Georg Schaur, University of Tennessee

Daniel X. Nguyen, University of Copenhagen

Firm Flexibility and Export Potential

Abstract

We present and test a model relating a firm's idiosyncratic cost, its exporting status, and the volatilities of its domestic and export sales. In prior models of trade, production costs for domestic and exports were linear and thus additively separable. We introduce a nonlinear cost function in order to link the domestic and export sales of a firm. This theoretical contribution has two new implications for the exporting firm. First, the demand volatility in the foreign market now directly affects the firm's domestic sales volatility. Second, firms hedge domestic demand volatility with exports. The model has several testable predictions. Total and domestic sales volatilities should decrease with firm size. Also, total and domestic sales volatilities for exporters are structurally different from nonexporters. We find evidence for these predictions with Danish firms operating between 1992 and 2006.