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The international strategies of France's business sector

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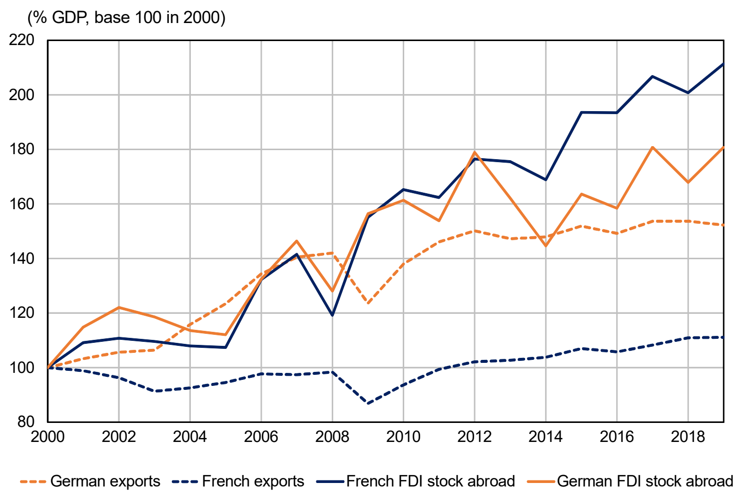
- When a business goes international, it can either export from its home market or invest in local subsidiaries in its target markets. Large multinationals tend to do both. The decision is a matter of not just domestic competitiveness and target market potential, but also sector-specific factors and company culture.
- After falling sharply in the 2000s, the number of French exporters trended upward between 2011 and 2019, dominated by large groups, similar to France's domestic production landscape. However, French exporters still lag behind their German counterparts in both number and performance.
- France has high outgoing foreign direct investment (FDI), dividends from which have partially offset a deteriorating trade balance. It reflects a decline in France's competitiveness in the 2000s, its mid-range position in terms of quality, a production structure heavy on large corporations capable of foreign investment and cultural factors.
- These increased FDIs led to a decline in domestic value-added, in contrast to Germany, whose FDIs tend to split up production processes while keeping higher value-added segments at home, which is consistent with increased production and exports.
- The COVID-19 crisis is expected to further drag down already slowing global FDIs and could lead some French companies to shift strategy and develop local production capacity to secure their supply chains. That could transform France's production base and reposition the French economy in global value chains.

French and German exports and FDIs



Sources : UNCTAD, World Bank.

1. French exports have been increasing over the past decade[1]

1.1 France has a balanced current account, despite fluctuations in the balance of trade

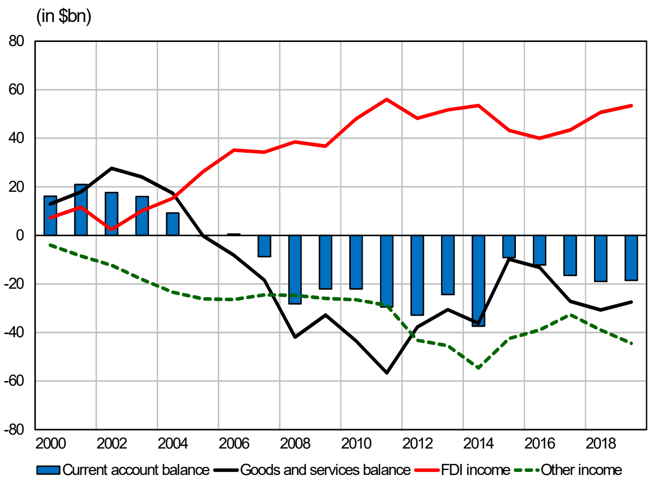
France's current account, which is the sum of cash flows into and out of the country and a measure of its lending capacity or borrowing requirement, is nearly balanced (–0.8% of GDP). It includes the goods and services deficit, which has been affected by a goods trade deficit. While the early 2000s saw France run a goods and services trade surplus, the balance fell to a low in 2011.

In terms of goods and services trade, France's global market share has fallen over the past 20 years (particularly in the first ten), from 5.2% in 2000 to 3.5% in 2019. Meanwhile, Germany and Spain have seen theirs stabilise (at 8% and 2%, respectively) and Italy's has gone down only slightly (from 4% to 3%). At the same time, France's exports-to-GDP ratio has stagnated (29% in 2000 vs. 31% in 2019), whereas other major European countries have seen steady growth, most notably Germany (31% vs. 47%) but also Spain (29% vs. 35%) and Italy (26% vs. 32%).

