Preface

This report takes a look at the challenges manufacturers and distributors faced throughout 2011—and the steps thriving and growing companies are taking to continue their growth in 2012.

The number of companies that are thriving and growing almost doubled in 2011 compared to the 2010 figures. Some industry sectors—notably Automotive and Industrial Equipment—gained new life after being hit particularly hard by an uncommonly weak economy. From this perspective, it seems the industry could be on the cusp of a true renaissance and leading the economic recovery.

The recent recession provided an opportunity for almost all companies to do a “reset” to critically look at their business and align their staffing, investment and sales efforts with their current orders. As a result, many companies got much leaner, focused on improvements in sourcing and cost management, and continued to market in spite of slower orders. Exporting sales was recognized by thriving companies as a key driver for growth. As the economy has improved, these companies have shown an incremental improvement in productivity and profitability, with some posting their best performance in their company’s history during 2011.

The past 12 months weren’t always about growth. In the midst of the federal gridlock, global unrest, rising commodity prices and natural disasters that captured headlines during 2011, it was difficult to feel optimistic about the prospects for future growth. Many companies were addressing rising costs, for example, by passing them on to their customers. Free trade agreements, research and development credits, and corporate tax rates are among the issues some industry advocates say need to be addressed if the U.S. manufacturing industry is to remain competitive. In addition, a shortage of skilled manufacturing labor across the country could dampen the improved results.

In this report, we provide an analysis of the Monitor results for the past year. The unique aspect of this data lies in the fact that approximately 87 percent of the companies participating in the survey are privately owned or are private equity-owned organizations. Because most data referred to in the media is typically based on publicly available data, this makes the Monitor results rather exceptional for the industry.

Additionally, in the spirit of improved results and cautious optimism, we share with you a comprehensive look at best practices gathered from the industry’s thriving and growing companies throughout the year, including suggestions for addressing:

- **Process improvement**—Leveraging vendor relationships to manage costs, developing a culture of continuous improvement, investing in efficient equipment, using IT innovations to drive growth and efficiency, and evaluating your risk management programs
- **Human capital**—Identifying your company’s high-potential talent and closing the skills gap
- **Profitability**—Pricing products based on value and understanding the impact of capital strategy issues
- **Exporting**—Planning to participate in the worldwide economy by establishing global compliance policies as well as planning for exporting

Contributions by McGladrey specialists and industry professionals provide supportive insights as well. Once again, many thanks to our winter survey respondents for offering their time and knowledge, as well as to the industry and business associations that encouraged their members to participate.

Regards,

Karen L. Kurek, Partner
National Manufacturing & Distribution Practice Leader
McGladrey & Pullen, LLP
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Core McGladrey Monitor Trackers

Encouraging tendencies in company health

Overall, it’s been an encouraging year of improvement for the manufacturing and distribution industries. The number of participants in the McGladrey® Manufacturing & Distribution Monitor surveys who said their companies are thriving and growing remained relatively steady between 43 and 47 percent. This is nearly twice the level of those who responded in 2010 and is comparable to 2007 levels. Notably, the number of companies in decline is much lower than in 2007.

These results are supported by the January 2012 manufacturing Report on Business® from the Institute for Supply Management (ISM). The report shows that the manufacturing sector in the U.S. has expanded for 30 consecutive months, a trend seen in the industry’s number of new orders, production and employment. As Chad Moutray, chief economist for the National Association of Manufacturers (NAM), notes, recent regional surveys are upbeat regarding future production, employment and capital spending in the coming months.

These results all suggest that cautious optimism can be found not only in large, multinational companies capturing the headlines but also in the middle-market companies that comprise the heart of U.S. manufacturing and distribution—the organizations that serve as a critical component for the continuous growth of the economy. Recent comments by politicians in Washington, D.C., show that they support these sectors and recognize their importance to the U.S. economy and our country’s long-term prospects.

Chart 1

Current condition of business

*Percentages may not total 100% due to rounding
Both Metal Fabrication and Industrial Machinery have experienced significant growth since 2010. In that year, only 20 percent of Industrial Machinery companies were said to be thriving and growing; 15 percent for Metal Fabrication. That demographic changed considerably in 2011 for these sectors that represent the heartland of America. In particular, Metal Fabrication shows a striking 42 percent increase from fall to winter in the number of thriving and growing companies. Industrial Machinery also shows a notable increase of 25 percent in thriving companies over Fall Monitor results.

Some are suggesting we are in the midst of a manufacturing renaissance. Companies that supply component parts for large industrial and agricultural equipment, in particular, have enjoyed growth over the past year. The primary concern looking forward is the unknown impact of the reduction in spending on military products by the U.S. government.

