Chart 5

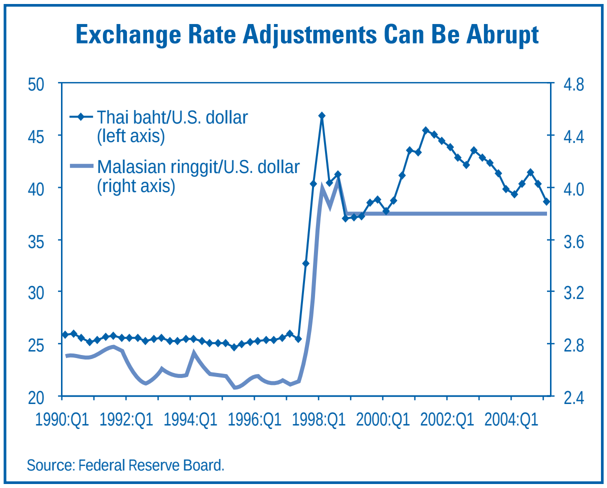
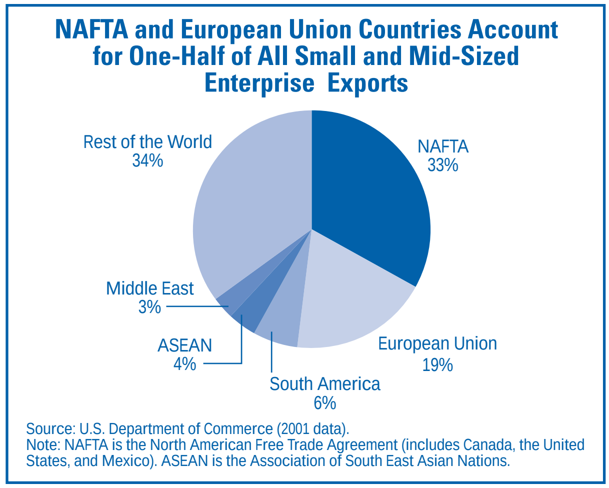


Chart 6



value of their currencies fell abruptly. Although this drop proved beneficial to U.S. importers doing business with these countries, it was significantly detrimental to U.S. exporters, as the local cost of their goods and services rose dramatically (see Chart 5). In other examples, crises related to international capital markets (such as Mexico in 1994, Russia in 1998, and Argentina in 1998 and 2000) triggered turmoil in currency markets and, in some cases, limited the ability of businesses to move funds across borders.

Shifts in currency exchange rates need not occur abruptly to affect SME exporters and their lenders, and the shifts need not always have ill effects. For example, between first quarter 2002 and first quarter 2005 the euro appreciated relative to the U.S. dollar by almost 49 percent. This decline in the value of the U.S. dollar relative to the euro had the effect of enhancing the competitive position of U.S. firms that export to the European market. In 2001, nearly 20 percent of SME exports were sold to European Union nations (see Chart 6). And American small businesses making items ranging from forklifts to computer security hardware to toothpaste are reporting gains in overseas sales in response to the declining dollar.[19]

Offshore-Outsourcing Risk. Often, domestic firms may opt to purchase goods and services from a cheaper foreign source, whether actively engaged in international trade or not. This practice is referred to as "offshoring," or "offshore outsourcing." Offshoring can be motivated by shifts in exchange rates that might make certain inputs more costly to acquire in one country than another. Generally, the more dependent a business is on foreign relationships—including U.S. firms that have set up production operations overseas, those that obtain a majority of their inputs from abroad, and those that sell the bulk of their outputs abroad—the more significant the potential impact from international trade and transactions on the firm's risk profile. In ***Industrial Distribution***'s 58th Annual Survey of Distributor Operations, manufacturers ranked "moving offshore" fifth as a concern, behind "economic conditions," "price competition," "customers going out of business," and "increased operating costs."[20]

Import Competition Risk. Finally, community lenders may be exposed to internationally driven credit risk even when lending to SMEs that do not engage in global trade. With today's trend toward globalization, the reality is that firms that produce and sell only within U.S. borders are not immune to what is happening in the rest of the world. Shifts in the U.S. dollar against other currencies and other economic factors overseas, such as productivity and wage–cost differentials, may significantly affect the competitiveness of domestically oriented SMEs. Several industries in the Southeast—including the apparel, furniture, and cotton industries—are feeling the effects of cheaper imports that are available in the United States. Such import competition can harm sales, profits, and the ability of some SMEs to service existing commercial credit lines.

[19] Mark A. Stein, "Export Opportunities Aren't Just for the Big Guy," *New York Times*, March 24, 2005.

[20] Victoria Fraza Kickham, "Making Inroads Overseas," *Industrial Distribution,* March 2005.