of all sizes and civil society.

Greater international efforts are needed in this area. As the global economy becomes more interconnected and globalised the opportunity costs of not engaging in further international cooperation rise. From traditional standards to new regulatory issues in the digital age, global challenges require global solutions to provide an international operating environment where SMEs can flourish.

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