As noted in the Fall Monitor, the Automotive sector saw declines in the early part of 2011 due to the impact of the tsunami in Japan and the ensuing disruption of the supply chain. Nevertheless, by the end of the year this sector—thought to be on its last legs only three years ago—surged back to life. General Motors reported its biggest profit ever for the year and is now the largest seller of automobiles in the world. Chrysler will be adding jobs to its U.S. factories. Ford is showing a significant increase in its 2011 pre-tax operating profits from 2010 levels.
In fact, among the 55 U.S. markets adding manufacturing jobs between 2010 and 2011, Detroit led the pack with 11,400 new jobs, according to the U.S. Bureau of Labor Statistics. Total vehicle production in the U.S. in 2011 increased nearly 11 percent over 2010, according to Wards Auto. Foreign automotive companies have expanded into the U.S. on the backs of a weaker dollar, and one foreign company is planning to build cars in the U.S. for export to other countries. The ripple effect from these large auto makers can be felt by the middle-market companies in their supply chains.

Automotive, Industrial Machinery and Metal Fabrication are the leading thriving and growing sectors; these represent the traditional core of manufacturing in the U.S. The strength of this positive trend, especially during the fourth quarter, suggests a momentum that will continue into 2012.

Building Materials also experienced a positive trend in 2011, principally in the 82 percent increase in thriving and growing companies in the winter survey compared to the fall. This is more than double the number of companies than the previous year and suggests a glimmer of hope for the housing market.

This hope is borne out by National Association of Home Builders statistics, which show the rate of construction of new single-family housing and apartments is rising: January 2012 saw nearly 700,000 housing unit starts, a level not seen since October 2008. There is an increased optimism among home builders as conditions improve in a growing number of markets nationwide.

This is not to say that housing starts are anywhere near the levels they were before the recession; while the numbers have improved, they’ve done so at a turtle’s gallop. Given the bubble foundation that houses were built on just before losses on subprime mortgages battered the U.S. housing market, unit starts cannot be expected to reach those levels any time soon, if ever. But the upward trend reflected in the increasing number of thriving and growing companies in Building Materials (as well as Furniture and Fixtures overall) reflects the industry’s optimism. A drag on the economy to this point, perhaps now this sector is poised to return to stability.
Private label products are typically sold at lower prices, an important consideration for consumers who are looking to save money as a result of the rising food prices. Higher-than-average unemployment rates and low consumer confidence scores tend to drive private label sales up. As neither of these indices is expected to improve markedly in the near term, private label sales should remain strong.

**Cristin Singer, National Leader, Food and Beverage Industry, McGladrey & Pullen, LLP, New York, N.Y.**

**Pessimism falling, cautious optimism rising**

As noted in the Fall Monitor report, manufacturing and distribution executives are often more pessimistic about issues that extend beyond their company walls than they are about their own companies or industry segments. The outlook for the U.S. and global economies was particularly bleak in the fall, so it’s all the more striking for the change in the Winter Monitor.
Pessimism increased steadily from the spring through the fall, but this attitude has retreated considerably since the Fall Monitor, particularly as it concerns the U.S. economy: a drop to 47 percent brings this attitude to parity with the Spring Monitor. The number of executives pessimistic about their companies or industries dropped more than 30 percent lower than in the fall to summer levels.

“In addition to a stronger domestic economy, the primary drivers of future growth will be found in product development innovation, enhanced efficiencies in production and international sales increases. Unlike the overall economy, these are areas where manufacturers can have a direct impact on company performance.”

Chad Moutray, Ph.D., Chief Economist, National Association of Manufacturers

The pessimism figures from the Fall Monitor in particular now appear to be a spike rather than a trend, but perhaps this is to be expected. Although company perspectives may not be leading economic indicators, they did mirror events throughout the year. As political events in the U.S., like the summer’s debt ceiling debate, dominated the headlines and global issues, such as the viability of the euro and rising levels of Greek debt, held our attention, the level of pessimism grew.

But just as this was becoming a winter of our discontent, unemployment levels began to fall and bellwether benchmarks such as housing starts began to rise. As the U.S. economy began to show signs of improvement, optimism began to appear once again.

This level of optimism is even more striking in the contrast between fall and winter outlooks on the state of the U.S. economy. In the winter, the number of executives optimistic about the U.S. economy is nearly 150 percent greater than in the fall.

Optimism about the world economy, however, is a bit more tenuous and still far below the consensus in the spring. Because challenges to the world economy may never be completely resolved, these figures are easy to understand. They suggest there is an ongoing concern in the minds of Monitor participants regarding the European economy—as much a crisis of confidence as it is for its sovereign debt.