Buoying France's current account balance is a primary income surplus[2] (€51bn in 2019), driven by its foreign direct investment (FDI) income balance, which has risen sharply since the mid-2000s to stand at €46bn in 2019. It is the result of the business sector's strategy to offshore a portion of their operations in the mid-2000s, leading to high levels of FDI income – 3.3% of GDP in 2019, which is higher than in many other developed economies (3.2% in Germany, 2.6% in the US and Japan, 1.1% in Italy). In contrast, the balance of other income has declined significantly since 2000, driven by the secondary income balance.

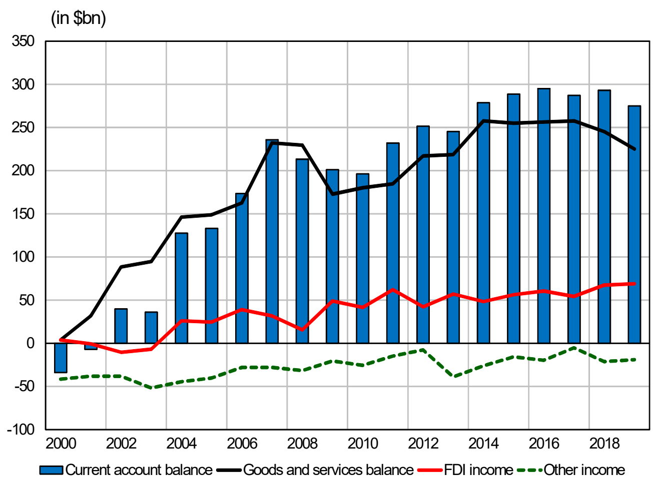
The structure and trajectory of France's current account balance stand in particular contrast to Germany's, which, after sitting close to equilibrium in the early 2000s, swung sharply into surplus territory, driven by a goods and services surplus and, to a lesser extent, FDI income. The shift can be attributed to the internationalisation strategies of German companies, with a high volume of exports out of Germany combined with major investments abroad to develop production facilities to supply Germany's production base with intermediate goods.

Chart 1: France's current account balance (in $bn)



Source: IMF.

Chart 2: Germany's current account balance (in $bn)



Source: IMF.

(1) This analysis was conducted prior to the COVID-19 crisis; data presented here may change significantly in 2020.

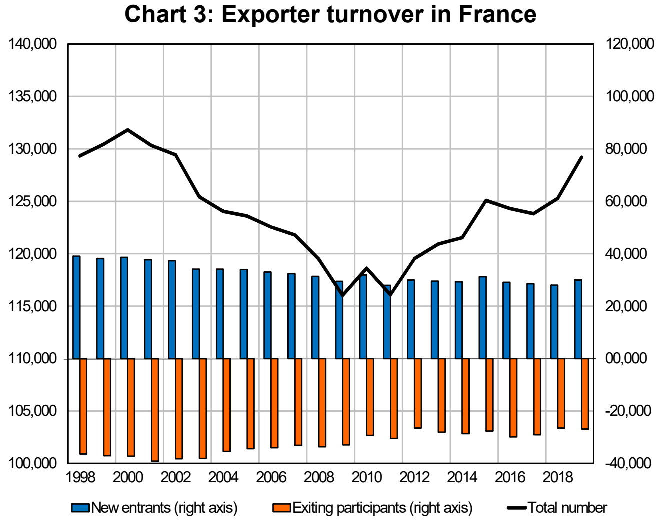
(2) Primary income represents the international inflows received by economic agents for their participation in the production process (compensation of employees), for the provision of financial assets (investment income) or for the leasing of natural resources (rent). Secondary income records current transfers (provision of goods, services or assets without a corresponding return of an item of economic value) between residents and non-residents, e.g. current taxes on income, social benefits and contributions, international cooperation, transfers of funds by migrant workers.

