

# Bridging Trade Finance Gaps: State-Led Innovations to Bolster SME Exports

Kati Suominen<sup>1</sup> and Jessica A. Lee

## Summary

Fostering increased levels of exports continues to be an important component of states' economic development strategies. Exports helped bring the United States out of the Great Recession, with particularly rapid growth in certain states and metropolitan areas.

Despite these recent gains, many companies remain reluctant to enter into foreign markets. This is especially true of small and medium-sized enterprises (SMEs), which have long been content to conduct business exclusively within the United States. However, as emerging markets expand and demand for U.S. products and services grows, SMEs would be remiss in continuing to avoid exporting.

Unfortunately, access to capital remains a sizable obstacle for SMEs looking to become exporters. Although the federal government has worked to address export finance challenges, these interventions have proven imperfect solutions, particularly given the growing uncertainty surrounding the future of such efforts. Meanwhile, several other critical challenges have yet to be resolved, including a lack of awareness about existing export finance programs, financial instruments that are poorly designed for SME needs, and the private-sector financing gaps faced by SMEs.

Given these challenges, states interested in bolstering exports have an important role to play in improving SME access to export financing. This brief argues that states can draw on three complementary approaches to address the SME export financing shortfall:

- ▶ Raise awareness among SMEs and financial institutions regarding the various instruments and sources of export financing that are currently available
- ▶ Adopt additional financial instruments to alleviate financial constraints for SMEs interested in global trade
- ▶ Create new finance entities to improve SME access to export financing

“pullquote.”

## I. Introduction

**F**rom 2009 to 2012, exports contributed significantly to the nation's recovery from the effects of the Great Recession.

Altogether, exports accounted for nearly 40 percent of U.S. GDP growth during the initial recovery period, with many states and metropolitan areas experiencing rapid growth. In fact, a number of states—including Minnesota, Washington, and Pennsylvania—saw exports grow at a rate of over 5 percent a year during that time.<sup>2</sup>

That surge did not go unnoticed. With global demand on the rise and nearly 80 percent of the world's purchasing power now beyond U.S. borders, many states—and growing numbers of metropolitan areas throughout the country—are recognizing that international markets offer important opportunities for increased trade, job creation, and sustainable economic growth.<sup>3</sup>

However, despite the sizable benefits that derive from exporting, neither metro areas nor the companies within them are taking full advantage of the opportunities in global trade. At present, only a small fraction—just 4 percent—of U.S. firms export. Small and medium-sized enterprises (SMEs), or firms with fewer than 500 employees, represent 98 percent of all U.S. exporters and 35 percent of U.S. export revenue. However, the majority of these firms export to only one market (typically Canada or Mexico).<sup>4</sup>

The low level of exporting activity in the United States stems in part from the fact that America's large domestic economy has long been sufficient for U.S. SMEs. Now, however, record numbers of U.S. companies are seeking growth through exports, motivated by the need to diversify their markets, offset sluggish growth at home, and cater to the expanding pool of middle-class consumers in emerging markets.<sup>5</sup> Their timing is propitious: American products and services remain highly competitive and desirable in international markets, while macroeconomic trends such as lower energy prices and increasingly competitive labor costs are likely to favor U.S. exporters in the years ahead.

Yet the costs involved with expanding into new markets are hampering this new generation of exporters. Exporting is expensive: International marketing and sales, distribution, order fulfillment, shipping, and trade compliance often involve much greater investments of time and money than does domestic trade. Given these various costs, access to capital is of critical importance to most companies looking to grow through exporting. But for many U.S. firms, securing sufficient financing poses an obstacle to engaging in global trade.

SMEs face particular challenges in accessing capital, given their smaller size, limited assets, and general inability to raise funds through credit markets or publicly traded equity.<sup>6</sup> Given that SMEs tend to have greater volatility in earnings and growth than large companies, they are often seen as riskier investments, and are therefore subject to higher interest rates. Furthermore, it typically takes as much work, if not more, for lenders to assess the creditworthiness of a small borrower compared to a larger one, especially since smaller firms tend to have less financial history and fewer formal financial tracking processes. Meanwhile, new bank regulations are elevating loan processing costs, which make banks, the typical source of financing for exporters, even less inclined to work with SMEs. These challenges are compounded by SMEs' lack of awareness about programs designed to improve access to export financing.

The federal government has worked for decades to bridge these gaps. The U.S. Export-Import Bank (Ex-Im Bank) and the Small Business Administration (SBA) offer a number of instruments for exporters, including loan guarantees for exporter SMEs and, in the case of the Ex-Im Bank, trade credit insurance to guarantee that an SME will be paid for a shipment even if the foreign buyer fails to pay. However, these federal interventions are imperfect solutions. High local content requirements and long processing times discourage many companies from applying for loan guarantees from these agencies. In addition, SMEs' use of the Ex-Im Bank's new Global Express Loan program, which provides export working capital loans up to \$500,000, has been limited due to high upfront fees and restrictive requirements. Meanwhile, the capacities of both the Ex-Im Bank and the SBA are spread thin, with limited staff available to service SMEs. In the case of the Ex-Im Bank, staff are incentivized to focus on large companies rather than SMEs. The Ex-Im Bank is also notoriously politicized in Washington and has faced regular struggles to secure Congressional reauthorization. As such, the federal export finance system is suboptimal for America's emerging generation of exporters.