Given their recent growth, it’s not surprising that Automotive and Transportation executives are more likely than others to be optimistic about their companies. Interestingly, Automotive executives are most likely to be optimistic about the U.S. economy as well.

Industrial Machinery executives, who are likely to be optimistic about the world economy, join Chemicals, Oil and Plastics executives in being more optimistic about emerging markets—and with good reason. Worldwide net sales and revenues for Illinois-based Deere & Company, for example, increased 11 percent for the first quarter of 2012, due in part to exporting. Another Illinois-based company, Caterpillar, saw record-breaking financial results in 2011—its sales and revenues saw the largest percentage increase in any year since 1947—much of it driven by demand for Caterpillar products and services outside of the United States.
Many companies had significant margin pressure during early 2011 due to large changes in commodity pricing; they saw less volatility in the later part of the year. Companies should closely monitor their supply chains and implement procedures to manage both selling prices and product costs to maintain or grow gross margin in the future.

Steven A. Menaker, Assurance Partner, McGladrey & Pullen, LLP, Charlotte, N.C.

If signed into law, the president’s Framework for Business Tax Reform would result in U.S. businesses paying more taxes collectively. Some companies, such as manufacturing companies, would pay less; others, such as those in the oil and gas industry, would pay more. Over the coming months, we will continue to monitor and report on this proposal.

Tom Windram, Tax Partner, Washington National Tax, McGladrey & Pullen, LLP, Washington, D.C.

Concerns over high commodity prices continue to recede from their high points in the summer and spring. In the summer, when this apprehension was at its highest, 85 percent of respondents said they planned to pass increased costs of raw materials on to their customers through a variety of price increases, some by as much as 6 to 10 percent. While the concerns over commodity prices appear to have been mitigated in the winter results, the potential pressure of reigniting inflation continues as companies are concerned in the first quarter of 2012 about rising oil prices.

Perceived risks to growth

Concerns over high commodity prices continue to recede from their high points in the summer and spring. In the summer, when this apprehension was at its highest, 85 percent of respondents said they planned to pass increased costs of raw materials on to their customers through a variety of price increases, some by as much as 6 to 10 percent. While the concerns over commodity prices appear to have been mitigated in the winter results, the potential pressure of reigniting inflation continues as companies are concerned in the first quarter of 2012 about rising oil prices.

Just as optimism has risen regarding the U.S. economy, distress over federal regulation or oversight has also receded to its spring level. Yet there is concern among manufacturers regarding the level of regulation. As NAM points out, it is 20 percent more expensive to do business in the U.S. than it is in its nine largest trading partners—and that excludes the cost of labor.

The federal government gridlock was seen as a high risk by significantly fewer executives than in the fall, but this outlook continues at significantly higher levels than in the spring. This could be due not so much to the ability of government entities to work together, but more to the lack of high-profile partisanship battles over economic issues.

While many concerns remain, Monitor respondents generally believe that final resolution of these uncertainties will not have a direct impact on their business (or they do not have the ability to evaluate the impact). As of the writing of this report, President Barack Obama released his Framework for Business Tax Reform. The upcoming election in the fall may ultimately provide clarity on the course of regulations and taxes and the impact it may have on their business.

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Tom Windram, Tax Partner, Washington National Tax, McGladrey & Pullen, LLP, Washington, D.C.
As further illustration of the confidence most industry executives are feeling, projections of both domestic and international sales remain solid and strong. This confidence is supported by the ISM report showing new export orders remaining strong for the past 31 months. Although raw material costs have dropped well below their high in spring, concerns regarding commodity prices and the potential inflation remain.
Throughout 2011, Monitor respondents showed a relatively consistent pattern of increasing inventory levels in order to meet required stocking levels and optimism for future increases in sales. Many companies reached historic levels of sales activity resulting from an increased emphasis on new opportunities.

While nearly 60 percent of survey participants expect to increase their workforce—a figure significantly higher in winter than it was in the fall—finding qualified workers to fill open positions continues to be a concern for the industry (see page 16 for more on this topic). Given that the national unemployment rate is still so high, this appears to be an unusual dichotomy. The need for a skilled workforce could be one of the greatest impediments to growth for U.S. manufacturers and distributors, making it difficult to compete in the global market.
Order backlogs also returned to figures more consistent with spring and summer reports. Decreasing backlogs are significantly greater in the winter than they were in the spring and in the fall, but they are statistically on par with the summer; fall figures may have been an anomaly. This is good news for the U.S. economy.

