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Understanding the Impact of the Global Economic Crisis on U.S. SMEs' Trade Exports to BRIC

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**UNDERSTANDING THE IMPACT OF THE GLOBAL ECONOMIC CRISIS ON
U.S. SMES' TRADE EXPORTS TO BRIC**

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Abstract

The global economy offers vast trade opportunities for U.S. businesses. United States' SMEs are grossly under-represented in the global market. It is essential that U.S. SMEs adopt a global approach by expanding trade focus to include the emerging BRIC markets. Demographics and increasing purchasing power in the emerging countries of Brazil, Russia, India and China (BRIC) offer significant trade potential for U.S. SMEs export expansion. However, there are external and internal barriers to expanding beyond the NAFTA region. Free trade agreements reduce trade barriers, while creating opportunities for U.S. exports. Although US SMEs face their own set of challenges to expanding internationally, BRIC markets remain vigorous in spite of the world economic crisis. The paper describes SME trade activity and contributions to jobs, innovation and U.S. economic growth. Further it describes specific trade barriers to each of the BRIC countries, investors' perceptions of BRIC's stability and ability to partner with US companies and the industry sectors that have the most potential for US trade expansion to BRIC.

Introduction

Small and medium sized (SMEs) businesses have a strong impact on a country's economy through job creation, wealth generation, and innovation (Trade Promotion Coordinating Committee, 2008). In the developed economies, such as United States, SMEs have a substantial impact on jobs by employing nearly 50% of the private sector work force (The Small Business Economy, 2009). Small and medium sized businesses face many barriers that impact their growth potential, some of which are related to the cyclical nature of the economy. Further, in the era of globalization, SMEs have to integrate themselves into the global economy. However, in the world economy SMEs continue to play a smaller role compared to large corporations, which that continue to maintain the dominant role (Ghosh, Lucy and Lepage, 2009). There are several barriers to US-based SMEs engaging in international trade. Key barriers include insufficient country specific policies and bureaucracies, lack of trade agreements, need for long term financing, inadequate intellectual property rights protection, bribery and corruption, limited knowledge and experience with international trade and with e-commerce technologies, and finally, the need for effective local partnerships (Ghosh, Lucy and Lepage, 2009).

To deepen the understanding of the need for US-based SMEs to expand to BRIC markets, this paper addresses a definition and description of SMEs in the United States in the context of all U.S. businesses. Further, it analyzes the contributions made by SMEs to U.S. jobs, innovation and the economy, and their role in U.S. international trade. Barriers to internationalizing U.S. SMEs are both internal and external. This descriptive paper summarizes key export barriers to US-based SMEs and suggests industry sectors with the most potential for US trade expansion to BRIC. Further, it describes and analyzes the market opportunities for US SMEs resulting from the purchasing power of BRIC, investors' perceptions of doing business with BRIC countries, and the impact of the 2008-09 world economic crisis on U.S. SMEs exports to BRIC. Industrial sectors in which SMEs are engaged, as well as key barriers to conducting business with BRIC are discussed along with as well as the prospects for overcoming those barriers.

US SMEs indicate significant contributions to jobs, innovation and economy

Driven by globalization forces, multinational corporations have expanded their investments into the emerging world markets. The United States Small Business Administration (2007), reports that there are 18,000 U.S. companies with over 500 employees. Companies with 1 to 500 employees are defined as small to medium sized enterprises (SME) and represent the vast majority of United States' businesses (United States International Trade Commission, 2010). In 2006, there were 26.8 million businesses in the U.S. of which 20.6 million firms were classified as self-employed individuals owning small unincorporated businesses, and the remaining 6 million businesses were employer firms with more than one employee.

SMEs represent 50.2% of the jobs in the United States (excluding the non-farm private sector). These non-farm sector SMEs with fewer than 100 employees totaled 35.6% of non-farm employment in the U.S. and 70.9 % of total SME employment (United States International Trade Commission January, 2010). Consequently, the vast majority of jobs are generated by SMEs.

U.S. SMEs contribute significantly to the number of jobs in the United States, as well as being the source of the majority of new jobs. From 1993 to 2009, SMEs accounted for 64.1% of net new jobs (United States' Department of Labor, 2010). According to Kobe (2007), over the past fifteen years SMEs created more jobs than larger companies of 500 or more employees; SMES with fewer than 20 employees accounted for 38.4% of jobs gained compared to 22.7% for firms of 500 or more. SMEs profoundly contribute to the U.S. economy, creating 44% of private jobs in 2006, as well as 50% of private non-farm gross domestic product (GDP).

