

The Canadian Dollar

How Canadian businesses are adapting to a strong Canadian dollar

The Canadian dollar has strengthened over the last few years, posing major challenges to Canadian companies. A survey conducted with The EDC Online Research Panel, helped EDC gain insights into how Canadian exporters are adapting to a strong Canadian dollar. A total of 424 respondents completed the ten-question survey, held from August 4 to August 25, 2010.

Results of this survey showed that the strong Canadian dollar continues to be a primary concern for most exporters. Some firms are more exposed to risk than others from a strong dollar, and thus there are varying implications for their costs, competitiveness, sales, profits or growth. Canadian exporters have been resilient, taking measures at all levels to adapt to a strong dollar and to remain competitive.

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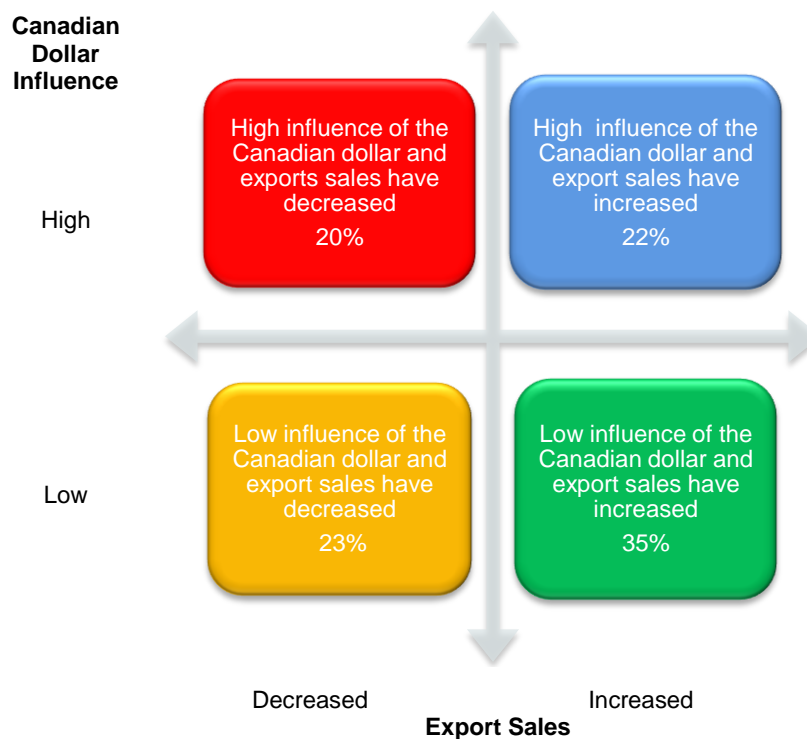
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Influence of a strong Canadian dollar on export sales

The strong Canadian dollar has had a broad and dominant effect on export sales. Forty-two percent of respondents said the influence of the strong Canadian dollar was very or extremely influential, 37 percent said it was low or moderate, and 21 percent said it did not have any effect. In terms of export activity, 43 percent of respondents said their export sales have decreased over the last five years, while 57 percent believed that their export sales have increased.

The strength of the dollar affects trade-engaged businesses to different degrees, even for companies within the same industry. Affects depend on a variety of factors and economic conditions. Survey participants were asked whether their sales had increased or decreased in the last five years, and were also asked if a stronger Canadian dollar had influenced their export sales. To better understand the influence of the strong Canadian dollar on export sales, responses were sorted into four categories (table 1).

Table 1: Influence of the strong Canadian Dollar on companies' export activities



1) High influence of strong Canadian dollar and a decrease in export sales

Most firms in this category are facing stagnant or less demand for their products. They are forced to absorb the appreciation of the Canadian dollar by reducing profits, cutting costs, downsizing or looking at market diversification with strong emphasis in the domestic market (i.e., Canada). They face strong competition and their sales are very price-sensitive. Therefore, they are put in a difficult position where they must increase

prices and possibly create a competitive disadvantage for themselves. Consequently, some firms are facing a high risk to go out of business.

Some firms are facing another challenge with contracts paid in local currency, and thus the exchange rate has heavily affected their revenue in Canadian dollars.