Fortunately, state governments can help SMEs overcome export-related financing challenges by designing export financing tools that are in line with the fast pace of business and the specific needs of export-driven SMEs. States are also well-positioned to offer more flexible approaches than the federal government. In addition, states can customize their programs to the realities of their regional economies. Each state has distinct industry strengths, export profiles and ambitions, and bank penetration rates, among other factors—for example, compare Texas, with its high level of energy-related exports, with California, which is teeming with small high-tech firms and manufacturers. Unlike federal programs, which typically do not account for sizable state or regional differences, state governments can tailor their interventions to best suit their SMEs, lenders, and export objectives. By taking steps to elevate the profile of existing export finance programs, instituting new financial instruments, and establishing new state-funded export finance entities focused on meeting the needs of smaller exporting firms, states can take action to bolster metropolitan export levels and strengthen their metropolitan economies in the process.

## II. The Challenge

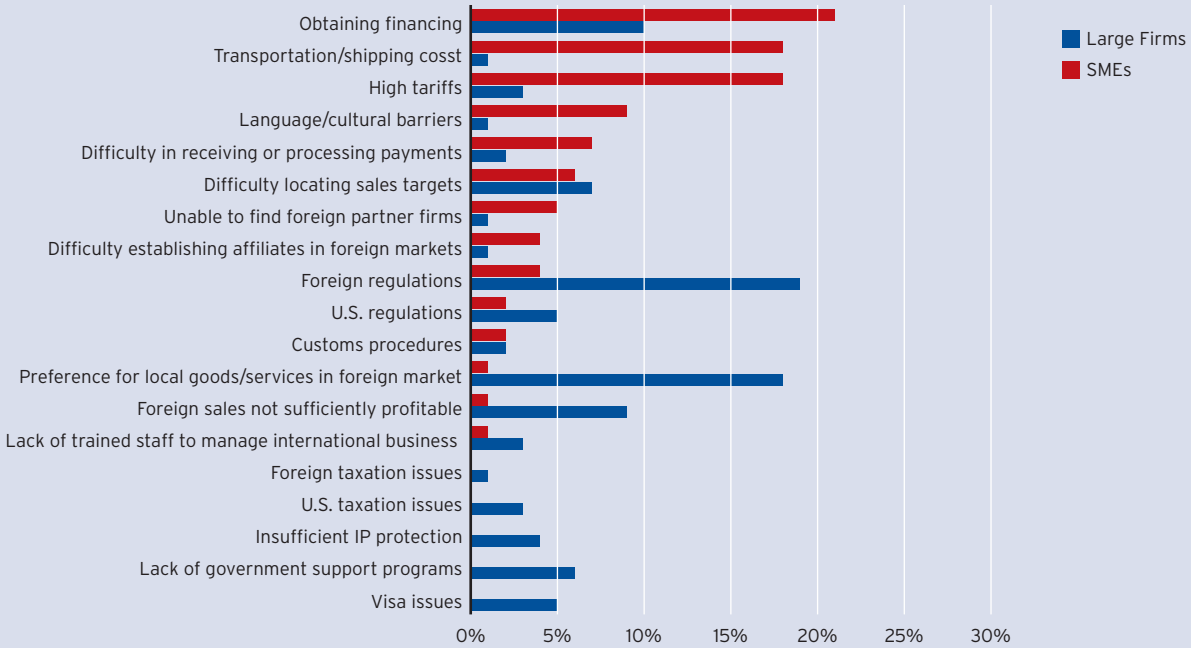
Global trade offers clear opportunities for metropolitan areas looking to strengthen their economies. However, inadequate financing can hamper trade, especially among SMEs, which tend to be more credit-constrained than large companies. In a 2010 U.S. International Trade Commission (U.S. ITC) survey of 2,349 SMEs and 849 large firms, 32 percent of SMEs in manufacturing sectors and 46 percent of SMEs in services sectors responded that obtaining financing was “burdensome” when conducting cross-border trade. By contrast, only 10 percent of large manufacturing firms and 17 percent of large services firms shared the same view.<sup>7</sup> This perceived difficulty in securing financing, combined with the fact that many SMEs fear entering foreign markets, makes SMEs much less likely to pursue an export-oriented growth strategy.

For SMEs looking to start exporting or expand into new markets, lack of access to capital is a critical constraint. Of the 19 impediments to trade offered in the U.S. ITC survey, obtaining financing ranked first among manufacturing SMEs and third among services SMEs (Figures 1 and 2). Typically, exporters in industries that are more dependent on external finance (such as transportation equipment and other durable goods) or those that have few assets that can be used as collateral (such as information technology and professional services) find the struggle to secure financing particularly acute.<sup>8</sup> Recent literature finds that credit-constrained firms are less likely to export.<sup>9</sup>

Export activities create a number of financial demands beyond those involved with selling in the domestic market. Export entry is known to involve high upfront costs stemming from activities such as identifying foreign customers and new export markets, creating distributor networks, and meeting foreign product standards. SMEs that are new to exporting often do not fully appreciate the extent of these fixed costs, which are proportionally much greater for SMEs than they are for large firms. Exporting also requires firms to cover ongoing expenses for shipping, logistics, and trade compliance. Cross-border shipping and delivery usually take 30-90 days longer to complete relative to domestic orders, with each day in transit adding to shipping costs.<sup>10</sup> In addition, exporters need sufficient resources to manage risks such as potential customer non-payment and exchange rate instability—all while having to accommodate foreign buyers, including large foreign original equipment manufacturers (OEMs) that demand payment terms extending beyond the 60- and 90-day norms of the U.S. market.