According to Breitzman & Hicks (2008), SMEs play an important role in innovation. For example, SMEs develop more patents per employee than do large companies. Furthermore, findings indicate that SMEs' patents are more significant than those from larger firms based on metrics including growth, citation impact and originality.

SMEs' economic activity is also spread across several industry sectors. The available statistics on allocation of SMEs (Table 1) by sector reveal that in 2006, construction was the leading sector where SMEs accounted for 13% of firms. The service sector contributed 51% of firms involved in the following sectors: Wholesale and retail trade (17%), professional, scientific and technical services (12%) followed by other services (11%), and health care and social assistance (10 %). Less than 5% of SMEs are involved in the manufacturing sector. According to United States International Trade Commission (2010) SMEs associated in service sectors contributed more to the Gross Domestic Product (GDP) than manufacturing and construction.

Table 1: US-based small and medium size firms by industry sector, 2006

Industry	Total of SME Firms In Sector	Percent in Sector	Rank in Sector
Construction	791,558	13.13	1
Professional, scientific and technical services	772,025	12.81	2
Retail trade	725,577	12.03	3
Other services (except public administration)	672,056	11.15	4
Health care & social assistance	605,845	10.04	5
Accommodation & food services	467,120	7.75	6
Wholesale trade	334,597	5.54	7
Admin, support, waste mgt., remediation services	323,282	5.36	8
Real estate, rental, leasing	305,981	5.06	9
Manufacturing	286,039	4.74	10
Finance and insurance	263,028	4.36	11
Transportation & warehousing	171,947	2.82	12
Arts, Entertainment & recreation	115,049	1.9	13
Information	74,952	1.22	14
Educational services	73,793	1.21	15
Unclassified	27,027	0.44	16
Management of companies & enterprises	26,760	0.43	17
Forestry, Fishing hunting & agriculture	22,888	0.36	18
Mining	20,583	0.33	19
Utilities	6,554	0.09	20

Source: United States Small Business Administration, 2006

These data indicate that SMEs play an important role in the economy of the U.S. with economic activity distributed across several sectors. They are responsible for half the jobs in the non-farm sector and play an important role in innovation. However, U.S. SMEs are primarily concentrated in construction and service sectors, which tend to be more locally based. While there may be potential for firms to export, professional, scientific and technical services, in construction and other personal service sectors **it** may be more challenging to engage in export activities. Of 20 sectors listed in Table 1, the top five account for nearly 60% of SME firms. The 15 remaining sectors range from 7.75% to less than 1%, indicating that most SME business remain concentrated in construction, professional, scientific and technical services,

retail trade, other services (except public administration, and health care and social assistance). However, in **the** future, SMEs engaged in entertainment, information, and educational services might have the potential to increase their presence in the international market place.

Expanding U.S. SME export activity impacted by internal and external barriers

Examining U.S. export activity illustrates that SMEs are important contributors to U.S. international trade. Of all U.S. companies that engage in exports, 97% were SMEs, accounting for 28.9% of the U.S. export value (United States Department of Commerce, 2006). However, United States' SMEs are grossly under-represented in the global markets except for Canada, Mexico. Canada and Mexico are key North American Free Trade Agreement (NAFTA) partners to the U.S. The United States Census Bureau (2008) reported that 58% of all US-based SMEs exported to Canada or Mexico exclusively. In fact, nearly four times more US-based SMEs trade with Canada than trade with China (International Trade Administration, 2007).

However, given that globalization vastly broadens the trading partner opportunities around the world, it is surprising that US business exports are so narrowly focused on NAFTA. Expanding U.S. exports to the economically developing countries, such as Brazil, Russia, India and China (BRIC), offer current and future growth opportunities. Increases in the number of middle-class homes in BRIC (countries, as well as projections of population growth should be of interest to SMEs worldwide.

There are external and internal barriers to SME's expanding beyond their comfort zone of the NAFTA markets. The frequently cited external barriers to SME expansion into emerging markets include a broad range of issues from inadequate national policies and bureaucracies, both US and export countries, to misconceptions that international markets are suited for existing products and services, rather than re-engineering, distributing and packaging to fit the various cultural settings of the emerging markets (Trade Promotion Coordinating Committee, 2007; Fliess, and Busquets, 2006; Organisation for Economic Co-operation and Development, 2006).

The internal barriers are dominated by SME managers and owners who do not have a global mindset. According to Edfelt (2010) the vast majority of U.S. CEOs have less international experience than their counterparts in Asia, Europe and Latin America. Nummela, et. al. (2004) suggest that having a global mindset is vital to a manager or owner's commitment and responsiveness to internationalization.

