SME trade: the next frontier?

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Queen’s Institute on Trade Policy
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Questions to address

1. What are the benefits and costs of trade?
2. How does SME and large firm trade differ?
3. Do we need more SMEs traders? Why?
4. What tools might help more SMEs to engage internationally?
One motivation for SME trade

Demands for more inclusive growth/trade
The upside of global engagement

Small domestic market, by population
The upside of global engagement

Large global market, by population
## SME exporter performance benefits

### Dual causality:
**Better firms trade**
and **trade makes firms better**

<table>
<thead>
<tr>
<th></th>
<th>Exporters</th>
<th>Non-exporters</th>
<th>Exporter premium (% difference between exporters and non-exporters)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue ($ millions)</strong></td>
<td>3.5</td>
<td>1.6</td>
<td>121</td>
</tr>
<tr>
<td><strong>Pre-tax profits (%)</strong></td>
<td>13</td>
<td>11</td>
<td>18</td>
</tr>
<tr>
<td><strong>Firms that invested in (%)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Research and development</td>
<td>24</td>
<td>7</td>
<td>222</td>
</tr>
<tr>
<td>New information and communications technology</td>
<td>60</td>
<td>41</td>
<td>46</td>
</tr>
<tr>
<td>New machinery and equipment</td>
<td>42</td>
<td>40</td>
<td>5</td>
</tr>
<tr>
<td>Training</td>
<td>46</td>
<td>35</td>
<td>33</td>
</tr>
<tr>
<td><strong>Percentage of firms that innovated</strong></td>
<td>60</td>
<td>35</td>
<td>71</td>
</tr>
<tr>
<td>Product</td>
<td>40</td>
<td>21</td>
<td>90</td>
</tr>
<tr>
<td>Process</td>
<td>26</td>
<td>13</td>
<td>100</td>
</tr>
<tr>
<td>Organizational</td>
<td>27</td>
<td>14</td>
<td>93</td>
</tr>
<tr>
<td>Marketing</td>
<td>28</td>
<td>15</td>
<td>87</td>
</tr>
<tr>
<td><strong>Imported</strong></td>
<td>49</td>
<td>23</td>
<td>113</td>
</tr>
<tr>
<td><strong>Outsourced</strong></td>
<td>13</td>
<td>2</td>
<td>529</td>
</tr>
<tr>
<td><strong>Were part of a global value chain</strong></td>
<td>13</td>
<td>4</td>
<td>212</td>
</tr>
<tr>
<td><strong>Engaged in foreign direct investment</strong></td>
<td>2</td>
<td>1</td>
<td>157</td>
</tr>
</tbody>
</table>
Plenty of potential trade costs

- Gather market knowledge
- Attract new customers
- Vet foreign suppliers
- Financing
- Transportation/logistics
- Import duties

- Comply with:
  - int’l regulations
  - rules of origin
- Distance/culture/language
- Awareness, use of gov’t trade support programs
A key feature of trade costs

*Disproportionately restrain SMEs*
More acute obstacles for first-time traders

- information
- capacity/resource constraints
- finance
Firms that can afford to incur the costs of exporting are typically more productive.

Baseline Melitz model

- Exporters
- Non-exporters

Over 1974-2010, average labour productivity was 13% higher for Canadian manufacturing exporters than non-exporters.

Don’t produce

Profits

Productivity

$cpo = \text{cut-off productivity level for operating}$

$cpe = \text{cut-off productivity level for exporting}$
Even though exporting increases with firm size...

Export propensity, 2014
(percent of firms that exported a good and/or service)

Number of employees

1-4  5-19  20-99  100-499

SME average

8  11  19  34
...because the vast majority of Canadian businesses are small...
...most exporters in Canada are SMEs.
Distribution of goods exporters by size

Share of exporters (percent of total)

- Small: 89.8%
- Medium: 2.6%
- Large: 7.6%
…most export value is concentrated among a small number of large firms.

