Euler Hermes Economic Research

Euler Hermes North America

Economic Insight

United States: Trying to feel the export pulse

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Executive summary

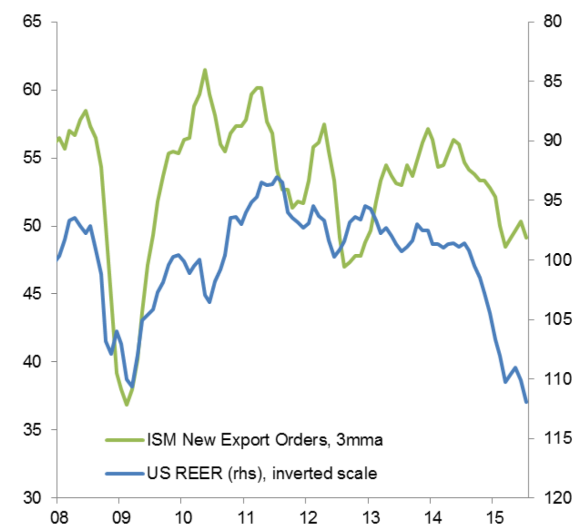
- As global trade is contracting (-2% this year) on the back of currency carnage and lower commodity prices, U.S. companies could stop going after export opportunities. Yet, according to our estimation, there is still an additional USD58bn to make in goods exports in 2016.
- To gauge the mood of American exporters, Euler Hermes conducted a proprietary survey earlier this year.
  - Two in three exporting SMEs feel that exports have contributed to the growth of their companies. U.S. exporters tend to sell to a few markets but view exporting as an efficient means of increasing revenue and profits, and gaining a competitive edge. Exporting SMEs estimate that they could increase their revenues by 26.3% in 3 years (and by 42.2% in 5 years);
  - Canada and UK are most common export markets. China tops list of countries SMEs would most like to begin exporting to;
  - A third of SME exporters have experienced a non-payment in the past year with an export shipment, with a mean of 4.1 incidents. 47% of exporters are familiar with trade credit insurance.

The context: A risk of *domesticalization* for U.S. companies

Exports fell markedly (-3% in the first half of the year) on the back of a stronger dollar and a slowdown in global demand. American exporters can feel the heat; World trade growth has contracted by -14% in value in the first half of the year, as a result of currency carnage in emerging markets and lower revenues from trading commodities. Euler Hermes expects trade to contract by -2.0% in value this year and to moderately recover next year (+2.6%). The ongoing nervousness from China to Russia to Latin America and the flat recovery in Europe are not strong incentives for U.S. companies to venture in this global mess. Indeed, export revenues in weaker foreign currencies contribute less top line growth and price competitiveness has eroded, making it harder to conquer new markets.

For U.S. companies, it feels good to be home these days. The combination of rising real disposable income and a stabilizing savings rate should lead to faster consumption growth in the U.S. (+3% in 2015, contributing 2.1pp to a +2.4% GDP growth forecast). Domestic consumption could represent as much as 87% of total U.S. growth (+13pps compared to pre-crisis levels).

Figure 1: ISM New Export orders vs USD Real Effective Exchange Rate



Sources: IHS, Euler Hermes

In spite of visible trade policy efforts, including deepening trade agreements such as the Transatlantic Trade Investment Partnership (TTIP) with Europe and the Trans-Pacific Partnership (TPP) with Asia and Oceania countries, the risk of a stronger *home bias* has increased. The short-term consequences of this withdrawal are the missed opportunities: Euler Hermes forecasts USD58bn in additional demand for U.S. goods worldwide in 2016 (+2.8% increase y-o-y). To benefit from this potential, U.S. companies will have to continue weaving export routes and invest in product development. The chemicals and machinery sectors could benefit the most (USD10.7bn and 9.7bn respectively). This demand will come from Canada and Mexico, as well as Asia and continental Europe. The long-term consequences of staying home include limited innovation, reduced diversification of risks, and a potential loss of market shares to other companies, for good.

"It's the exports, stupid!"

In order to better understand the current mindset of U.S. SME exporters, Euler Hermes surveyed a representative sample of businesses about their opportunities, challenges and growth-related needs.

Initial results showed that most non-exporters (73%) see themselves as limited to the U.S. market based on their product lines. However, 20% are interested in exploring new markets outside the U.S. and 8 in 10 of those companies believe they will begin to export within four years. This result confirms the fact that U.S. companies are often too U.S.-centric in developing their product lines. The already large size of the U.S. market could explain why American companies do not necessarily launch a product with a "rest-of-the-world version" in mind.