Exporting to BRIC emerging economies offers opportunities to U.S. SMEs

The main factors influencing the opportunities for the US-based SMES to expand to emerging BRIC economies include BRIC demographics, the impact of the global economic crisis on US-based SMEs' export activity, and the purchasing power of BRIC economies offering vast opportunities for SME expansion. BRIC countries account for 15% of the global economy and 42% of the world's population (Population Reference Bureau, 2007).

Although the emerging economies were not spared from the serious effects of the global economic crisis, they have fared better than the developed economies. According to the World Bank, the industrialized economies' GDP growth is projected to come in at 2.7% in 2010 and is expected to grow only by 3.2% in 2011. However, the emerging economies are projected to grow by 5.2% in 2010 and are expected to have a 5.8% rise in 2011 (World Bank, 2010).

The International Monetary Fund (IMF) forecasted that the emerging economies would grow by 6% in 2010 and accelerating to 6.3% in 2011 (International Monetary Fund, 2010). On the other hand,

developed economies are forecasted to grow by 2.1% in 2010 and by 2.4% in 2011 (International Monetary Fund, 2010). Furthermore, while most emerging economies will outpace the global average, the IMF expects China and India to lead the way for the emerging markets.

Globalization offers expanded export business opportunities. These opportunities are dramatic in the countries of Brazil, Russia, India and China (BRIC), whose populations together total 42% of the world's population (Population Reference Bureau, 2007). Population growth leads to increased demand of goods and services and the BRIC emerging markets are significant drivers behind the new consumerism. BRIC's per capita income increases has impacted the growth of the world's economy through a growing middle class around the world (Ghosh, Lucy, Lepage, 2009). The middle class is projected to grow from 400 million in the year 2000 to 1.2 billion by 2030 (The World Bank (2007). BRIC countries were selected by the United States Department of Commerce's U.S. Commercial Service's National Export Strategy in 2007 and again in 2008 (Trade Promotion Coordinating Committee, 2007; 2008) to be priority markets fuelling growth in the US export business.

Brazil's economy grew from 3.4% increase in 2006 to 5.4% in 2007, and continues to be the largest trading partner with the United States (The Trade Promotion Coordinating Committee, 2008). Brazil's \$1.3 trillion Gross Domestic Product index (GDP) is approximately half of the entire economy of South America. Brazil's imports from the United States have expanded considerably. From 2006 to 2007, the U.S. trade deficit with Brazil dropped from \$7.1 billion to \$1 billion.

Russia's economic growth potential is appealing for U.S. SME exports. Russia's economic growth was ranked among the top 10 in the world in 2007 and is growing at 8.1%, with a GDP of \$1.3 trillion, (Trade Promotion Coordinating Committee, 2008). From 2002 to 2006, Russia's consumer spending increased 107%, and disposable income grew to 11% (Financial Times, 2008).

India's population is also on a remarkable growth curve. India's middle class, primarily located in the cities and accounting for 41% of the population, will total 583 million by 2025. Amazingly, 75% of the urban population will be in the middle class by 2025 (Beinhocker, Farrell and Zainulbhai, 2007). This growth in the purchasing power of India holds untold possibilities for countries that are prepared to serve these markets.

Similar growth is expected of the Chinese middle class. Also, its middle class is growing more quickly than that of the upper and lower economic classes (Gadiesh, Leung & Vestring, 2007). A shift in the age of the Chinese middle class is also important to note. The middle class will be younger than in more economically developed countries in the world, from 25 to 44 years in China, compared to 45 to 54 years in the advanced countries (Farrell, Gersch & Stephenson, 2006).

Given these economic statistics, it is not surprising that the United States Department of Commerce identified the BRIC economies as priority markets in 2009 and for the foreseeable future (Trade Promotion Coordinating Committee, 2008). Economic growth projections for BRIC countries remain strong even in the context of the world's current economic crisis.

Foreign direct investment indicators suggest BRIC countries as export destinations

Emerging markets with their growing economies provide new opportunities for international businesses. As their households' earnings and concomitant spending capacities are expanded, consumer demand rises. Global businesses are presented with a myriad of opportunities as they position themselves to meet the growing needs in equipment, consumer products and services. Often the driver of this growth is foreign direct investment (FDI).