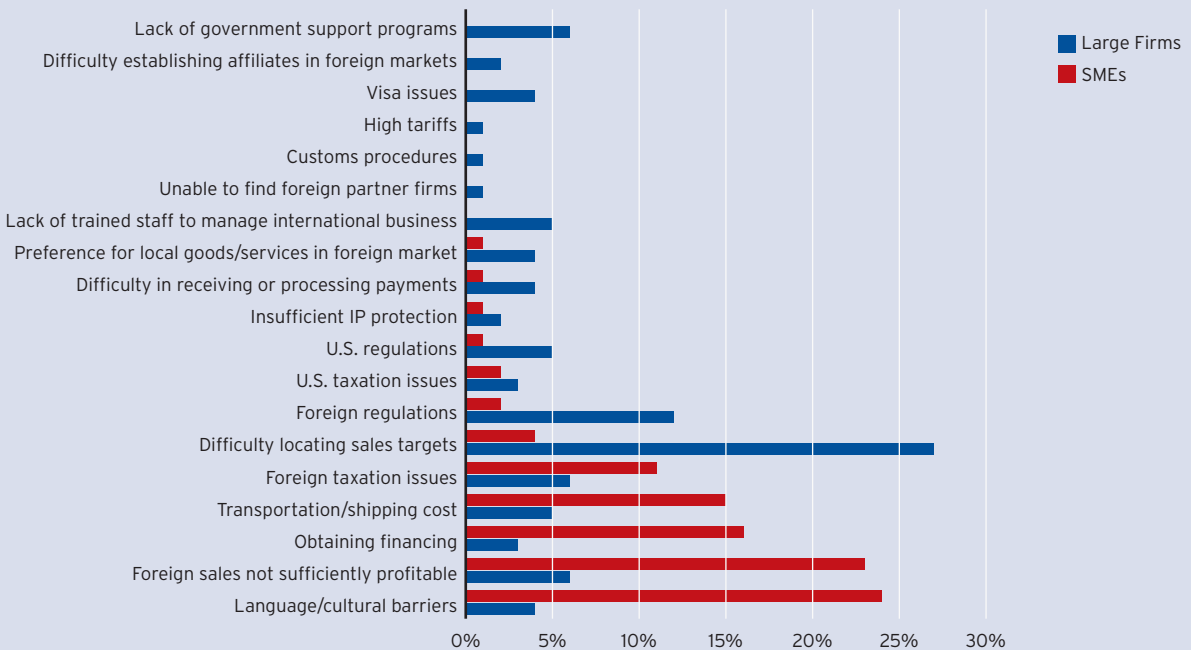
Companies interested in exporting possess unique financial needs and face constraints to securing capital. Larger firms are better able to overcome the challenges related to exporting, as they not only tend to have more extensive pre-existing contacts and distributor relationships, but also have several external financing options at their disposal. SMEs, meanwhile, are more likely to face higher financing costs and often have fewer financial windows available to them.

**Figure 1. U.S. Manufacturing SMEs Cite Obtaining Financing as the Leading Impediment to Engaging in Global Trade**



Source: U.S. International Trade Commission (2010)

**Figure 2. U.S. Services SMEs View Obtaining Financing as the Third Leading Impediment to Engaging in Global Trade**



Source: U.S. International Trade Commission (2010)

SMEs' access to export-related financing is further exacerbated by three key factors:

**First, a lack of awareness of and challenges with existing export finance programs means that few companies take advantage of them.** Both SMEs and their primary sources of financing—regional and national banking institutions—remain relatively unsophisticated in their knowledge of government programs geared toward reducing lender risk and SMEs' cost of capital, such as the export working capital loan guarantees provided by the Ex-Im Bank and the SBA, and the international trade loan guarantees offered by the SBA. In a 2013 survey by the National Small Business Association, 82 percent of small businesses already engaged in exporting reported that their lending institution never discussed Ex-Im products with them, and 22 percent had never even heard of the Ex-Im Bank.<sup>11</sup> Only 12 percent reported using an Ex-Im product to help finance their export activities, and just 5 percent had used Ex-Im financing through a commercial bank. In addition, a mere 3 percent had made use of the SBA's export lending programs.

These findings reflect, in part, the federal agencies' limited capacities to market to SMEs and lenders across the United States. To illustrate the shortfall through a comparison, Export Development Canada (EDC), Canada's export credit agency, has a staff of approximately 1,200 to serve the country's 45,000 exporters, while the Ex-Im Bank has a staff of just 400 to serve nearly 300,000 exporters. Over the past three years, the Ex-Im Bank has not met its target of having small business transactions account for 20 percent of all transactions.<sup>12</sup>

Furthermore, even when SMEs are aware of federal programs, they will generally not seek to use these programs if they view the application process as excessively slow. Content requirements pose an additional burden for SMEs, which are unable to qualify for SBA and Ex-Im Bank programs unless 50 percent of their final product cost is of U.S. origin. This rule has persisted despite the fact that tens of thousands of American SMEs are highly globalized and make liberal use of foreign inputs in producing their export products.