Offshore manufacturing operations

As noted in the Fall Monitor, almost one quarter of the largest companies participating in the survey had more than 50 percent of their production offshore. Even among companies with revenues of less than $25M, a surprising 21 percent produce outside of the U.S.—exemplifying just how globalized manufacturing has become.

Yet that could be changing. Due to high freight costs and the relative skills of the U.S. workforce, companies with manufacturing operations located offshore appear to be rethinking their production strategies. Since mid-2010, for example, Wisconsin-based Master Lock, known as the world’s largest manufacturer of padlocks, has “insourced” approximately 100 jobs that were previously outsourced to China. Illinois-based Caterpillar recently opened or expanded facilities in various locations in the U.S. as part of a strategic decision to shift production from Japan to the United States to be closer to the majority of its customers.
Best practices of thriving and growing companies

As organizations address their challenges, certain key principles can help them with the uncertainty that continues to define the fiscal environment and serve as guidelines to strengthen and grow their businesses.

Following are best practices culled from our quarterly Monitors over the past year as well as insights contributed by specialists and industry professionals during our Executive Summits, which took place throughout the country in the fall of 2011.

Process improvement

Leveraging vendor relationships to manage costs

Few companies are leveraging vendor competition and relationships to lower procurement costs, yet this is an opportunity for growth. Only a small number of manufacturers and distributors who measure these costs feel they have an effective analytics tool to track their company’s spend with vendors.

Manufacturers are also measuring other vendor metrics, such as evaluating on-time delivery, and comparing the amount charged against what was stated within the contract, among other areas. Because manufacturers have to deal with the challenges that come with managing rising raw material input costs, working with vendors to develop a partnership is a critical element in managing the entire procurement process. Negotiating with your vendors can ensure you are getting a good value for what you’re paying as well as, if applicable, ensuring that your sales contracts incorporate mechanisms for increases as key component costs change.

Considering the opportunity for identifying substantial cost savings in procurement practices, collaborating on pricing and applying appropriate metrics to monitor effectiveness is essential. More important, it might provide a chance to gain a competitive edge.

“A detailed spend analysis is a great way to better understand your indirect costs and identify new savings opportunities. It takes a little time, but the effort usually uncovers savings you may not have previously considered. Also, if you start with spend analysis, the savings are more likely to be sustained over the long term and you may also find new methods to improve available cash flow.”

Gerry Hodson, Practice Leader, Spend Management Solutions, McGladrey & Pullen, LLP, Kansas City, Mo.
Developing a culture of continuous improvement

To what degree has your organization developed a culture of continuous performance improvement?

- Advanced culture: 67%
- Little or no culture: 41%

Source: Manufacturing & Distribution Monitor Summer 2011 Report

Companies that are thriving and growing are more likely to foster an environment focusing on continuous improvement, incorporating business management strategies such as Six Sigma, continuous performance feedback loops, lean manufacturing and other good manufacturing practices.

To track key indicators of operational effectiveness, management’s priorities traditionally focus on improvements in production, inventory and scheduling/planning. But a change in emphasis toward procurement and spend analysis could have a more direct impact on profitability. Best practices companies are analyzing procurement spending through a comprehensive, data-driven approach to identify significant savings.

"Confirming what we have observed in practice, there is strong correlation between those companies that consistently deploy process improvement and quality programs and methodologies and those that are "thriving and growing." Nearly 70 percent of organizations with an advanced culture of continuous improvement are thriving compared to only approximately 40 percent of companies without an emphasis on continuous improvement."

Greg Maddux, Principal, Performance Improvement Consulting, McGladrey & Pullen, LLP, Kansas City, Mo.

Investing in efficient equipment

Companies with revenues over $100M are significantly more likely to look to investments in equipment to spur productivity and are more likely to have the resources to invest. Companies with more than $500M in sales are much more likely to cite investments in high-tech automation as productivity enhancers. Recent tax law changes incorporated into various government stimulus programs have significant advantages for the investment in equipment. A large number of companies investing in their production infrastructure are reaping the benefits of new and more efficient equipment to control costs. While government policy may have hoped for an increase in employment due to the tax advantaged equipment investment policies, some companies have been able to add capacity without a related increase in hiring.
According to the U.S. Department of Labor, manufacturing productivity has increased 227 percent since 1987. A large part of this is due to a focus on process enhancement, which creates a continuous improvement culture as well as continued investment in machinery and equipment.

**Utilizing IT innovations to drive growth and efficiency**

Manufacturers and distributors need technology innovations to manage their operations more effectively. Yet cost-cutting efforts, distributed operations and multiple locations and customers around the world have changed the nature of the industry.

Collecting, analyzing and acting on business intelligence derived from internal and external electronic information can improve decision-making and overall efficiency as well as reduce costs, waste and risks. But business intelligence is a journey, and before companies can gain the insight required to take action, a core set of applications and capabilities must be built on a solid foundation of data governance.