1.2 France's export capacity has grown since 2011

After peaking in 2000, the number of French exporters fell sharply over the following decade, coinciding with a drop in global market share of goods (from 5.1% to 3.4% over the same period). Since 2011, exporter numbers have picked back up again, accompanied by a rise in exports (+15% since 2011 in nominal terms) and a stabilisation of export market share above 3%. Meanwhile, other leading European countries have seen a contraction in the number of exporters (–18,000 in Germany, for example).

There are also signs of stabilisation in France's export sector, with lower turnover rates: in 2018, the rate of businesses entering and exiting the export sector was 22%, down from 27% in 2010. Similarly, the number of regular operators (those continuously exporting over the previous five years) has increased in recent years, from less than 60,000 in 2011 to more than 67,000 in 2018. The increasing capacity of French companies to survive multiple years in the export market has helped boost France's export performance, with companies managing to successfully develop long-term opportunities abroad. The backdrop for this improved export capacity over the past decade has been an improved economic situation, a better competitive position for the French business sector and increased global trade. It could also be attributable to better exporting practices and new support measures (enhanced export credit insurance, prospecting insurance, revised export support scheme, etc.).

Chart 3: Exporter turnover in France



Source: Customs.

Still, France has fewer exporters than most other leading European countries. With 129,000 exporters and just under 109,000 exporting enterprises (after business profiling[3]), France lags behind its main European partners (297,000 exporting enterprises in Germany and 220,000 in Italy). The number of exporters depends on the specifics of each country's business sector. For example, Italy exports less than France but has more exporters, because its industrial companies are smaller, limiting individual export capacity. Similarly, Germany's high number of exporters is attributable not only to its having twice as many companies in its production sector as France, but also to a tendency to break up large groups, a devolved federal system of governance and political support for the *Mittelstand* – although these aren't necessarily contributing factors to strong export performance.

Although the proportion of companies with export operations is lower in France than in Germany, it is higher than in other leading European partners. The gap is especially apparent among manufacturing companies with fewer than 250 employees (SMEs), where German companies are particularly export-oriented (8.5% vs 6.9% for French SMEs). Italian and Spanish companies have more difficulty accessing export markets (the proportion of companies with fewer than 250 employees that have exporting activities stands at just 3.7% and 4.7%, respectively).

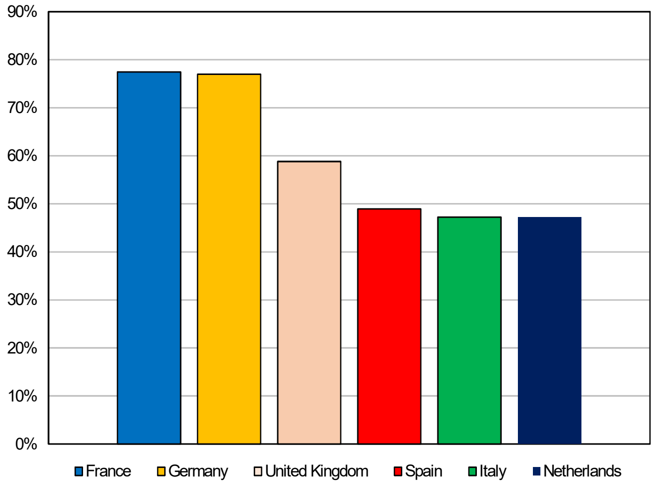
1.3 The prominence of large enterprises in France's export market reflects the composition of its production base

France's export sector is particularly concentrated and has only become more so over time: in 2019, the top 100 exporters were responsible for 42% of exports, up from 37.5% in 2009.

The top 5% of France's largest companies are responsible for nearly 90% of exports, compared to just 80% for the top 5% in Germany.[4] And while the export contribution of companies in France with over 250 employees is similar to Germany, it is much higher than in other leading European partners. This mirrors the highly concentrated nature of France's production structure and the predominance of large groups (e.g. there are 19 French companies on the Euro Stoxx 50, compared with 14 German and 5 Italian).

(3) European export data is compiled by Eurostat from countries' customs reports.
(4) Differences in methodology used by different countries (reporting thresholds, profiling techniques, etc.) can affect both the number of exporters and the export sector structure, which limits the reliability of comparisons.

Chart 4: Contribution to exports by manufacturing companies with more than 250 employees (2017)



Source: Eurostat.