**Second, existing mainstream financial instruments do not fully accommodate the complexities of doing global business or the needs of America's emerging generation of exporters.** Exporters require a range of financial products to meet their respective needs and stage of exporting. While numerous banks offer government-guaranteed working capital loans, additional instruments can be critical for successful exporting:

- ▶ **Equity for exporters.** Both earlier-stage, “born global” companies that internationalize soon after being founded and seasoned exporters in turnaround situations face challenges in meeting banks' underwriting requirements, regardless of how promising their export prospects may be. These firms typically require equity financing, whereby companies raise funds by selling shares, or long-term, higher-interest debt. However, securing equity is time-consuming, and typically only a limited number of companies succeed
- ▶ **Foreign buyer finance.** Emerging-market firms that wish to acquire U.S. products and services often face difficulties in securing credit to finance such purchases, particularly for large-scale projects that require medium- or long-term financing (up to five years and 10 years, respectively). The Ex-Im Bank supports the purchase of U.S. goods and services by creditworthy foreign buyers that are unable to obtain financing through traditional commercial sources. However, these efforts have received mixed reviews, including complaints that some exporters have limited “skin in the game” and thus have little incentive to find reliable foreign buyers
- ▶ **Long-term accounts receivable financing.** The availability of accounts receivable financing for long payment terms is limited, despite the fact that overseas customers of U.S. companies often request long payment terms and pay well after the conventional 90-day time frame. When payment is held up in this way, U.S. exporter cash flow is constrained. In some cases, this problem can be ameliorated through the services of factoring firms—companies that purchase U.S. firms' foreign accounts receivables and take responsibility for securing payment from the foreign firms. This helps U.S. companies maintain the cash flow needed to produce new goods and services and cater to new customers. However, factoring firms do not typically work with companies whose foreign buyers have payment terms longer than 90 days. The inability to accept lengthy payment terms can limit U.S. companies' competitiveness because they cannot match the terms that foreign competitors may be able to offer. Affordable trade credit insurance offered by the Ex-Im Bank and the SBA can help ensure that exporter SMEs are paid for foreign sales with terms up to

180 days in the event that the buyer fails to pay or goes bankrupt, but SMEs are often unaware of this product and would need to meet the 50 percent local content requirement in order to qualify

**Third, a lack of private-sector lending in the SME segment has created a financing gap for firms seeking access to export-related financing.** While some might argue that credit-constrained firms do not merit financing because they may not be able to manage the debt, there are sufficient reasons to believe that even “good” companies poised for substantial export growth lack access to affordable financing. For example, many SME exporters struggle to secure the smaller loans (less than \$500,000) often needed for export-related investments and transactions, such as the fulfillment of ready orders from overseas buyers. Loans of this size have a low payoff for banks due to high transaction and underwriting costs, but can be too large for a typical angel investor. Although the Ex-Im Bank’s Global Credit Express Loan program issues direct loans up to \$500,000, it has thus far had limited success in addressing this challenge.<sup>13</sup>

It can also be difficult for SMEs to secure larger-scale, longer-term financing in the \$1 million to \$10 million range for export-related acquisitions, production capacity expansions, market development activities, and other investments, as banks consider these sums too large relative to the size of the SME. Debt and equity funds can provide supplementary financing (such as long-term subordinated debt and equity financing), but they tend to be highly selective and can be uncomfortable with overseas risk. Meanwhile, federal solutions (like the SBA’s international trade loan guarantees aimed at export-related investments of up to \$5 million) remain wanting due to limited interest on the part of banks and other lenders, possibly due to documentation requirements.

The financing gaps faced by SMEs are expected to deepen as Basel III capital adequacy requirements come into effect in 2015. Because banks will have to hold additional cash in reserve to meet the terms of Basel III, they will have less money to lend compared to pre-crisis levels. These new standards are expected to have a disproportionately negative effect on SME financing opportunities. Two problems can result from this reduction in available credit: credit pricing, where a reduced credit supply leads banks to set a higher price for firms seeking credit; or, worse, credit rationing, where lenders limit the supply of additional credit to borrowers even if the latter are willing to pay higher interest rates.<sup>14</sup>

To help address these gaps, six U.S. trade agencies embarked on a U.S. Global Business Solutions campaign in April 2013, aimed at expanding the base of financial institutions and service providers facilitating exports. Among other goals, this initiative aims to bundle government trade finance products for lenders and exporters, so as to facilitate usage. Although this new effort focuses on many of the right problems, the program will not deliver results for two to three years—and whether it will significantly improve SME access to financing remains unclear. Even when banks are aware of programs to support export financing, they may still be reluctant to issue loans for small export-related transactions, given their diminished appetite for small business loans and their exposure to the non-guaranteed portion of the loan. In addition, SMEs would still need to meet the 50 percent local content rules.

Taken together, these constraints not only limit SMEs’ ability to enter the global marketplace; they also have a negative effect on state and metropolitan economies, which could benefit from increased levels of export activity.

### III. Toward a New State Approach to Export Financing

**G**iven these challenges, states looking to strengthen their economies by bolstering export levels both within and outside their metropolitan areas would benefit from seeking out ways to expand SME access to export financing. Improving the availability of capital for export-related activities would help existing exporters deepen their level of engagement while encouraging currently domestic-focused firms to enter new markets. In time, such efforts could help companies enter a virtuous cycle of export growth, productivity increases, and greater access to credit.

States hold comparative advantages in addressing the financing gaps facing SME exporters. One such advantage is that they can start from a blank slate and circumvent various regulations that have, over the years, constrained federal trade finance programs. For example, states can forego excessive local content requirements, and thus accommodate the tens of thousands of American SMEs that use

a strong portion of foreign inputs in their production of exportable goods. Another inherent advantage for states is the ability to customize export finance support for the particular needs of their respective industries. By stepping up to strengthen SME exporters' access to capital, each state can tailor its interventions to best suit its SME and lender base and export objectives.

Of course, several states are emerging from a highly constrained budget environment and must contend with competing priorities. However, state export financing programs can operate using minimal tax dollars, are able to become self-sustainable over time, and have a high return on investment in the form of increased exports and job creation.