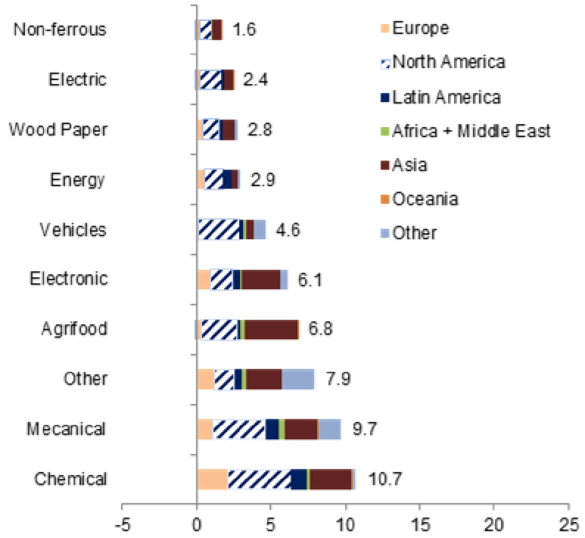
Among exporters, 56% of SMEs tend to export to a few markets and view it as an important and growing part of their business, while 25% export to a few markets and claim it is a small part of their overall business.

When asked about the benefits of B2B exporting, increased sales and profits are most important (77%), at par with giving exporters a competitive advantage 77%). Stability during difficult times (74%) and increasing position as industry leader (73%) are also very important benefits for exporters. Among non-exporters, 70% think exports could boost sales and profits and 67% believe it would strengthen their image and position as a global player. Academic studies indeed show that exporters are bigger and more productive than non-exporters. Though exporting companies were probably more productive initially (a determinant to start the exports journey), exploring new markets and confronting oneself with international competitors force a company to innovate and become in turn more productive.

Exporting SMEs estimate that if they had all the tools to be successful in B2B exporting that they could increase their revenues by 26.3% in three years, and by 42.2% in five years. This is equivalent to 8.5-8.8% turnover growth per annum, a sizeable boost.

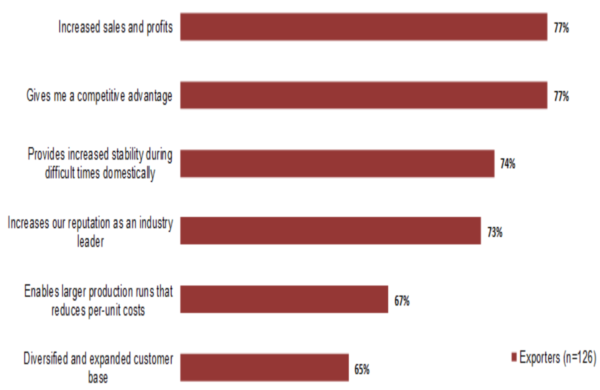
A little more than one-third of SME exporters view exports as a means of increasing revenue with little incremental cost (38%) or a way to make

Figure 2: Additional foreign demand in USDbn in 2016 (by sectors and countries)



Sources: Chelem, Euler Hermes

Figure 3: How important are each of the following B2B exporting benefits to your business?



Source: Euler Hermes U.S. Export Survey operations more efficient (32%). However, 27% complain about foreign trade tariffs, 20% see exports as too costly (while 40% of non-exporters do), 20% worry about getting paid and 18% are concerned about political risks abroad. Among non-exporters, 21% do not know much about exporting and are not even sure where to start.

Exports: Where there is a will, is there a way?

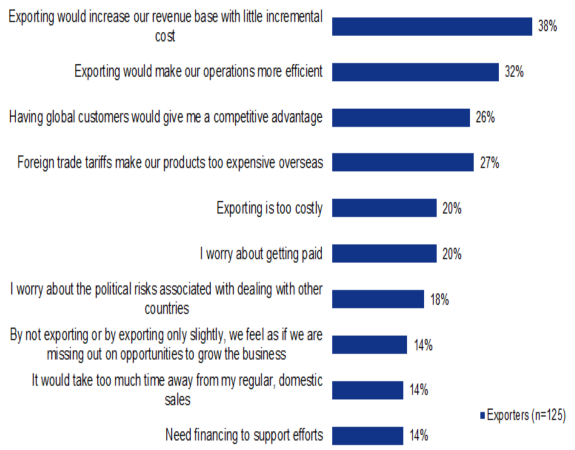
One-third of exporting SME companies export to one or two countries. Another 28% export to 3-4 countries. Smaller companies ($5 mil-$9.9 mil) are significantly more likely to export to one or two countries (46%). Top export countries include: Canada (33%), the United Kingdom (25%), Mexico (21%) and Japan (19%). Firms naturally tend to export to neighboring countries (Canada, Mexico) and countries sharing the same language (Canada, UK). Big emerging markets (China, India and Brazil) come as a second cluster of preferred export destinations: The power of American brands continue to be a growth engine. However, continental Europe represents a top export route for less than 10% of respondents, and South East Asia for less than 5%. The little diversification of American exporters limits the overall potential for revenue-making.

When asked about their wish list, respondents emphasized China (14%), Canada (11%), Germany (11%), France (10%), Mexico (10%) and Australia (8%). A renewed focus on Europe can be explained by stronger signs of recovery across the Atlantic after six consecutive years of muddle-through. Large emerging markets, which have been particularly disappointing over the past couple of years due to currency risks, political turmoil, etc., seem to have disappeared from exporters' radars. For the top destinations, credit risks are high. The stock market crash in China was quite a nudge to credit risk. Chinese companies that already pay 22 days longer than in 2007 will experience further past-dues and non-payments: corporate insolvencies are expected to increase by +25% in 2015, and +20% in 2016. Note that Australia will be negatively affected by Chinese developments. In Canada, the recession in H1 2015 also questions how safe increasing exports are. All in all, our survey confirms the strong concentration in traditional export markets but highlights cautious expansion from seasoned exporters.