This category includes firms of all business sizes, but the proportion of small businesses is higher compared to medium- and large-sized companies. Of the small firms responding to the survey, 26 percent fall into this category, while 15 percent are medium-sized and 10 percent are large.

2) High influence of strong Canadian dollar and an increase in export sales

Export sales for firms in the second category are growing because their products tend to be in high demand. In some cases, firms have unique products or products with distinct competitive advantages, making sales of these products less price-sensitive. To deal with the strong dollar, some firms are increasing prices, passing the dollar impact on to customers with the risk that they may become less competitive. In most cases, firms have prices more sensitive to demand. They have kept their prices the same, but at the expense of reduced margins, making them less profitable and limiting their capacity for growth. The strong Canadian dollar has had a direct and negative impact on their business operations.

Some firms are pursuing market diversification to compensate for reduced margins. Others have been more aggressive and innovative with their pricing structures, allowing them to obtain more business but at reduced margins and a lower ability to take on new markets or pursue new business. Medium-sized businesses are predominant on this category at 32 percent, followed by large companies with 27 percent and small companies at 16 percent.

3) Low influence of a strong dollar and export sales have decreased

For most companies in this category, export sales have decreased because of a reduction or lack of demand for their products due to difficult economic conditions. This is especially true for exporters in the construction or housing sectors. At the same time, the influence of the dollar on their operations is low because they have natural hedging and products or services that are paid in foreign currency. Thus the strong dollar has little impact on their revenues, but they can still experience a negative effect on their margins when converting foreign currency in Canadian dollars.

On the other hand, there are some firms whose domestic operations are benefiting from the strong dollar, given the high component of inputs purchased in foreign currency. These companies have increased their imports and made themselves more competitive in Canada. They are also pursuing more opportunities at home to counteract the revenue loss on exports. There is a pronounced participation of small firms—29 percent—in this category, with medium and large firms weighing in a 15 percent apiece.

4) Low influence of a strong dollar and exports sales have increased

For most firms in this category, products are less price-sensitive. These firms face little competition, are in niche markets or offer unique products, have a strong brand, or have high added value. They also, in many cases, are paid in foreign currency for their products, so they have a natural hedge, resulting in low or moderate impact from the strong dollar on their export sales.

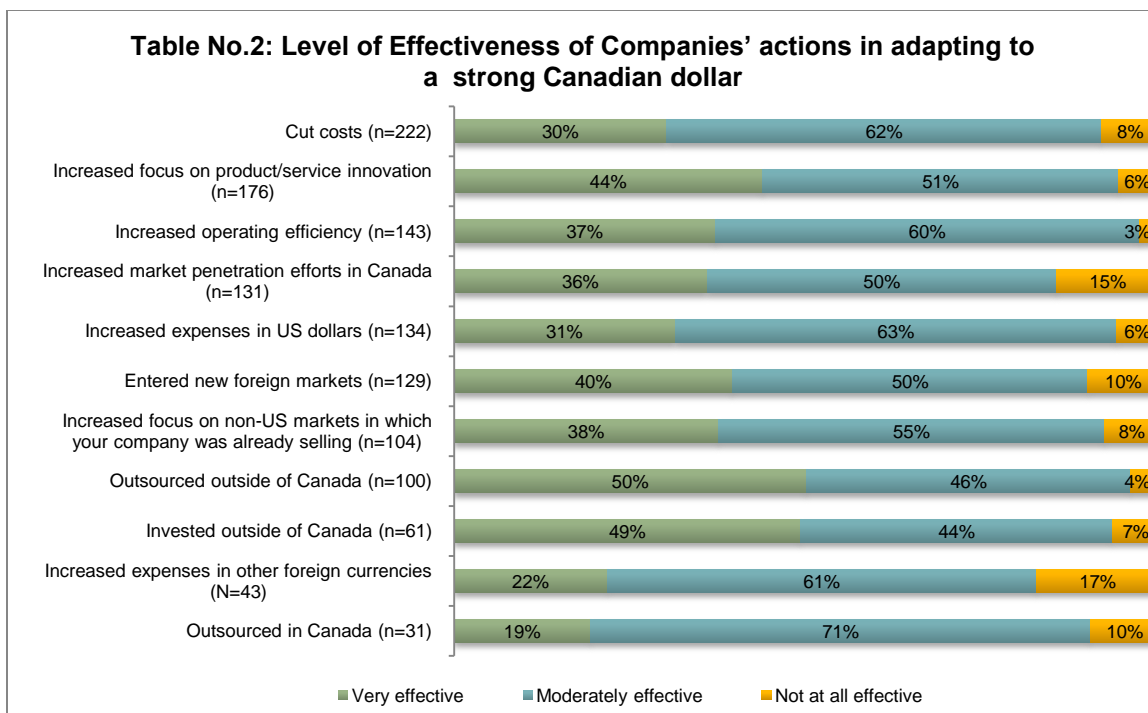
The companies in category four are in a good position for continuing growth given the moderate effect of the strong dollar and the measures many have already taken to adapt. Market penetration and diversification play a major role for firms in this category. They are exploring and expanding to other markets. Large companies are predominant in this category with 47 percent of respondents, while 32 percent of all medium companies and 16 percent are small firms fall into this category.