States, in short, are well-placed to offer more flexible approaches to SME export financing. Among the various interventions that states can make to bridge financing gaps, the following three complementary approaches bridge existing gaps in the export finance marketplace. These can be employed individually or in combination, depending on each state's needs:

**First, states can raise awareness among SMEs and financial institutions alike regarding the various instruments and sources of export financing that are currently available.** By making SMEs and banks more fully aware of existing instruments and sources of export-related financing, state governments can work to ensure that firms in their states make the most of current export support programs. Frequent seminars, webinars, and other forms of direct engagement with SMEs and industry associations are critical to reaching SMEs and raising their awareness of financing opportunities for export-related activities. These outreach efforts could also educate SMEs that are new to exporting about the various fixed expenses involved in selling to foreign markets. This additional information would help new SME exporters develop more effective export strategies that account for the full cost of entering new markets. At the same time, educational outreach to local and regional banks and non-bank lenders could help these players better grasp the advantages of government guarantees for trade finance, recognize new opportunities in the SME segment, and learn more about available state and federal loan guarantees and other export finance instruments. One strong example of such an effort is the state of Washington's Export Finance Assistance Center. In addition to acting as a matchmaker between exporters and banks, the Center counsels exporters about mitigating foreign payment risk, securing export finance, and leveraging export finance guarantee programs offered by the Ex-Im Bank and the SBA.<sup>15</sup>

**Second, states can adopt additional financial instruments to alleviate financial constraints for SMEs interested in global trade.** In addition to raising awareness of existing export-finance programs, states could also make available specific financial instruments designed to alleviate the leading financial constraints facing SMEs looking to engage in the global marketplace:

- ▶ States could offer *pre-shipment loan guarantees*, including working capital guarantees for up to 18 months, as well as export-related capacity-expansion capital guarantees for up to 24 months. Numerous banks participate in the Ex-Im Bank and SBA working capital guarantee programs, but both programs require exporters to adhere to excessive local content requirements, among other regulations, and most federal guarantees in terms of export volume are for large firms. States can fill these gaps by making available flexible finance instruments and by accepting applications only from SMEs
- ▶ States could also explore offering *post-shipment accounts receivable guarantees and financing*, so as to enable exporters to extend more flexible and lengthier payment terms (e.g., for 180 days) to foreign buyers and to sell their receivables at a limited discount and fuel their cash flow. These guarantees would complement the Ex-Im Bank's trade credit insurance
- ▶ States can also make available *alternative, long-term debt and equity instruments and royalty-based financing*, particularly for "born global" companies, nascent export efforts, and larger capital raises by exporters. These instruments could also benefit seasoned companies that are viable exporters but have struggled in the aftermath of the financial crisis. For example, states could help by co-investing with local debt and equity funds aimed at helping an SME exporter grow its export markets and domestic production capacity. States could also consider royalty-based financing to enable lenders to peg repayment to companies' exports revenues or total revenues; while probably riskier, such transactions could help firms weather the frequent lumpiness of export revenue streams

One example of alternative financing for exporters is offered by the government of Malta, whose

Malta Enterprises has operated a variety of periodic and permanent export financing programs for both “born global” companies and new export efforts. One program in effect from 2010 to 2013 allowed innovative startups in manufacturing, IT, biotech, and other sectors with international growth potential to access cash grants and loan guarantees for as much as \$250,000 for up to 10 years for various growth and globalization purposes. Malta has also established a royalty financing scheme to support early-stage firms and SME internationalization.

The Equity Program, founded by Export Development Canada (EDC), is another example of alternative financing that accommodates “born global” companies and nascent SMEs that typically struggle to access adequate debt financing from banks for exporting and international expansion, and lack the international market contacts that large companies might possess (see Box 1).

These alternative financing instruments could also support overseas operations of U.S. companies. In the globalized economy, overseas production is an important part of American companies’ competitiveness, especially given that it enables them to be closer to the end customer. Canada’s EDC also supports Canadian companies that invest abroad through the Canadian Direct Investment Abroad (CDIA) program, which offers a wide range of solutions to help Canadian companies obtain financing for their foreign affiliates and subsidiaries and to research foreign markets.<sup>16</sup> The CDIA program was based on an EDC study that found that foreign investments made by Canadian companies complement exports and growth in Canada because they enable Canadian companies to have more sales, lower costs, greater productivity, improved market penetration, and enhanced customer service.

### **Providing Equity for Export-Driven Companies: Export Development Canada’s Equity Program**

Export Development Canada’s Equity Program serves two types of companies that typically have trouble accessing the capital required for internationalization: innovative “born global” companies, and SMEs that want to grow their business through exports. EDC provides growth capital investment to these firms both directly and via co-investments, and connects Canadian companies to international venture capital and equity fund managers. In particular, the program provides equity funding for exporting and international expansion and helps companies develop international relationships that include senior leadership at large global corporate buyers.

The Equity program seeks to bridge the three gaps—in financing, networking, and experience—typically faced by internationalizing firms. It has increasingly been oriented toward venture capital for advanced and clean technologies, middle-market private equity for high-growth companies, and the development of emerging-market investment strategies.