Distribution of Canadian merchandise exports by firm size, 2016
(percent of total)

- Share of exporters
  - Small: 89.8%
  - Medium: 7.6%
  - Large: 2.6%

- Share of export value
  - Small: 18.4%
  - Medium: 22.4%
  - Large: 59.2%
On average, large firms exported 10 times more value than medium-sized firms, and 100 times more than small firms.
SMEs reach fewer international markets

Share of goods exporters by number of destination countries, 2016 (percent of total)

Number of destination countries

SMEs
Large firms

1 2-19 20 or more

71.2
43.0
27.2
44.3
12.8
1.7

0
10
20
30
40
50
60
70
80
SMEs engage less in the highest-value export industries

In 2014, if the SME export basket in Canada had had the same industrial composition as that of large firms, the value of total SME exports would have been 56% greater, all else being equal.
Trade liberalization and the “extensive margin”
Getting in the exporting game

- Become internationally aware
- Build knowledge
- Make connections
- Get financing; get paid

- Business strategy
- Economic forecasts; market risks; tariff finder
- Matchmaking to find customers and suppliers
- Performance guarantees; accounts receivable insurance; etc.
Typical Canadian exporting journeys

Canadian direct exporters

US starters
(~65% current exporters took this path)

Non-US starters
(~22% of current exporters)

Born Globals: start in multiple int’l markets
(~13% of current exporters)
Most Canadian exporters ship to the U.S. market

Share of goods exporters that export to the U.S. by firm size, 2016
(percet of total)

<table>
<thead>
<tr>
<th>Firm size</th>
<th>Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small</td>
<td>80.1</td>
</tr>
<tr>
<td>Medium</td>
<td>92.9</td>
</tr>
<tr>
<td>Large</td>
<td>93.4</td>
</tr>
</tbody>
</table>
Most Canadian exporters ship to the U.S. market; but small firms are far less engaged with Mexico.

Share of goods exporters that export to the U.S. and Mexico by firm size, 2016

(Percent of total)

<table>
<thead>
<tr>
<th>Firm size</th>
<th>US</th>
<th>Mexico</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small</td>
<td>80.1</td>
<td>3.3</td>
</tr>
<tr>
<td>Medium</td>
<td>92.9</td>
<td>13.2</td>
</tr>
<tr>
<td>Large</td>
<td>93.4</td>
<td>20.0</td>
</tr>
</tbody>
</table>
# Key challenges for traders at different stages

<table>
<thead>
<tr>
<th>Not exporting</th>
<th>Planning to export in the next 1-2 years</th>
<th>Currently exporting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack appropriate product/service to export (22%)</td>
<td>Finding buyers (37%)</td>
<td>Competition (39%)</td>
</tr>
<tr>
<td>Lack operational capacity (15%)</td>
<td>Volatile Canadian dollar (27%)</td>
<td>Global economic conditions (31%)</td>
</tr>
<tr>
<td>Lack financial resources (15%)</td>
<td>Maintaining sufficient cash flow (26%)</td>
<td>Connecting with customers (29%)</td>
</tr>
<tr>
<td>Lack knowledge about exporting (13%)</td>
<td>Competition (26%)</td>
<td>Volatile Canadian dollar (28%)</td>
</tr>
<tr>
<td>Difficulty finding foreign customers (13%)</td>
<td>Compliance with/understanding gov’t regulations (22%)</td>
<td>Talent/resources (24%)</td>
</tr>
</tbody>
</table>
Opportunities for SMEs in value chains

Note: Lines between countries represent bilateral share of trade in inputs; thicker lines for greater shares
Sources: Santoni, Gianluca, Dari Taglioni (2015)
Digital opportunities

Destination of first export market, firms in digital economy sector, Canada, 2016

