## Maintenance Supplies



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# The Drooping Dollar

By **Mike Schaffer**

**In recent years, the U.S. Dollar has dropped to record lows against the Euro. In addition, it has reached record lows against several other currencies as well. Although some U.S. business leaders, manufacturers and politicians believe this is good for the United States — helping to keep the costs of our exports unusually low so that they will be more cost competitive abroad — growing evidence indicates this exchange rate imbalance is causing various problems. In fact, it is beginning to have a significant effect on our overall economy and it is also impacting industries.**

In large part, the current situation is caused by geopolitical actions and considerations. For example, a major factor is that the U.S. now has more than a $750 billion "current-account" trade deficit with other countries. This refers to the gap between what the U.S. makes through trade and investment and what it spends. Therefore, we are losing more than $750 billion, or an unprecedented seven percent, of the nation's gross domestic product (*BusinessWeek*, October 2005).

**It's getting personal**

For most of 2006, the dollar has fluctuated in value against the euro, ranging between 70 to 80 cents to one euro. Those who attended ISSA/INTERCLEAN® Amsterdam in May 2006 experienced firsthand what a strong euro and weak dollar feels like. Many found that:

- Hotel rooms priced at 250.00 euro a night cost about $320.
- A budget of $10,000 to send four representatives to the show required an additional $2,750 or more to offset the exchange rate.
- If a U.S. manufacturer, for example, had a large booth, which might be supported by a $75,000 budget, they had to spend more than $95,000 this year, simply due to the exchange rate. All other costs — booth services, set-up and teardown — would be at least 25 percent higher as well.
- Even enjoying a locally-brewed Heineken after the show, priced at 5.00 euros, cost about $6.30.

While everyone in the industry obviously doesn’t attend or display at international shows, there has been a growing European influence on the U.S. Jan/San market in recent years. For example, microfiber and flat mop systems entered the U.S. via European suppliers. Several large U.S. equipment manufacturers are now owned by European firms and we are seeing more products from these ports than ever before.

Even if what is shipped is not a complete product or machine, the weak dollar is directly affecting the costs for these parts and components, which U.S.-based firms must pay to use in construction of their own products. The weak dollar makes equipment parts more expensive.

Although many suppliers try to absorb some of these costs, they can only absorb so much. Worse, the swing in the dollar’s value has been so significant that it simply cannot be totally absorbed. In fact, over the past two to four years, the differences in the exchange rate, in many cases, is more than the average gross profit margin a manufacturer may make on specific equipment. With this the case, the additional costs must be passed on, reflected in higher list prices and costs to the customer. In a very competitive and price sensitive industry, such as ours, this resulting cost increase can make or break a sale.

Interestingly, the United States Commerce Department does not gather data on the number of small and mid-sized businesses that import goods to sell in the U.S. Evidence, however, suggests that importers, businesses and U.S. manufacturers are scrambling to find ways to survive the weak dollar.

And, we should not expect a turnaround any time soon. UBS, an investment banking and securities firm, has said: “We think the dollar will continue a sharp correction lower, so we are revising our short-term one-month and three-month currency forecasts to bring them into line with our long-term twelve-month dollar forecasts.”

What options do the manufacturers have to deal with this situation? Many are taking short- and long-term steps to stay competitive and meet the financial challenges the exchange rate has thrust upon them.

Some have become exchange rate “gurus,” searching for ways to hedge funds today to protect against future decreases in the dollar. However, many more are reevaluating their entire manufacturing strategy, seeing what changes they can make on the factory floor to protect themselves and their products from uncontrollable exchange rate fluctuations.

**Turning to the FX market**

A short-term way to deal with the situation is by aggressively working what is known as the Forex Market (FX), which is a way to protect against daily currency fluctuation swings. This is similar to a currency exchange. Essentially it calls for trading in or exchanging U.S. currency into the currency of the country where we are traveling.

When firms do business overseas they have to work with currency exchanges as well — just on a much bigger scale. Since currencies fluctuate in value, the timing can have an enormous affect on their bottom line. To protect against that fluctuation, firms enter the market, buying and selling currencies to lock in rates. The currency market is actually the largest market in the world in terms of cash transactions.

While it can be rather complicated and takes a substantial amount of management time and resources, essentially, it entails attempting to offset or even outperform the foreign exchange risk by entering contracts to buy a percentage of your estimated needs at an agreed upon exchange rate for a particular date in the future. That transaction then occurs on that date, regardless of what actual market rates are then.

One challenge is simply estimating your future currency needs, knowing that once you enter the contract, it will occur at the agreed rate and amount, even if your needs change. The FX market is not for the faint of heart and even the most astute investor may lose money. According to Allen Greenspan, former chairman of the Federal Reserve, “predicting [returns and] forecasting exchange rates are often no better than predicting the outcome of a coin toss.”

**The road ahead**

One way manufacturers are tackling the situation is by moving their sourcing needs away from mature markets, such as Europe, to developing parts of the world, such as Asia and India. If parts, components or finished products are made in developing countries, the problem of the lopsided exchange rate can be sidestepped for now. Add in the lower operating and labor costs of these countries and the U.S. manufacturer can be in a strong, competitive position to compete in the states.

Unfortunately, however, this is not particularly good news for U.S. factory workers. Additionally, although it can produce excellent results and can make the exchange rate dilemma go away, U.S. manufacturers have found that outsourcing entire product lines can be both risky and problematic.

“There’s a lot of risk [in outsourcing production abroad,] including the intangible cost of giving your product or market knowledge away to another company,” says Ivy Meadors, president and founder of High Tech High Touch Solutions, a consulting and outsourcing firm based in Woodinville, Washington. Meadors adds that loyalty between U.S. companies and foreign manufacturers can vary considerably, compounding the problem. Additionally, some U.S. manufacturers that have outsourced overseas have encountered serious workmanship issues and other problems.

Record lows in the dollar’s value have also had another negative effect. Foreign buyers are capitalizing on that by buying up U.S. manufacturers at what translates into bargain rates. A number of major U.S. companies were acquired this year by European buyers, taking advantage of their strong currency to buy a market presence or American technology.

“It is a no-brainer,” a noted economist recently said. “The dollar has fallen thirty-three percent against the euro over the last several years. What that does is make it vastly cheaper for foreigners to buy our assets.” This is causing many free-trade critics to predict that this activity will have a long-term negative impact on the U.S. economy.

Regardless, these challenges have motivated manufacturers to improve their processes, increase employee training and invest in new products. Many factories are proving to be as cost-efficient as their counterparts abroad. With today’s exchange rate — resulting in overseas firms entering the U.S. Jan/San market in record numbers — American manufacturers are incorporating measures and adjusting to a totally new business climate.

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