To date, the EDC Equity Program has made sizable investments in Canadian firms looking to expand into foreign markets. For example, in January 2011, EDC provided CAD\$ 3 million of equity investment for Neuralitic Systems, a Montreal-based mobile and wireless company that was expanding in emerging markets. This investment was part of an CAD\$ 8 million Series B round of financing with four other private-sector investors.<sup>17</sup> Likewise, in July 2012, EDC invested CAD\$ 7.5 million in Avrio Ventures Limited Partnership II, a venture capital fund that invests in innovative Canadian food and agricultural companies that provide solutions to global health, wellness, and sustainability challenges.<sup>18</sup>

By the end of 2011, investments over the life of the EDC Equity Program had reached a total of CAD\$ 694 million in commitments, including CAD\$ 320 million in commitments to next-generation exporters; CAD\$ 120 million to middle-market exporters; and CAD\$ 254 million focused on connecting Canadian companies to emerging markets. EDC’s approach is well-suited to meeting the needs of high-growth companies with outstanding export prospects that are too nascent or small for bank financing.

Finland’s export credit agency Finnvera, an entity that helps finance the business operations of Finnish SMEs abroad, offers another potential model. Finnvera’s Internationalization Loan may be used when a Finnish SME’s subsidiary or an affiliated company abroad needs funding for investment, development, or growth. It can also be used to acquire or increase a holding, or to raise the share of capital in a subsidiary or affiliated company abroad. To be eligible for financing, the subsidiary or



affiliate abroad must primarily engage in production, assembly, maintenance, or service; sales offices cannot qualify for this support. Post-investment, the borrower must hold at least 20 percent of the voting rights in the company.

**Third, states can create new finance entities, possibly within existing economic development programs, to improve access to financing for SMEs looking to export.** In some cases, establishing some type of state-level export-import bank backed by the state government may prove most effective. Such interventions are not without precedent. For example, the state of Florida operates the Florida Export Finance Corporation (FEFC), a not-for-profit corporation that guarantees a lender's revolving line of credit up to \$500,000 and makes direct loans for a single transaction up to \$50,000.<sup>19</sup> Applicants for a direct loan or a loan guarantee must be Florida-based exporters who have been turned down by at least one potential lender. The FEFC is also a member of the City/State Partners Initiative of the Ex-Im Bank and the SBA and provides Florida exporters access to export assistance programs offered by these federal institutions. On the West Coast, the California Export Finance Office (CEFO) offered a variety of guarantees for smaller export-related loans from its inception in 1985 until 2003, when state budget problems forced its closure. The instruments provided by CEFO were more flexible overall than those offered by the federal government and were targeted to SMEs in particular (Box 2). Because CEFO was widely viewed as beneficial to California exporters, there have recently been calls in the state to reinstate the office.

### State Institutions to Support SME Exporting: The California Export Finance Office (CEFO)

From 1985 to 2003, California operated a state program called the California Export Development Office (CEFO), which assisted California-based SME exporters with loan guarantees. Initially funded with a mere \$2 million from the state's general fund, the program consistently performed well and grew to \$10 million before succumbing to budget cuts in 2003.

CEFO offered both pre-shipment working capital guarantees at more flexible terms than those offered by the Ex-Im Bank, and post-shipment account receivable guarantees that covered post-shipment risks pertaining to exporter performance not normally covered by the Ex-Im Bank or private insurers.

CEFO also issued combination guarantees when pre-shipment financing was required but the nature of the transaction included post-shipment exposure. CEFO's guarantees covered 90 percent of an export loan. The transactions were tailored for small companies: The maximum guarantee was \$750,000 (and thus the maximum loan was \$833,000). Guarantees supported short-term (up to 18 months), transaction-specific working capital loans; single or multiple transactions; and cash loans or the issuance of standby letters of credit. In addition, CEFO also helped raise awareness among new-to-exporting SMEs about the additional expenses involved in foreign trade so that the firms could plan accordingly.

CEFO was widely seen as successful in working with lenders and serving exporters, and the program was solvent. In recent years, there have been calls to revive it in order to support the many California metropolitan areas seeking growth through SME exports.

In developing plans for such institutions, states should apply five key principles:

- ▶ States should make sure that any new programming carries *an explicit and exclusive focus on SMEs*. It is SMEs (rather than large companies) that face an export financing gap—and also typically represent the backbone of state and metropolitan economies
- ▶ New institutions will also need rigorous *marketing and outreach efforts* to ensure that the companies they seek to serve know about the new services offered and the ways in which to best pursue them. Building relationships and educating SMEs, lenders, and investors about the instruments, processes, and policies of the new institution will require investment in marketing teams, a strong and effective web presence, social media campaigns, and other forms of outreach
- ▶ Any new state-led export financing institution will also need to prioritize *user-friendliness*. SMEs consider the relatively slow pace of processing by federal export programs particularly onerous.<sup>20</sup>

Global business moves fast and U.S. exporters need prompt access to financing in order to keep pace with foreign competitors. Delays come at a cost, and lack of responsiveness can deter SMEs from seeking financing altogether. As such, state institutions should place a high premium on offering a prompt and transparent underwriting process

- ▶ State institutions must be *flexible*, recognizing that the export operations and constraints of each firm will differ depending on their industry, market focus, and familiarity with global trade. In the eyes of SMEs, successful exporting is not just about financing a set of transactions; rather, it involves developing and deepening relationships in foreign markets and building a holistic set of export capabilities and production capacities, all of which require resources. Officers at state export financing institutions should be rewarded for devising creative solutions to SMEs' distinctive challenges, and the institutions themselves should maintain flexibility in order to more closely align efforts with market needs. An approach modeled on Malta's decision to offer distinct, innovative products for limited periods of time could be a way to test the uptake and viability of various financial products among SMEs
- ▶ State export finance institutions must *design policies and processes that suit America's globalized small businesses*. While it might be tempting to favor businesses that are able to source most raw materials and inputs domestically, such a policy proves self-defeating in a world where some of the most successful American exporters are also voracious importers that compete precisely because they can access quality inputs at competitive prices from world markets

In sum, states can take a number of actions to bridge export financing gaps, complement existing federal programs, and encourage greater numbers of SMEs to engage in the global marketplace. States can also tailor approaches to best serve their respective SME bases. In time, greater engagement and experimentation by state governments can begin to surface new models and best practices in export-related finance that could be adopted more widely by other states—and propel a healthy race to the top among state and federal programs that finance export activities.