More midsize companies are switching their focus from cost containment to performance management. And they’re moving to Software-as-a-Service (SaaS), a form of cloud computing, to help them manage costs, improve flexibility and assist in disaster recovery. With its implementation speed and lower capital investment, SaaS is also popular among manufacturers because it allows them to respond quickly to business demands and work effectively across geographies.

Another example is the use of server virtualization, sometimes called private cloud or Infrastructure-as-a-Service (IaaS). For example, multiple applications can be run on consolidated servers on premise or procured computing power from a vendor. As a result, applications run faster and more efficiently; utility costs and physical space requirements diminish; and backup and recovery capabilities are improved.

"The interest in Software-as-a-Service is projected to rise significantly through 2013. While some companies have concerns regarding security and integration with other applications, cloud-based technologies are helping our manufacturing and distribution clients protect their margins, operate across borders, manage far-flung supply chains and exploit new opportunities."

*Jon Caforio, National Leader, Technology Consulting, McGladrey & Pullen, LLP, Chicago, Ill.*

**Evaluating your risk management programs**

Risk management is vital to the success of your enterprise. If not managed and appropriately mitigated, exposure risks could have a serious impact on your company's profitability and reputation. For example:

- **Supply chains represent a large potential risk for many organizations.** Disruptions to the supply chains can increase procurement costs, reduce quality, diminish customer satisfaction and tarnish your company’s reputation. It’s critical for management to minimize these risks by diversifying supply sourcing, building a stronger supply chain and establishing an early warning system.

- **The myth in information security is that hackers are just mischievous teens having fun.** The reality is that they are sophisticated, educated computer experts employed by corporations, organized crime, terror organizations and governments with significant resources.
**Knowing, evaluating, managing and monitoring risks to your organization in a systematic way can give you better insight into the operations of your company and also allow you to turn certain risks into opportunities that allow you to continue to thrive and grow in today’s challenging times.**

Hussain Hasan, Principal and Practice Leader, Risk Advisory Services, McGladrey & Pullen, LLP, Schaumburg, Ill.

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### Creating a risk management plan

In a risk management program, you identify, prioritize and monitor risks both inside and outside your organization:

- Establish a formal, disciplined framework and governance strategy.
- Formalize the process to identify all key risks within the organization.
- Develop quantitative and qualitative measures.
- Quantify risks, examine risk treatment and determine risk gaps.
- Establish risk monitoring processes and continuous improvement activities.

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**“Knowing, evaluating, managing and monitoring risks to your organization in a systematic way can give you better insight into the operations of your company and also allow you to turn certain risks into opportunities that allow you to continue to thrive and grow in today’s challenging times.”**

Hussain Hasan, Principal and Practice Leader, Risk Advisory Services, McGladrey & Pullen, LLP, Schaumburg, Ill.

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### Human resources

Throughout the past year, executives at a majority of the companies participating in the Monitor surveys have expected to increase their workforce. As noted earlier, nearly 60 percent of Winter Monitor participants plan a workforce increase, the highest percentage for the year.

### Identifying your company’s high-potential talent

While investments in technology and equipment are important, organizations need a strategic focus on talent. In particular, succession planning is vital to a company’s future. Establishing succession and leadership development programs helps ensure that an organization can survive deliberate or unexpected changes in leadership. Executives, however, may overlook such initiatives due to perceived time restrictions, assumed costs or because they just don’t like the thought of someone leaving. Yet ignoring the need to develop new leaders can put an entire organization at risk.

Organizations need to identify and strategically focus on top talent, that is, those individuals who handle relationships well, understand other people’s views, are better able to cope with the ambiguities of leadership and are emotionally mature in dealing with others.

Development approaches may include formal or informal job rotation; coaching and mentoring; vertical or horizontal promotions; high-visibility roles; expatriate assignments or assignments on challenging projects; and cohort development programs.

First decide whether to communicate top talent/high-potential status to employees. Next, develop and re-recruit your top talent through a mix of development approaches and reassure talent that they have a future in the organization. Top talents’ relationship with their managers is key to their development. The manager provides the testing and training ground for success.
Types of succession planning

- Leadership development—Ongoing activities based on defining a strategic vision, identifying the leadership competencies and character
- Emergency succession—Planning that ensures key leadership positions can continue without disruption in unplanned absence of leader
- Departure defined—A planned departure

Closing the skills gap

Finding qualified workers to fill open positions continues to be one of the most critical and difficult issues to address for manufacturers and distributors throughout the U.S. It is reaching a level where this skill gap is having an impact on the ability of some companies to compete.