Foreign direct investors are typically long-term focused in expected returns, but are also keenly interested in limiting their risks. The decision to invest overseas, especially in emerging economies, is often based on a wide variety of variables including the results of some leading indices (World Bank, 2009). The surveys conducted for their 2009 report on *World Investment and Political Risk* confirm that investors are confident about their prospects in emerging markets in general and in the BRIC economies in particular (World Bank, 2009). Investors are most confident in China (59%), with India (47%) as their second choice. Confidence in investing in Russia and Brazil is comparable at 39% and 38%, respectively. Over, the next three years in 2010 through 2012, the trends are the same as in 2009 (World Bank, 2009).

According to A.T. Kearney (2010) the senior executives in the world's largest companies ranked three of the BRIC countries in the top five of the 2010 FDI Confidence Index. Table 2 indicates investor's perception of attractiveness of selected countries as destinations for FDI at the world and regional perspectives. As seen in Table 2, investors from around the world ranked China the primary country in which to invest FDI by three of the four investor types, and ranked second after the U.S. by the North American **investors**. While India ranks third and fourth among the same group of investors, Brazil ranks between fourth and seventh, and Russia made the top 10 ranking only according to the European investors.

Table 2. Perceptions of BRIC as FDI Destinations

Ranking	World Investors	Asian Investors	European Investors	North American Investors
1	China	China	China	U.S.
2	U.S.	Vietnam	U.S.	China
3	India	U.S.	India	India
4	Brazil	India	Germany	Brazil
5	Germany	Hong Kong	Brazil	Mexico
6	Poland	Indonesia	Romania	Poland
7	Australia	Brazil	Italy	UK
8	Mexico	Australia	France	Canada
9	Canada	Italy	Poland	Australia
10	UK	UAE	Russia	Australia
Russia	18	Not in top 10	Russia	Not in top 10

Source: A.T. Kearney, 2010

Both the World Bank and the A.T. Kearney studies focus on country rankings based on attractiveness of markets and perceptions of risk. The London-based consultancy of Grant Thornton conducts a similar survey, the *Grant Thornton Emerging Markets Opportunity Index*. This index ranks the level of opportunity for investors in twenty-seven emerging economies across the world. The rankings are based on weighted calculations of several key indicators including per capita GDP, GDP, population size, international trade, Human Development Index (HDI) and growth projections (Grant Thornton, 2010). Further, the study offers interesting insights into global executive thinking on emerging markets. The top five ranked emerging economies include, in order of ranking, China, India, Russia, Mexico and Brazil (Grant Thornton, 2010). According to the three indices described above, the BRIC emerging economies are perceived as attractive markets with low levels of political risk. Analyzing the attractiveness of nations through the lens of the *FDI Confidence Index* provides potential exporters with valuable information as they weigh the risk and reward factors in their decision making for market expansion.

US SMEs face key export barriers when conducting business with BRIC

Expanding US SME international business in general is impeded by a number of variables. The most frequently reported barriers to US SMEs exporting to foreign markets relate to 1) inadequate national policies and bureaucracies, both US and export countries, 2) trade agreements and treaties to promote international trade, 3) long term capital financing and investment, 4) lack of intellectual property rights protection, 5) lack of international trade knowledge and experience, 6) bribery and corruption, 7) inadequate technology and e-commerce knowledge, 8) lack of or ineffective local partnerships and 9) misconception that international markets are suited for existing products and services, rather than re-engineering, distributing and packaging to fit the various cultural settings of the emerging markets (Trade Promotion Coordinating Committee, 2007; Fliess, and Busquets, 2006; Organisation for Economic Co-operation and Development, 2006).

While the global business landscape illustrates significant promise for expanding US business exports to the emerging BRIC markets, there are specific barriers that hinder US businesses. A specialized study conducted by the United States Trade Representative (2009) reported foreign trade barriers to US businesses. It was based on data from various sources including the U.S. Department of Commerce, United States Department of Agriculture, and information provided by trade advisory committees in the private sector and from U.S. embassies.

The report defines these barriers as “government laws, regulations, policies, or practices that either protect domestic products from foreign competition or artificially stimulate exports of particular domestic products” (United States Trade Representative, 2009; p.1). The 10 major trade barriers experienced across all of these countries are: 1) Tariff policies, 2) bureaucratic standards, testing, labeling, and certification, 3) government procurement requirements, 4) export subsidies, 5) lack of intellectual property protections, 6) barriers to financial and data flow services 7) investment barriers, 8) anti-competitive practices, 9) trade restrictions on electronic commerce, and 10) other practices including bribery, corruption and lack of transparency.