#### IV. Conclusion

**F**or America's small businesses, exporting is a high-yield growth strategy like few others: It steadies cash flows, expands sales, and bolsters productivity. As such, exporting also boosts economic growth and job creation among firms that are the source of employment for millions of Americans.

However, SMEs that seek to export face several challenges, including reluctance by banks to underwrite small loans; lack of awareness by SMEs and banks of export-related government guarantees and credit enhancements; and gaps in the range of instruments critical to supporting America's diverse export base, including companies that source components from abroad and "born global" companies with superior export prospects.

State governments are uniquely positioned to bridge the financing gaps facing SME exporters because they have a front-row seat to the issues and challenges specific to their SME and lender bases. By developing innovative solutions to the specific problems that current and potential SME exporters face in their states, state governments can foster greater global engagement and strengthen economic growth in their metropolitan areas, to the benefit of their states and the U.S. economy as a whole.

## Endnotes

1. Kati Suominen is founder and CEO of TradeUp Capital Fund, a new equity crowdfunding platform for globalizing companies, and of Nextrade Group, LLC, a consulting firm on leading-edge issues in trade. She is also Adjunct Fellow at the Center for Strategic and International Studies (CSIS), and Adjunct Professor at the UCLA Anderson School of Management.
2. Brad McDearman, Ryan Donahue, and Nick Marchio, "Export Nation 2013: U.S. Growth Post-Recession" (Washington: Brookings Institution, 2013), 3-4. State export profiles available at [www.brookings.edu/~media/Multimedia/Interactives/2013/ExportNation/data/profiles/State%20Profiles.zip](http://www.brookings.edu/~media/Multimedia/Interactives/2013/ExportNation/data/profiles/State%20Profiles.zip) (June 12, 2014).
3. U.S. Commercial Service, "Exporting is Good for Your Bottom Line" (Washington: International Trade Administration, 2008).
4. Kati Suominen, "U.S. SME Exporters as a New Asset Class" (Los Angeles: TradeUp Capital Fund, 2014), available at [www.tradeupfund.com/white-papers.html](http://www.tradeupfund.com/white-papers.html) (June 12, 2014). Fifty-nine percent of SME exporters engage with only one foreign market.
5. See summary in Suominen, "U.S. SME Exporters as a New Asset Class."
6. Joe Peek, "The Impact of Credit Availability on Small Business Exporters" (Washington: Small Business Administration Office of Advocacy, 2013).
7. U.S. International Trade Commission, "Small and Medium-Sized Enterprises: Characteristics and Performance," Investigation No. 332-510, Publication 4189 (2012), available at [www.usitc.gov/publications/332/pub4189.pdf](http://www.usitc.gov/publications/332/pub4189.pdf) (November 18, 2013). These findings are echoed by the 2012 GE Capital and Ohio State University survey of SMEs with \$10 million to \$1 billion in revenue. Although this survey did not specifically ask firms about financing for cross-border trade, it did find that 55 percent of SMEs reported a lack of adequate access to capital. See Fisher College of Business, Ohio State University, and GE Capital, "The Market That Moves America: Insights, Perspectives, and Opportunities from Middle Market Companies" (2011), available at [www.middlemarketcenter.org/middle-market-insights-perspectives-opportunities](http://www.middlemarketcenter.org/middle-market-insights-perspectives-opportunities) (November 18, 2013).
8. Jean-Charles Bricongne, Lionel Fontagné, Guillaume Gaulier, Daria Taglioni, and Vincent Vicard, "Firms and the Global Crisis: French Exports in the Turmoil" (Paris: Banque de France, 2009).
9. See, for example, Flora Bellone, Patrick Mussoy, Lionel Nestaz, and Stefano Schiavox, "Financial Constraints and Firm Export Behaviour," *The World Economy* 33 (3) (2010): 347-373; and Joachim Wagner, "Credit Constraints and Exports: Evidence for German Manufacturing Enterprises." Working Paper Series in Economics and Institutions of Innovation 286 (Royal Institute of Technology, CESIS - Centre of Excellence for Science and Innovation Studies, 2012). Granted, although financing can pose a sizable problem, it is not the only challenge facing SME exporters. Many U.S. SMEs are still new to exporting and tend to require several export-related services—identification of markets and customers, go-to-market and export management services, distribution, freight forwarding, trade law assistance, and so on—that are highly fragmented. While cities, states, and federal government agencies all aim to help companies export, SMEs often lack awareness of existing programs and their comparative advantages.
10. Kalina Manovay, "Credit Constraints, Heterogeneous Firms, and International Trade," *The Review of Economic Studies* 80 (2013): 711-744.
11. National Small Business Association and Small Business Exporters Association, "2013 Small Business Exporting Survey," available at [www.nsba.biz/wp-content/uploads/2013/06/Exporting-Survey-2013.pdf](http://www.nsba.biz/wp-content/uploads/2013/06/Exporting-Survey-2013.pdf) (October 16, 2013).
12. In 2013, the Ex-Im Bank authorized a record 3,413 small business transactions supporting \$5.2 billion in small business loans, of which 54 percent went toward export credit insurance and 35 percent went toward working capital loan guarantees. See summary in Suominen, "U.S. SME Exporters as a New Asset Class."
13. For more on the credit constraints facing small businesses, see Karen Gordon Mills and Brayden McCarthy, "The State of Small Business Lending: Credit Access During the Recovery and How Technology May Change the Game," Working Paper 15-004 (Cambridge: Harvard Business School, 2014).
14. Basel III requires banks to hold 4.5 percent of common equity and 6 percent of Tier I Capital by 2015 (up from current standards of 2 percent and 4 percent, respectively), as well as an optional buffer. Association of