An economy's export performance depends on the competitiveness of its production, but also the capacity of its businesses to enter and remain in export markets. The intensity of export activity by large companies, which adjust their exports to economic conditions while remaining present in their target markets, is more of a contributing factor to export performance than ups or downs in the number of exporting enterprises.[5]

The structure of France's export sector is a direct reflection of its production landscape and its public policy decisions (e.g. regional structure). There are also cultural factors (companies' regional ties, management practices, shareholder composition), legal factors (such as buyout rules) and financial factors (cash resources, access to financing for SMEs, etc.). For example, German companies' affinity for exporting may be partly attributable to a business sector structured around partnership networks.

2. French companies' growth has been supported by investment abroad

2.1 The size of France's FDI reflects the sectoral and cultural characteristics of its business sector

When a business goes international, it can either export from its home market or invest in local subsidiaries closer to its target markets.[6] These two strategies are often used together, and the companies that invest the most abroad are usually the bigger exporters. But how much a company invests in either strategy is influenced by the production conditions in its home market (competitiveness, business environment, etc.) and the potential of the target markets.

A company's decision to either invest abroad to serve its target markets or export from its home market can also depend on (i) the sector it specialises in (some sectors, such as extractive industries or the service sector, prefer local facilities so they can be closer to raw materials or to their customers, whereas others – luxury, agri-food, high-tech sectors – prefer to export), (ii) its positioning (companies will have different internationalisation strategies depending on their R&D ambitions or how interested they are in developing new IT capabilities or improving labour costs),[7] (iii) its size (FDIs tend to be favoured by large multinationals with the legal, financial and operational capacity to invest abroad, whereas SMEs tend to opt for exporting and the flexibility that comes with it), and (iv) corporate culture (regional ties, shareholder composition, etc.).

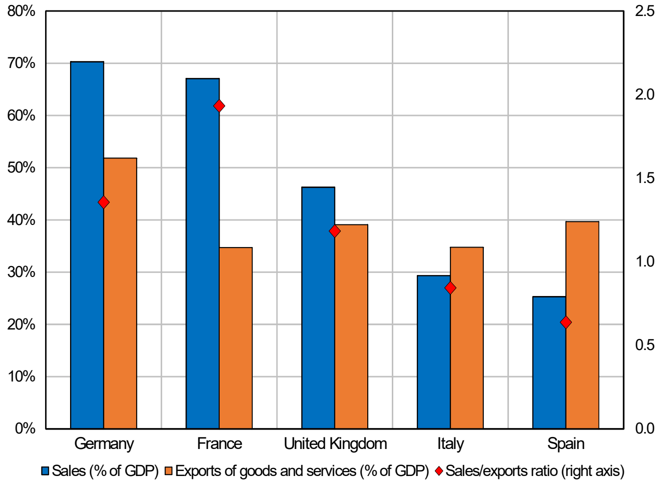
Since the mid-2000s, French companies have been heavily involved in direct investments abroad, with FDI stock representing 57% of France's GDP in 2019, compared to 45% for Germany (whereas it was around 25% for both countries in 2000). This preference for investment can be attributed to the legal framework, tax rules and public policy that have shaped France's production landscape (price competitiveness, capital taxation, inheritance tax, decentralisation, business supports, etc.), particularly in the 2000s.[8] Other contributors include market position and R&D capability (which are lower in France than in Germany)[9] and the predominance of large companies in France. Some

(5) New and exiting export market participants tend to be smaller companies that make limited contributions to national exports. Variation in the number of exporters therefore has a relatively small impact on foreign trade.
(6) Pierre-André Buigues & Denis Lacoste (2016), "Les stratégies d'internationalisation des entreprises françaises et des entreprises allemandes : deux modèles d'entrée opposés", *Annales des Mines.*
(7) Sea-Jin Chang & Philip Rosenzweig (2011), "The choice of entry mode in sequential foreign direct investment", *Strategic Management Journal*.
(8) Charlotte Emlinger, Sébastien Jean & Vincent Vicard (2019), "The surprising sluggishness of French exports", *CEPII Policy Brief*.
(9) According to the CEPII, in 2015, 48% of Germany's exports were of high-end products, compared to 41% for France. *Cf.* Maria Bas, Lionel Fontagné, Philippe Martin & Thierry Mayer (2015), "La France en mal de qualité ?", *La Lettre du CEPII*.

aspects of French corporate culture also come into play – less local ownership on average, a more international shareholder base, organisational structures closer to Anglo-Saxon norms – whereas Germany's higher levels of local and family-owned businesses make it naturally more export-oriented.