Companies' actions to adapt to a strong dollar and their success

Firms have taken a variety of actions to counteract the appreciation of the dollar. They have cut costs, increased efficiencies, found new ways to operate their business, and looked for new products and markets. The most aggressive actions are focused on operation activities (costs, efficiency, R&D), followed by market diversification and using financial instruments.

The three main actions cited are: cutting costs, increasing innovation, and improving operating efficiencies. Some 54 percent of respondents have attempted to cut expenses, which is a natural reaction to adjust to cost variations and to keep or increase efficiencies; as profit margins go down, cost-cutting goes up. At the same time, 43 percent say they are focusing on product /service innovation, while 34 percent is working to improve operating efficiencies.

Respondents were asked to rate the effectiveness of the actions they've taken. Interestingly, while cost-cutting is the most popular measure taken, it is not deemed to be the most effective: only a third of respondents thought cost-cutting was "very effective", while outsourcing outside of Canada and investing outside of Canada were considered very effective by half of respondents. Focusing on innovation was considered to be the third-most effective measure, with 44 percent considering it to be very effective. Some actions that were implemented less often were considered more effective for Canadian exporters. For instance, foreign investments, outsourcing, product innovation and market expansion have been the most effective actions to adapt to the strong Canadian dollar (Table 2).



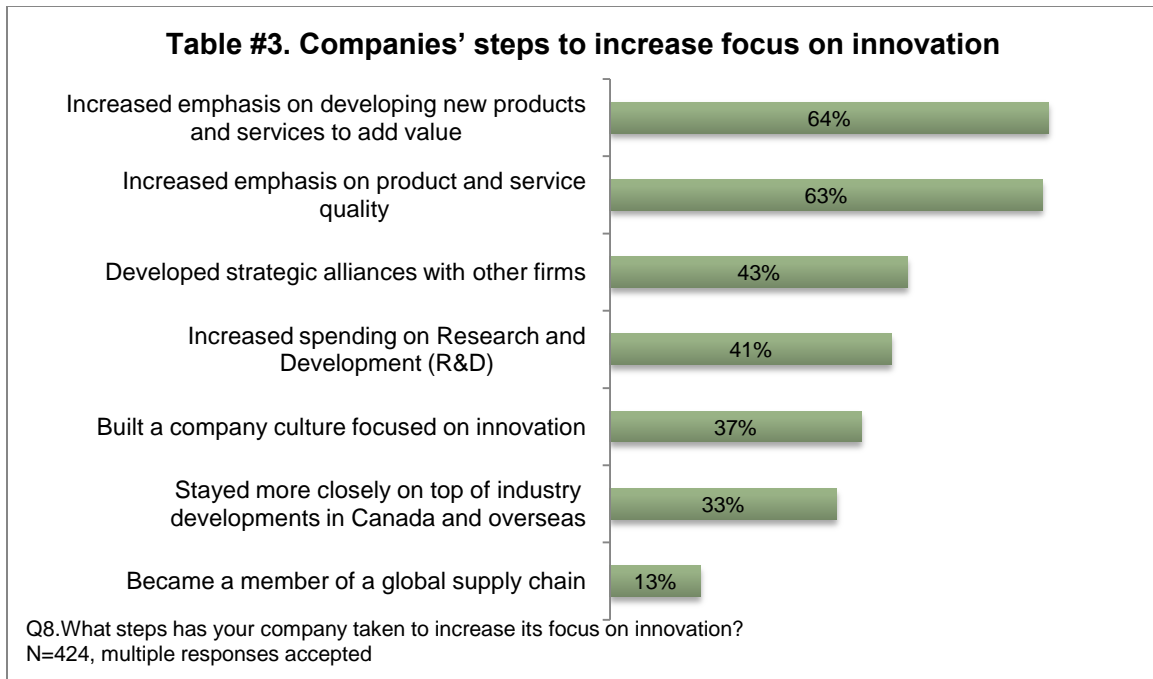
Some survey respondents included written comments that the strong Canadian dollar has, in fact, been an incentive for them to break into new markets and has actually helped them to grow and strengthen their business. They believe that expanding their focus from one market to other markets will put them in a stronger position due to the diversification of their export sales. Some have also found that the strong dollar has helped them rethink global supply chains as a solution to remain competitive. They were not only encouraged to diversify to new markets, but to also invest in foreign markets for their supply chains, labour and manufacturing requirements.