A study focusing on export issues was conducted by CompTIA, (2010), which surveyed 660 SMEs across several sectors. The top three criteria for selecting an export market were 1) the size of the market, 2) legal costs of conducting business and 3) available finance. The common export obstacles experienced in both NAFTA and BRIC are: 1) corruption, 2) cultural requirements 3) language barriers, 4) problems with online trade, 5) tariffs, 6) taxes and 7) tax laws. The common trade barriers with the EU are 1) taxes, 2) tax laws and 3) tariffs (CompTIA, 2010). It is interesting to note that the US SMES trading with NAFTA and the EU experienced some of the same barriers when exporting to BRIC.

The most egregious manifestations of the challenges to trade can be neutralized through Free Trade Agreements (FTAs), which are vital to the success of U.S. trade policy. FTAs provide SMEs with a powerful international trade partner, the Government of the United States of America. From the report of the United States Trade Promotion Coordinating Committee (2008), the vast majority of the U.S. trade deficit (84 %) in 2007 came from countries where the U.S. did not have FTAs. In fact, in 2006, 90% of the U.S. trade to Australia, Canada and Mexico, and 70% of all other FTA trading countries, were SMEs (United States Trade Promotion Coordinating Committee, 2008). To date, there are no U.S. FTAs with any of the BRIC nations.

The survey study by CompTIA (2010) also indicated that 85% of SMEs stated that FTAs were important to their trade expansion, and 64% responded that participating in international trade made them significantly more competitive. Developing FTAs is a fundamental first step towards dramatically reducing some of the external barriers and encouraging business activity beyond domestic markets. There are a multitude of other external factors that must be addressed, as well. If the United States is to fulfill President Obama’s call for the doubling of U.S. exports by 2015, (White House, 2010), it is important to go beyond FTAs to incent SME leadership to consider exporting and/or diversifying its export markets.

Conclusion and future studies

The current global economic crisis, ushered in late 2008, has a profound impact on the U.S. economy and corresponding employment opportunities. This economic crisis requires growth in U.S. jobs. Half of U.S. workers are employed by SMEs, making SMEs pivotal to the U.S. economy and its job growth. In this era of globalization, with vast opportunities to expand into international markets, BRIC countries, given their purchasing power potential, are among the most attractive export destinations. With President Obama's directive to double U.S. exports by 2015, and with other world economies seeking to reach the same markets, SMEs must be mobilized to expand their international focus.

Business decision makers have confidence that investment returns will be robust in both China and India. They have moderate confidence in Brazil. But in Russia, investors' confidence is fairly low compared to these three other BRIC countries. The *Perceptions of Confidence Index* addressing FDI indicates an optimistic picture of BRIC nations as international trade partners, especially in Brazil, India and China.

Multiple barriers, both internal and external to the SME organizations, appear to impede SME ability and willingness to risk international expansion of their businesses. One of the major constraints faced by SMEs is the lack of available resources to venture into the overseas market. Therefore, SMEs may be less likely to be proactive in exploring international business opportunities.

However, external barriers are so overwhelming, that SMEs may continue to focus in NAFTA markets. To achieve U.S. export goals, it is imperative that a multi-modal approach be developed to assist SMEs in this endeavor. Most importantly, U.S. Free Trade agreements are an essential component to that end, especially since the U.S. lacks FTAs with the BRIC countries. These agreements may serve as incentives for SMEs to venture out to more diverse international markets.

Within the wide variety of SME industry goods and services sectors, nearly two thirds are in construction, technical, scientific, health, retail and professional services. While SME sectors include such services as entertainment and educational services that may be appropriate for export, further study is needed to better understand the industry sectors that meet the needs of the emerging markets. Other questions for future studies would be to explore the role that education level, gender and ethnicity may have on SME managers' willingness to engage in international trade. If they are already engaged in international trade, would they be willing to expand beyond NAFTA countries? It would be interesting to know if being a first generation American, with networks in the country of origin, would help to expand export opportunities. Would having the knowledge of the country of origin and the networks help to reduce barriers and increase SME exports?

Economic growth projections for BRIC countries remain strong even in the context of the world's current economic crisis. President Obama's goal of doubling U.S. business exports will unlikely be achieved without supporting SMEs so that barriers are reduced to achieve this export goal. Future research is needed to determine strategies in support of SME trade expansion which states in the United States. Three potential areas of future research include a survey of US SME leadership designed to identify internal organizational barriers in the face of international trade; an evaluation of the policies of the States within the U.S. that have been successful in the promotion of SME exports; and finally, a study of US Government support directed towards SME trade since the 2010 announcement of the National Export Initiative.

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