Accordingly, France has a higher ratio between foreign subsidiary sales and national export levels than Germany, as well as the UK, which introduced attraction policies to support its balance of trade. In Italy, which has a trade surplus and a fragmented production structure, export levels are higher than foreign subsidiary sales.

Chart 5: Comparison between exports sales by foreign subsidiaries, 2017



Source: OFATS.

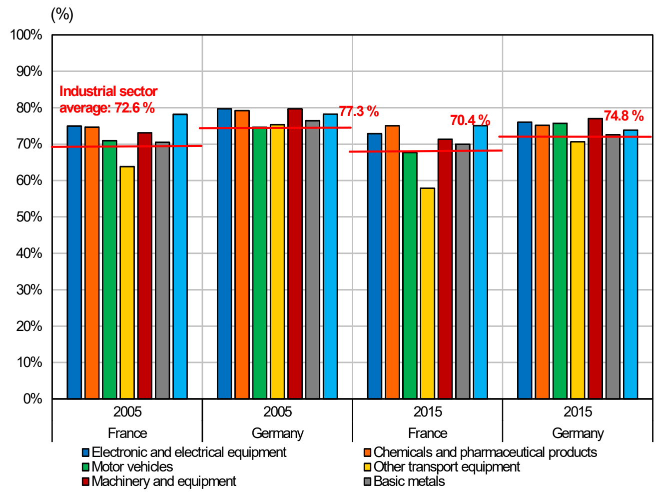
2.2 Industry value-added declined as French FDIs grew

French companies added more offshore production sites (more than 45,000 foreign subsidiaries, compared to 35,000 for UK companies and less than 30,000 for German companies), primarily to serve local markets or export to neighbouring ones. These investments, made as part of an approach to diversify and offshore production sites, translated into a loss of industry value-added produced in France and a corresponding decline in exports.

Inversely, the preferred strategy of German companies has been to optimise production chains, outsourcing lower value-added activities abroad to supply more affordable inputs to German producers, thereby underpinning the country's competitive position and preference for exports. It means German companies have been able to keep activities at the high end of the value-added chain in Germany, in areas where they have strong expertise (industry services, high-tech product assembly, automotive sector, etc.) – leading to high levels of exports.

The proportion of domestically produced value-added in France's industrial exports declined between 2005 and 2015, from 73% to 70%. This can be attributed to two of the country's biggest export sectors: aeronautics and automotive.[10] In the aeronautics sector, although most of Airbus's assembly work is still done in France, the production chain has been split up between multiple European countries (primarily France, Germany, Spain and the UK), and the production of some lower value-added components has been offshored to countries with lower production costs (in the Maghreb region). In other sectors, France has maintained a high level of value-added at home (luxury goods and chemical and pharmaceutical industries, with a domestic share of around 75%), which has a positive impact on the trade balance.

Chart 6: Comparison: Domestic VA content of French and German exports by sector, 2005 and 2015 (as a %)



Source: OECD (TiVA).

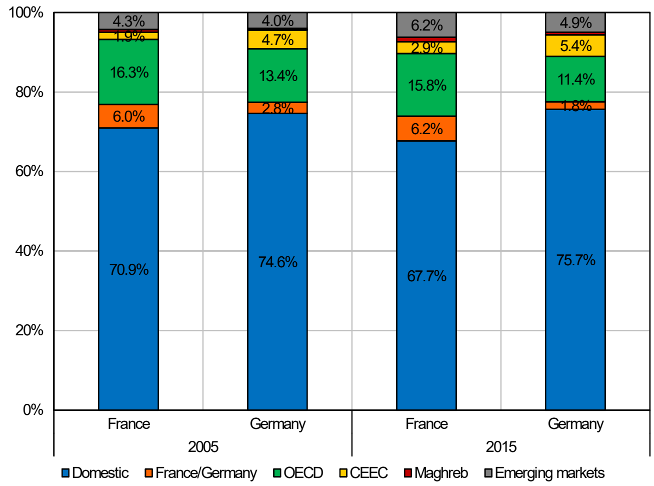
(10) *Cf.* Faquet R., Le Saux L. & R. Chakir (2019), "Composition and competitiveness of the French economy", *Trésor-economics* No. 248.