Steps taken towards innovation and challenges

New product offerings and increased product quality are the two principal steps companies have taken to increase innovation. Development of alliances and research and development (R&D) create the second set of actions in innovation. Increased emphasis on new products and improving product quality are being applied across all business sizes, sectors and regions, while lack of money, time and resources are the principal challenges on the innovation front. Small companies mentioned a lack of cash flow more than any other segment.

As mentioned, while the strong dollar has made some Canadian exports less competitive in terms of price, many companies have used the loss of this price advantage as a catalyst to become more competitive in other areas, such as quality, innovation (including research & development), customer service, supply chain efficiencies and company structuring.

For many firms, innovation is tied to differentiation through new products, quality and service in an effort to be less dependent on prices and face less competition. The value proposition is to focus on efficiencies as well as innovation and technology, so that customers are considering solutions first and price second.



Since reduced margins affected firms' ability to fund new innovation they became more efficient and cut costs were possible to maintain a sufficient level of cash flow to fund new technology and products. Consequently, they see lack of cash flow and financing for R&D as main challenges to innovate.

Panel members' recommendations for dealing with currency fluctuations and a strong Canadian dollar

Valuable lessons learned: Learning from our respondents' experience

Based on their experience, survey respondents have much advice to offer Canadian exporters who are struggling with currency fluctuations and the strong dollar. Written comments from survey respondents show that Canadian exporters are executing a number of strategies to deal with the dollar, and these can be grouped into five general categories.

Five Strategies to Deal with Currency Fluctuations and the Strong Dollar

1. Lie low or go with the flow

Some exporters commented that they're hunkering down until calmer or lower currency rates arrive. Activities involved slowing down their export business to concentrate on the domestic market, or waiting for the dollar's value to decrease or stabilize and just trying to manage to stay afloat in the meantime.

2. Diversify markets in the U.S. and beyond

Seeing a silver lining, several survey respondents said that the strong Canadian dollar has been an incentive for them to break into new markets and has actually helped them to grow and strengthen their business.

In fact, responses showed companies were not only encouraged to diversify their markets for sales, but also to invest in foreign markets for their supply chains, labour and manufacturing requirements.

"(We are) trying to manage in the prevailing scenario, which sometimes translates into taking losses. "

-EDC Research Panel Member

"It has caused a 30% drop in revenues on contracts signed prior to 2003 because we did not have the financial capacity to hedge on the currency."

-EDC Research Panel Member

"Unfortunately, increasing our prices significantly in response to the stronger Canadian dollar would place us at a competitive disadvantage."

-EDC Research Panel Member

"Our focus has certainly turned from a mainly U.S. market focus to one of emerging markets. There is a good argument that the rising CDN dollar may have in fact been an excellent catalyst to get diversified outside of the U.S. market."

-EDC Research Panel Member

“...I have a premium gourmet food product line, and (there is) less price sensitivity to this type of product than perhaps other consumer goods.”

“(We are) adapting our product to suit different needs of customers.”

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“It has made our product more expensive but due to (our) niche market... it has not hurt us badly.”