<table>
<thead>
<tr>
<th>Region</th>
<th>SMEs (fewer than 500 employees)</th>
<th>Large firms (500 or more employees)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asia</td>
<td>37</td>
<td>8</td>
</tr>
<tr>
<td>United States</td>
<td>34</td>
<td>56</td>
</tr>
<tr>
<td>Europe</td>
<td>29</td>
<td>36</td>
</tr>
</tbody>
</table>

Source: Horton (2016).
Note: Based on 129 Canadian firms in the Creating Digital Opportunity dataset for the CanAsia map.
SMEs provisions in trade deals becoming more mainstream

Cumulative number of trade agreements and SME provisions

Source: ITC SME Competitiveness Outlook, 2017
SME provisions in CETA

• references on regulatory support, info sharing and other help for SMEs on market access.

• parties to facilitate use of e-commerce for SMEs.

• SMEs to receive “sympathetic consideration” in investor-state dispute rulings.
SME chapter in the Trans-Pacific Partnership

TPP was the first Canadian and American FTA to include a stand-alone SME chapter.

Dedicated website with information for SMEs

SME committee
NAFTA: SME chapter (TPP 2.0 or TPP-light?)

• “substantively completed” in Round 3
• agreement on info sharing and cooperation
• NAFTA “SME Dialogue”
  – Annual, institutionalized process among private sector, NGOs, other stakeholders
• Relevant areas in other chapters: customs; trade facilitation; digital trade, regulatory cooperation
Potential impact of increased U.S. protectionism on Canadian firms in that market

Q: Please indicate what type of impact each of the following potential factors will have on your company's sales or business in the U.S. | n=132

<table>
<thead>
<tr>
<th>Factor</th>
<th>Large Negative</th>
<th>Small Negative</th>
<th>No Impact</th>
<th>Positive Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Higher tariffs</td>
<td>56</td>
<td>27</td>
<td>14</td>
<td></td>
</tr>
<tr>
<td>Buy American regulations</td>
<td>51</td>
<td>31</td>
<td>14</td>
<td></td>
</tr>
<tr>
<td>NAFTA changes</td>
<td>45</td>
<td>33</td>
<td>19</td>
<td></td>
</tr>
<tr>
<td>Heightened border security</td>
<td>33</td>
<td>40</td>
<td>23</td>
<td></td>
</tr>
<tr>
<td>New taxes</td>
<td>39</td>
<td>29</td>
<td>26</td>
<td></td>
</tr>
<tr>
<td>Travel restrictions for employees</td>
<td>26</td>
<td>32</td>
<td>40</td>
<td></td>
</tr>
<tr>
<td>New immigration policies</td>
<td>11</td>
<td>9</td>
<td>73</td>
<td></td>
</tr>
<tr>
<td>Mexican border &quot;wall&quot;</td>
<td>8</td>
<td>7</td>
<td>82</td>
<td></td>
</tr>
</tbody>
</table>

Legend: red = large negative, pink = small negative, white = no impact, blue = positive impact.
What strategies are being used to respond to U.S. developments?

- Seeking to expand into non-U.S. markets: 48%
- Nothing (wait and see): 31%
- Partnering with a U.S.-based firm: 21%
- Adjusting prices on sales to the U.S.: 15%
- Insuring sales to the U.S.: 12%
- Nothing (changes won't affect my business): 5%
- Leaving the U.S. market: 1%

Q: What strategy or measures are you putting in place in order to navigate or minimize any concerns you may have about doing business in the U.S.?

n=132
Will our export capacity diminish if the U.S. “training ground” is harder to access?

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Read more: irpp.org/research/trade/
Online EDC resources

› www.edc.ca
› Global Economic Outlook
› Global Export Forecast
› Country Risk Quarterly
› Weekly Commentary
› Trade Confidence Index
› The Commodity Tracker
› Research reports on international trade

› edc.trade
› Latest information and updates on US

› www.tarifffinder.ca
› Global Affairs, BDC and EDC – info on tariffs and trade agreements
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