Box 1: The example of the automotive industry

The trade balance of France's automotive industry, which registered comfortable surpluses between 2000 and 2005 (between +€10bn and +€15bn annually) entered deficit territory in 2008, reaching –€15bn in 2019 and making up 25% of France's goods trade deficit. The reason for the shift: comparative disadvantages in terms of labour costs; a mid-range position, where there is less market power; and stricter social and environmental regulations than in other countries.[a] The drop in exports was accompanied by a strong increase in the foreign subsidiary sales of French automotive groups (7.0% of GDP in 2017 vs. 4.3% in 2010) due to the offshoring of some production activities. These multi-site internationalisation strategies, with little fragmentation of the value chain, also resulted in a decline in the domestic value-added content of French exports, falling from 70.9% in 2005 to 67.7% in 2015.

In contrast, Germany saw the domestic value-added content of its auto exports rise from 74.6% to 75.7% between 2005 and 2015. In addition to its market position, Germany also kept a significant share of value-added at home (R&D and assembly) and made competitive gains by importing intermediate inputs from countries with lower production costs, namely in central and eastern Europe, instead of using more costly inputs manufactured in more advanced economies. The same disparity in terms of geographic disposition is present throughout France and Germany's manufacturing industries.

Chart 7: Source of VA of French and German automotive exports, 2005 and 2015 (as a %)



Source: OECD (TiVA).

a. The revealed comparative advantage indicator, a concept developed by Paris-based research institute CEPII, measures the difference between the observed trade balance for a given product on a given date and the theoretical balance of a country with no sector specialisation. A positive (negative) number means the country has a revealed comparative advantage (disadvantage) for the product in question.

Although France is integrated with global value chains in much the same way as Germany, more of its foreign value-added content comes from developed economies (for example, 16% from Germany but 7% in the other direction). There is less integration with central and eastern Europe (just 5% of the foreign value-added content of French exports, versus 11% for German exports, despite both countries having virtually the same number of subsidiaries in the region). At the same time, the 1,800 French subsidiaries in the Maghreb region barely contribute any production inputs for France (only 1% of foreign value-added).

2.3 The COVID-19 crisis could shift foreign investment policy

FDIs by French companies led to a deteriorating trade balance and the offshoring of production capacity, with social, regional and labour market consequences. However, these investments did also generate investment income for the shareholders of French groups, shoring up future investment capacity. This trade-off, which is reflected in the current account balance, is dependent on corporate headquarters (or financial holding companies, particularly after mergers/acquisitions) remaining in France.

France's position as a net global investor could shift over the coming years. The country's fundamentals have changed since the 2000s, particularly in terms of competitive position (with unit labour costs close to competitors like Germany) and capital and production taxes (which have been lowered since tax reforms were introduced in 2017). France has also made gains in terms of attractiveness, as illustrated by a record level of investment decisions recorded in 2019 (some 1,469 decisions resulting in the creation or retention of nearly 40,000 jobs, putting France at the top of EY's annual European attractiveness survey for the first time) and a 23% year-over-year increase in FDI inflows to stand at €39bn in 2019 (the third highest level since 2005, since which time France has well outpaced Germany and Italy). Additionally, a sector analysis of France's trade balance and production structure reveals high levels of specialisation in high-performing, high-value-added sectors where France has comparative advantages (chemical and pharmaceutical industries, luxury goods, aeronautics, naval construction, etc.) and which are less susceptible to offshoring.

The COVID-19 crisis could fuel protectionist tendencies and cause a global drop in FDI over the next few years.[11] It could incentivise companies (supply chain security, environmental issues, reputation risk, etc.) to keep or expand production capacity at or close to home[12] and diversify supply channels. These incentives, which have already been around for several years, could help gradually restructure France's production landscape and shift its position in the global economy.

(11) Przemyslaw Kowalski (2020), "Will the post-COVID world be less open to foreign direct investment?", *CEPR*.
(12) Richard E. Baldwin & Simon J. Evenett (2020), "COVID-19 and Trade Policy: Why Turning Inward Won't Work", *CEPR*.

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