Chartered Certified Accountants, "Framing the Debate: Basel III and SMEs" (London: 2011). According to the United Kingdom's Independent Commission on Banking, smaller banks, which lack the internal databases to produce risk management models, will have to hold three to seven times as much capital as larger banks in order to service SME loans. Joe Peek, "The Impact of Credit Availability on Small Business Exporters."

15. Export Finance Assistance Center of Washington, available at [www.efacw.org](http://www.efacw.org) (November 18, 2013).
16. Export Development Canada, available at [www.edc.ca/EN/Pages/default.aspx](http://www.edc.ca/EN/Pages/default.aspx) (November 20, 2013).
17. Export Development Canada, "EDC Equity Program Makes CAD 3 Million Investment in Montreal's Neuralitic Systems," January 31, 2011, available at [www.newswire.ca/en/story/773833/edc-equity-program-makes-cad-3-million-investment-in-montreal-s-neuralitic-systems](http://www.newswire.ca/en/story/773833/edc-equity-program-makes-cad-3-million-investment-in-montreal-s-neuralitic-systems) (June 12, 2014).
18. Export Development Canada, "EDC Commits CAD 7.5 M to Venture Capital Fund for Canadian Food and Agricultural Companies," July 26, 2012, available at [www.edc.ca/EN/About-Us/News-Room/News-Releases/Pages/avrio.aspx](http://www.edc.ca/EN/About-Us/News-Room/News-Releases/Pages/avrio.aspx) (June 12, 2014).
19. For further detail, see Florida Export Finance Corporation, "Export Finance Assistance for Florida Companies," available at [www.dos.state.fl.us/efec/summary.htm](http://www.dos.state.fl.us/efec/summary.htm) (November 18, 2013).
20. Export-Import Bank of the United States, "Customer Experience Survey Report" (2012), available at [www.exim.gov/oig/upload/Official-Final-Customer-Survey-Report-120928-20Summary-1.pdf](http://www.exim.gov/oig/upload/Official-Final-Customer-Survey-Report-120928-20Summary-1.pdf) (November 18, 2013).

## For More Information

Kati Suominen

xxx

Metropolitan Policy Program at Brookings

xxx

Jessica A. Lee

xxx

Metropolitan Policy Program at Brookings

xxx

## For General Information

Metropolitan Policy Program at Brookings

202.797.6139

[www.brookings.edu/metro](http://www.brookings.edu/metro)

1775 Massachusetts Avenue NW

Washington D.C. 20036-2188

telephone 202.797.6139

fax 202.797.2965

## In The Series

- *Delivering the Next Economy: The State Step Up*
- *Job Creation on a Budget: How Regional Industry Clusters Can Add Jobs, Bolster Entrepreneurship, and Spark Innovation*
- *Boosting Exports, Delivering Jobs and Economic Growth*
- *Revitalizing Manufacturing with State-Supported Manufacturing Centers*
- *State Transportation Reform: Cut to Invest in Transportation to Deliver the Next Economy*
- *Recapturing Land for Economic and Fiscal Growth*
- *Community Colleges and Regional Recovery: Strategies for State Action*
- *Moving Forward on Public Private Partnerships: U.S. and International Experience with PPP Units*
- *Leveraging State Clean Energy Funds for Economic Development*
- *State Clean Energy Finance Banks: New Investment Facilities for Clean Energy Development*

## Acknowledgements

xxx

*The Brookings Institution is a private non-profit organization. Its mission is to conduct high quality, independent research and, based on that research, to provide innovative, practical recommendations for policymakers and the public. The conclusions and recommendations of any Brookings publication are solely those of its author(s), and do not reflect the views of the Institution, its management, or its other scholars.*

*Brookings recognizes that the value it provides to any supporter is in its absolute commitment to quality, independence and impact. Activities supported by its donors reflect this commitment.*

## About the Brookings-Rockefeller Project on State and Metropolitan Innovation

This brief is part of a series of papers being produced by the Brookings-Rockefeller Project on State and Metropolitan Innovation. States and metropolitan areas will be the hubs of policy innovation in the United States, and the places that lay the groundwork for the next economy. The project will present fiscally responsible ideas state leaders can use to create an economy that is driven by exports, powered by low carbon, fueled by innovation, rich with opportunity and led by metropolitan areas.

## About the Metropolitan Policy Program at the Brookings Institution

Created in 1996, the Brookings Institution's Metropolitan Policy Program provides decision makers with cutting-edge research and policy ideas for improving the health and prosperity of cities and metropolitan areas including their component cities, suburbs, and rural areas. To learn more visit: [www.brookings.edu/metro](http://www.brookings.edu/metro).

## About The Rockefeller Foundation

The Rockefeller Foundation fosters innovative solutions to many of the world's most pressing challenges, affirming its mission, since 1913, to "promote the well-being" of humanity. Today, the Foundation works to ensure that more people can tap into the benefits of globalization while strengthening resilience to its risks. For more information, please visit [www.rockefellerfoundation.org](http://www.rockefellerfoundation.org).