If a properly skilled worker is not out there to fill an open position today, what can companies do to help fill that gap? To address this shortage of skilled employees needed to funnel into the manufacturing industry, NAM is challenging its members to double engineering internships in 2012. This initiative, led by NAM members GE, Intel and DuPont, will be a significant step toward fortifying a student pipeline coming out of the vocational programs at technical and community colleges. With 10,000 engineering graduates each year it’s a boost that seems increasingly necessary if the U.S. is to sustain its leading position in innovation and productivity.

“A solution for U.S. workers and employers is nationally portable, industry-recognized skill credentials. Prioritizing education and training in the skills needed in the private sector will be good for workers and enable manufacturers in America to maintain their global leadership.”

Jay Timmons, President and Chief Executive Officer, National Association of Manufacturers

In addition, nearly 50 well-known businesses from Alcoa to Xerox are committed to doubling or increasing the number of internships offered in certain disciplines critical to manufacturing, including science, technology, engineering and math.

Students who enroll in the vocational and technical programs will need time to complete the coursework before they will be ready to permanently join the workforce. On-the-job training programs will play a critical role in giving these students a jumpstart on the experience they’ll need upon graduation. Companies could help provide these on-the-job opportunities.

“The skill gap issue becomes more pronounced when you consider the sophisticated environment manufacturing companies operate in today. Not only are technical skills important, but problem solving skills are extremely critical for today’s manufacturing worker.”

Ronald D. Bullock, Chairman, Bison Gear & Engineering Corp; Chairman, Illinois Manufacturers Association; Director and former Vice Chair, National Association of Manufacturers; 2010 Lifetime Achievement Award Winner

Many middle market manufacturing organizations across the nation are partnering with high schools, community colleges and trade associations to ensure their communities have access to the appropriate training. With the right training and skills, the U.S. will be in a position to create good jobs, employ a capable workforce and lay the foundation for a robust economy. Companies of all sizes should develop a formal program to attract, train and retain a skilled labor force to ensure its production levels can be maintained and grown as the U.S. economy continues to improve.
Profitability

Pricing products based on value

Increasingly, manufacturers plan to pass on increased costs to their customers through blanket increases, selective price increases or a surcharge. The Summer Monitor results indicated the level of price increases that the participants were prepared to pass onto their customers.

**Percentage of price increases**

<table>
<thead>
<tr>
<th>Percentage of Price Increases</th>
<th>61%</th>
<th>32%</th>
<th>7%</th>
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<tbody>
<tr>
<td>Up to 5%</td>
<td></td>
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<tr>
<td>6% to 10%</td>
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<td>More than 10%</td>
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</table>

*Source: Manufacturing & Distribution Monitor Summer 2011 Report*

But with thousands of products being sold to thousands of customers, inconsistent processes lead to underpriced products, sales force confusion, lost profits and lost commissions. To effectively translate strategy into actionable plans, a pricing program needs to be data driven.

Your pricing should be based on the value you deliver, not what a product costs. To justify increases, prepare your customers in advance. The key is to communicate your value proposition and what differentiates you from your competition. Remind them that increasing costs, such as raw materials, fuel or regulatory restrictions, are contributing to rising prices. Then take the opportunity to emphasize the value of your services and relationship.

When price increases are introduced, one best practice is to pilot them to select markets to see the elasticity of the pricing. Across-the-board price increases sheltered into a smaller sub-segment of the business can be an effective way to see how customers react.

**Pricing roles and responsibilities in your organization**

If you don’t define the process or standards, you can’t hold people accountable for selling on value.

- Define pricing roles and responsibilities:
  - Who maintains your pricing structures?
  - Who is in charge of customer pricing assignments?
  - Who is allowed to override and by how much?
  - What are the control limits?
- Communicate the process to the organization.
- Define the pricing standards.
- Establish process metrics and review cycle.
- Align the compensation plan for the sales force and other internal stakeholders.
“Pricing is a ‘full contact sport,’ but much of the contact is within your organization. It is important to be strategic about pricing and make sure the strategy and methodology are communicated to individuals within your organization.”