Over three in five exporting SMEs (62%) believe that export activity has increased over the past five years. Two-thirds of exporting SMEs (66%) believe that exports have contributed to the growth of their companies.

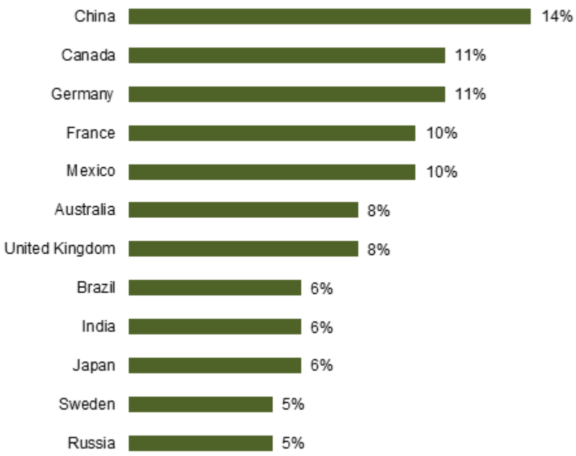
Two in five SME exporters (39%) believe that their international customers are more risky (39%). 37% sell through different distribution channels as they feel their international and domestic customers are altogether different. 30% of respondents state that customers abroad demand longer payment terms, and 22% feel that they need to add additional risk protection techniques to deal with international buyers. A third of SME exporters have experienced a non-payment issue in the past year with an export shipment, with a mean of 4.1 times for this group of exporters.

Figure 4: Which of the following statements about B2B exporting applies to your company?



Source: Euler Hermes U.S. Export Survey

Figure 5: To which countries would you like to begin exporting in the coming year?



Source: Euler Hermes U.S. Export Survey

Mitigating export risks is not rocket science; it requires the right toolkit

Access to information remains the most important tool for exporters: Credit reporting services are the primary way exporting SMEs are protecting themselves from exporting risks (46%). Letters of credit (33%) and advance cash payments (31%) continue to be widely used even though they harm competitiveness and include important transactional costs. Trading on open accounts should be the norm. By requesting advance payment, U.S. exporters may lose a client to competition in Europe and Asia-Pacific that accepts 30, 60, sometimes 90 days sales outstanding (DSO). Credit insurance is a very cost-effective tool to trade on open account. It is used by 29% of respondents.

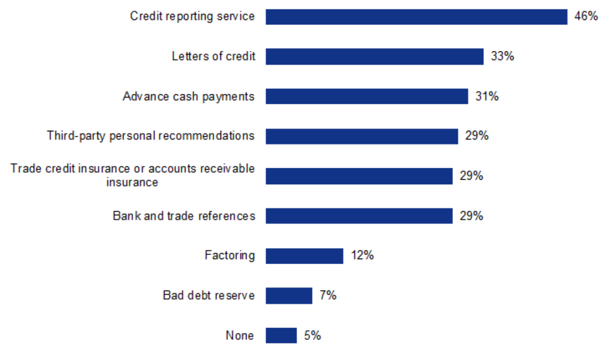
Just over three-quarters of SME exporters (78%) believe their existing export risk protection provides a competitive advantage. Just under three-fourths (74%) believe their risk protection is sufficient to protect against unforeseen loss. 47% of exporters are familiar with trade credit insurance vs. only 30% of non-exporters.

There is no secret recipe to successful exporting but there are some best practices for trade receivables management. First, get help accessing information on your clients. The strength of a balance sheet (and the credit terms you are ready to grant your client) depends on the individual company as well as country and industry drivers. This backdrop is useful to understand currency and financing risks (when invoices are denominated in a foreign currency), and geopolitical vulnerabilities (e.g., embargos). Second, consider *how* you want to sell abroad, including how to finance it. Distributors, sales agents, joint-ventures or a regional branch are very different operating models and this choice matters. If you choose a local distributor, your working capital needs to be well financed and your credit management pristine to bear with past-dues. Last, revise your terms and conditions: suppliers' protection varies dramatically across countries. Prevention is always best but when push comes to shove, local payment culture and collection practices need to be known. Once burnt, twice shy? You certainly do not want to experience a non-payment and stop your exports journey on a bad note.

Figure 6: In what ways, if any, do your international B2B customers differ from your domestic B2B customers?

Source: Euler Hermes U.S. Export Survey

Figure 7: What techniques or tools do you use to protect your company from risk when exporting to foreign customers/businesses?



Source: Euler Hermes U.S. Export Survey

About the Euler Hermes U.S. Export Survey

In an effort to investigate the export mood, Euler Hermes conducted a survey of 250 business-to-business (B2B) companies in all industry sectors. The sample included small and medium sized businesses (revenues between USD1-50mn), exporters and non-exporters and was conducted in April 2015. The survey was designed to provide a margin of error of 6.2 points for totals at 95% confidence, and compare exporters to non-exporters.

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