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“It has forced our company to focus on providing our customers with solutions as opposed to providing just a product. We cannot compete based on price. Margins would be too low trying to compete with offshore product at very low prices. Quality and customer service becomes a focal point, something you promote.”

-EDC Research Panel Member

“...(our price) competitiveness was not affected; reduced margins however affected our ability to fund new innovation as in the past, so we had to become more efficient and cut costs were possible to maintain a level of cash flow sufficient to fund new technology and products.”

-EDC Research Panel Member

3. Re-consider your company focus

Several insightful comments illustrated that the strong dollar didn't just compel some companies to take on certain offensive or defensive tactics, but to rethink the entire way that they do business. Most of these comments indicated that when they could no longer compete on price, then quality, customer service and innovation became their company's focal points.

In other instances, even when price competitiveness was not affected, lower profit margins due to currency valuations meant there was less money for such activities as research & development, encouraging companies to become more lean, green and efficient to meet their objectives.

4. Be unique or get niche

Providing some evidence for the previous point, a few companies said they were better able to weather the storm of currency fluctuations and a strong dollar due to their reputations, or because their product line was considered to very high-end, very high-quality, or they had a unique product that appealed to a niche market. As a result, customers were willing to pay the higher price to get the premium product that they wanted—and these companies didn't feel the pinch of being less price-competitive.

5. Deal in American dollars or other currencies

Many survey respondents suggested that pricing or paying suppliers in American dollars or other currencies can help stabilize and mitigate the risks of fluctuating currencies and a strong Canadian dollar. However, while this tactic helped them to better mitigate fluctuations and maintain cost competitiveness, the biggest drawback was that it could eat into their profit margins, leaving them with less money available for other activities or growth initiatives.

A similar strategy was to price export products on a par with American currency rates. Another was to “lock in” currency rates by purchasing forward or foreign exchange contracts as a hedging strategy.

Other Recommendations from our Panelists:

Canadian exporters pack creativity into competitiveness. Having dealt with the challenges, our Panelists had several other recommendations to share. While most written recommendations fell into the five general categories above, here’s a round-up of some other creative and helpful suggestions:

- “Add at least a 3% margin for currency fluctuation.”
- “Explored social media, considered more collaborative, open-source approaches.”
- “Looking at new technologies in process”
- “(We are) no longer selling our own product, have hired third-party sales agents”
- “... We have upgraded all our software to the latest in quality standards and are known to be the place where the best quality does win...however not all customers are that concerned and price dominates.”
- “Hire professionals who are experts at managing currency risk. Be aware of the difference between one who takes orders and conducts trades compared to one who analyzes not only the market but your specific business.”

“(The strong dollar has not affected us) very much. Our company is very unique and we just have to stay innovative...Keeping our reputation as good value for the dollar has made the biggest differences.”
-EDC Research Panel Member

“We price in USD, GBP and EUR, so sales have not been affected. However, our investment in marketing, which generates future sales, has decreased due to lower profitability. Although we are growing fast, we could be growing faster.”
-EDC Research Panel Member

“Keeping our prices almost at par with the U.S. dollar has been the safest way to keep up with the changing dollar. Showing really good value for your products is a must.”
-EDC Research Panel Member

EDC can help

EDC has prepared several documents on the management of foreign exchange, including a white paper with recommendations for Canadian companies to adapt to a strong dollar and how EDC can help ([link](#)).

http://www.edc.ca/english/publications_country_information.htm

http://www.edc.ca/french/publications_country_information.htm

Conclusion

Canadian exporters have implemented bold and hard measures to adapt to a strong dollar, expecting to be in better position and to remain competitive. Still, they are facing major challenges. Different sources agree that the Canadian dollar is overpriced, but still a Canadian dollar of less than 80 cents is long gone. Respondents were vocal in their advice to not rely on a weak dollar to promote exports, or make business profits. Instead, they are focusing on cutting costs, increasing operating efficiencies, and innovation--effective and necessary measures to remain competitive. Respondents also cited forward-looking and effective actions expanding into new markets and integrating into global value chains through outsourcing and foreign investment. Trade-engaged businesses have been resilient in dealing with a strong dollar. The hard actions taken and ongoing innovation should reap benefits when the global recession ends, and help them prepare for the new challenge of growth.