David S. Bauders, Founder and President, Strategic Pricing Associates, Inc., Cleveland, Ohio

Understanding the impact of capital strategy issues

Determining the right time to sell your business is a complex matter. It involves the coordination of aligning personal and other stakeholder objectives with the current market conditions of potential buyers. The near term looks promising for selling businesses due to a scarcity of deals with good value and the significant cash held by both financial and strategic buyers on the sidelines. This has resulted in a rise in the multiples for which companies are selling. Additionally, with the expected tax increases to come in 2013, now is a good time to consider the potential sale of your business. The following are some key items that are driving merger and acquisition activity:

1. **Financing**—Access to financing is improving. Borrowers might need to approach multiple banks rather than only one or two to access the capital needed to close a deal.
2. **Structure**—Deal structures are becoming more creative and buyers are looking for more assurance that the target company will perform in the future. Know that sellers are still looking for “determinable consideration,” meaning cash, equity or notes.
3. **Diligence**—The due diligence process is dragging on much longer than in the past. Buyers need to do more work upfront and focus on key issues rather than minor details.
4. **Company performance**—In some sectors, buyers are seeing improvement in recent company performance. It is important for companies that are considering selling to make sure financial records are in order and to look for ways to improve the quality of company earnings and financial performance.

“Before you make a move, remember that knowledge is power. Surround yourself with competent advisers, and do your financial due diligence before starting a sale process.”

Dana Williams, Partner, Transaction Advisory Services, McGladrey & Pullen, LLP, Irvine, Calif.

Globalization and exporting

As companies continue to participate in the global economy, there are a number of considerations that need to be addressed, depending on the organization’s operations. Offshore subsidiaries need to ensure they are in compliance with the laws and regulations of the countries where they have operations; exporting strategies need to be developed.

**Establishing a global compliance policy**

In a global economy, it is critical that companies establish a compliance policy to mitigate the risk of violating legislation both in the U.S. and abroad.
Domestically, conversion to IFRS in the U.S. continues to be a highly debated topic. Without an exact timeline on conversion or adoption in place, many U.S. companies are wondering when IFRS will have an impact on them. U.S.-based companies should continue to monitor key projects by the FASB and IASB, including lease accounting and revenue recognition, for the impact they may have on their financial statements.

Offshore, the Foreign Corrupt Practices Act, along with similar legislation, such as the U.K. Bribery Act and China’s Anti-Bribery Law, impose strict liability on companies for bribery of foreign officials as well as commercial bribery. In many cases, exposure goes beyond U.S. companies to their foreign subsidiaries, joint ventures and agents acting on their behalf.

As governments seek more tax revenue, transfer pricing continues to top the lists of revenue source opportunities. Consider your pricing methodology on intercompany transactions, the potential opportunities or risks related to taxation, and how well documented these transactions are in the event of a tax challenge. Even as some countries’ corporate income tax rates are decreasing, the tax law authorities are increasing the base and challenging taxpayers more aggressively in order to maintain the revenue. From a U.S. perspective, the focus on overall foreign-related tax compliance and reporting has significantly increased, with a substantial uptick in the issuance of substantial monetary penalties on related filing failures.

### Establishing a global plan for exporting

While the majority of exporting manufacturers and distributors have seen increases in exports, a striking finding is the correlation between growth in exports and a company’s health. In our fall survey, 60 percent of those companies self-identified as thriving have increased their exports, a significantly higher percentage than those companies holding their own.

As we’ve seen, exporting plays a significant role in the fiscal health of manufacturing and distribution companies. The following are best practices to consider when exporting:

- **It starts with your customers.** The most common mechanism for middle market manufacturers and distributors to export appears to be a basic one: customer and/or key client demand. Following your customers as they expand internationally is typically the first foray into an offshore market—and it is relatively less risky than venturing out on your own.
• **Then be strategic.** Reactionary exporting (i.e., following your existing customers as they expand globally) can cause companies to miss out on other potential markets that could present new opportunities. Questions manufacturing companies should ask themselves before executing an export strategy include:
  - Is our product exportable?
  - What are the demographics in the U.S. that make my product acceptable in this marketplace?
  - Which foreign countries have demographics that could be synergistic with my company’s product?
  - What does the competitive landscape look like and how does my company match up?

• **Ensure you have the right resources in place.** These should include:
  - **Financing**—Discuss exporting financial needs with your existing commercial banker. Investigate resources available through the Export-Import Bank of the U.S., the Small Business Administration and other export councils in your home state.
  - **Executive team**—Be sure the people leading the exporting charge in your organization are: committed to travel, good “ambassadors,” flexible and culturally sensitive.

• **Leverage incentives.** Explore and understand all tax and other relevant incentives. Engage consultants or specialists who stay up to date on incentives for which your company may qualify.
  - **Investigate tax incentives**—While a significant majority of survey participants indicated that tax strategies and related issues are not affecting exports, this may be an indication of missed opportunities due to a lack of knowledge about or implementation of available tax incentives or credits.

• **Level the international playing field for your company.** Understand U.S. free trade agreements (the U.S. is currently part of 14 FTAs) to overcome trade obstacles. Understand and access U.S. government trade advocacy programs. Arrange visits with potential business associates and key foreign officials with direct support from U.S. officials stationed overseas.

• **Leverage U.S. government resources.** Take advantage of resources provided by federal and state government entities, such as:
  - Become a Featured U.S. Exporter (FUSE), which puts your products on U.S. Commercial Service websites in more than 50 markets around the world.
  - International trade missions provide opportunities to meet with distributors, government and industry officials, prospective customers and U.S. Embassy officials.
  - Export.gov and other websites that provide information and assistance.

• **Know your market.** Approaching the sale of your product in another country the same way you approach it in the U.S. can be a recipe for trouble. Companies without experienced guides to foreign markets, for example, may fall out of compliance with local regulations and be barred from doing business in that country. Beyond regulatory issues, thinking strategically means having the right expertise and consultants to guide you along the way.

• **Evaluate potential partners or resources for “going global.”** One way companies have expanded is to develop a partnership with an appropriate foreign entity or bring on board the right resources to participate in the worldwide economy. We also have seen that companies aligned with private equity groups are using the experience and network of these groups to tap into new markets and drive growth and value in their company.

“Brazil is today’s ‘new China.’ Based on the survey’s results, expect the country to start becoming flooded with foreign imports by 2013. Exporters may want to turn their attention to other South American countries, such as Colombia, Panama and Peru—which are making considerable investments in infrastructure improvements—and Chile, with its sophisticated financial markets.”

*Frank Le Bihan, Managing Director, International Services, McGladrey & Pullen, LLP, Chicago, Ill.*
Looking ahead

From the vantage point of the first quarter of 2012, the manufacturing and distribution industries appear poised to continue their upward growth trends. Some believe we are truly on the cusp of a renaissance in these industries. There are a number of factors that support this conclusion:

- In January 2012, the Manufacturing sector added 50,000 net new jobs, with the prediction of more hiring on the horizon. Manufacturers are well on their way to enjoying a third consecutive year of job growth. These are good paying jobs for highly skilled personnel that are critical to helping the overall economy stay on its road to recovery.

- More companies are beginning to move production back to the U.S. This onshoring phenomenon is driven in part by the closing gap between labor costs and productivity in China (and other developing nations) and the U.S. Another factor is the increasingly unstable cost of oil, making the transportation of goods half way around the world a competitive disadvantage. A long supply chain also makes it more challenging to manage operations in distant parts of the globe.

How quickly we enter this state of renaissance will be tempered by the challenges many companies face, including the difficulty of finding skilled workers to fill the open positions, the lack of a meaningful energy policy in the U.S. and the uncertainty of regulations overall due to the impending election this fall.

By embracing these best practices, organizations can be prepared to join the ranks of thriving and growing companies that are seeing increased productivity and profitability—as well as contributing to our economic recovery.

“It is important for our economy to have a strong industrial base. We are seeing more companies looking to move their production facilities back to the United States. This onshoring is very positive for our economic outlook. More U.S.-based production means more U.S.-based jobs and it increases our exports, which is essential for closing our trade deficit.”

Karen L. Kurek, National Manufacturing & Distribution Practice Leader, McGladrey & Pullen, LLP, Chicago, Ill.
Total Monitor respondent composition

The Monitor launched separate surveys (for approximately two weeks each) in March, June, and September 2011, and January 2012. A total of 1,510 executives participated in the four surveys.

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<td>Distribution</td>
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<td>Mostly Distribution, some Manufacturing</td>
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| Titles and job functions | | |
|--------------------------|---------------------|
| CFO, Senior Finance Executive | 542 | 36 % |
| CEO, President or Chairman | 481 | 32 % |
| Chief Operating Officer | 64 | 4 % |
| Chief Marketing or Sales Officer | 37 | 2 % |
| Principal/Managing Partner/Partner | 29 | 2 % |
| Executive Management | 58 | 4 % |
| Finance Managers | 213 | 14 % |
| HR Managers | 15 | 1 % |
| Operations Managers | 33 | 2 % |
| CFO, Senior Finance Executive | 542 | 36 % |
| CEO, President or Chairman | 481 | 32 % |

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*Percentages may not total 100% due to rounding

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Upcoming events

The next McGladrey Manufacturing & Distribution Monitor survey will launch in spring 2012. Watch your email for details or contact your local McGladrey office to participate.

More than 2,000 manufacturing and distribution professionals participated in the McGladrey Manufacturing & Distribution Executive Summits held throughout the country in the fall of 2011. Contact your local McGladrey office or go to www.mcgladrey.com/manufacturing for details on the 2012 Summits and to learn about our other industry events, resources and services.
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