



# **Prospering in a Challenging Economy**

**Eight Ways to Weather This  
Difficult Economic Climate**

**2008 Manufacturing and Wholesale Distribution Summits  
Executive Summary**

# Eight Ways to Weather This Difficult Economic Climate

**More than 450 leaders** in the manufacturing and wholesale distribution industry from throughout the Great Lakes region attended our 2008 Manufacturing and Wholesale Distribution Executive Summits in Indiana, Illinois and Wisconsin. In addition to reviewing the results of the recently released 2008 Manufacturing and Wholesale Distribution National Survey, sessions on industry hot topics offered insights on staying profitable in these difficult economic times.

## State of the Industry

The current economic climate has significantly affected the manufacturing sector. Reductions in the building material and transportation industry segments have caused the number of thriving and growing companies to decline. At the same time, energy and inflation costs have challenged the bottom line.

However, while inflation expenses are high in the U.S., they are rising faster around the world – making the U.S. a consistently favorable place to create products and services, said Tom Murphy, RSM McGladrey Executive Vice President, Manufacturing and Wholesale Distribution, as he discussed the latest results of our annual national survey.

More than ever, it's important to think globally about cost and production needs. According to the survey results, only 45 percent of companies reported having a global strategy. Those who did had a 4 percent higher gross margin.

Manufacturers also face an ongoing need for capable workers. Even in the current slow economy, one in five companies reported a need for skilled workers – a drop from last year, when two in five companies said skilled workers were a pressing concern. When the economy rebounds, skill shortages clearly will be a challenge for manufacturers and distributors.

Despite the weak economy, manufacturing remains a crucial component of the U.S. economy. Many people believe that nothing is made in America anymore – but in truth, manufacturing reached its peak in 2007, Bill Canis, Vice President of The Manufacturing Institute, told summit attendees. Surprisingly, if the U.S. manufacturing sector were its own economy, it would be the eighth-largest economy in the world.

Increased productivity means manufacturers can be more competitive with their pricing structure and are able to generously compensate workers. In fact, manufacturing pays 20 percent more than the average U.S. wage, Canis said. Despite the current economic environment, the industry is very much still in the game – and here to win, Murphy added.

Focusing on the following eight areas can help you continue to grow your business and weather these tough times.

## #1: Working Capital Management

Cash is the lifeblood of every company. Understanding cash flow is critical, and working capital management provides a number of benefits. This includes: increased liquidity, which can allow a company to navigate difficult economic and credit market conditions; greater flexibility to pursue new business opportunities; and an increased return on investment.

In the current economic environment, flat or declining revenues and losing key customers or suppliers are distinct possibilities, said Tom Zipparro, Chase Bank. Having good working capital management can allow companies to pursue capital investments and pay down debt to reduce interest charges and improve their credit rating, in case they will need external funding in the future.

To establish a solid working capital management system, it's important to first understand your cash conversion cycle, and then see how it compares to other companies' cycles using ratios culled from public data sources such as SEC filings.

Making significant working capital improvements requires an internal and external focus. Internally, look at improving or changing processes, policies and incentives; externally,

closely manage relationships with customers and suppliers, but also keep in contact with lenders. In today's tight credit market, being proactive about reporting any potential cash flow issues can strengthen a company's relationship with its lender and make it easier to get an amendment or waiver.

### #2: Sales and Marketing Strategies

Reviewing your sales and marketing efforts can help you survive the economic downturn by focusing on your best customers. Marketing and selling to qualified targets is critical to generating profitable growth, Jim Fogarty, Principal, Frank Lynn & Associates Inc., said.

Understand your market and implement "actionable" segmentation based on buying behaviors. Track customer activity and score them based on payment performance and margins, determining which accounts are the worst performing and are worth exiting.

Recognize that one credit policy won't work for every customer, Fogarty said. Creating consistent collection procedures is important, but giving the sales force more authority to cut deals with customers can help increase customer relationships – and business.

### #3: Strategic Planning

In the current rocky economic climate, it is extremely important to carefully establish goals and operations and identify any adjustments needed to grow the company for the next several years, said Tom Ziemba, RSM McGladrey Director, Strategy and Human Capital Practice.

Accept that economic downturns happen, Ziemba said, and focus on what drives long-term shareholder value – such as increasing innovation; improving performance visibility; and increasing the focus on human and capital management.

Asking four questions can help a business plan effectively: What is our marketplace potential? What infrastructure investments do we need to make to reach our potential? How will we look from a financial perspective? And how do we remain innovative?

Although a management-driven approach can be effective, incorporating company leaders in the planning process and using a balanced scorecard framework to guide the planning process helps everyone stay on track. A scorecard can help encourage and gauge customer, infrastructure, innovation and financial target performance.

### #4: Lean Manufacturing and Inventory Management

Now is a good time for companies to examine functional areas of operations and scrutinize how well processes are working. To streamline the supply chain and to eliminate waste, companies are applying "lean manufacturing" methods across the entire organization.

Reducing excess inventory is a key cost-saving measure, said Dick Strojinc, RSM McGladrey Director, Performance Improvement Practice. The majority of companies surveyed are looking to reduce annual costs related to carrying inventory – which can negatively affect your bottom line by adding up to a staggering 27 to 46 percent of costs to your company based on your total inventory value. Triggers and management rules within the supply chain process can help optimize inventory.

Strojinc said technology can provide customer buying-habit information, help reduce administrative costs, offer real-time inventory status updates and provide alerts when inventory correction needs to happen. The results can be astounding: A typical company applying lean principles that starts with \$24.7 million in inventory and completes four inventory turns can reduce inventory to \$9.9 million and improve turns to 10 times, giving them an annual savings of more than \$4 million and a cash flow increase of \$15 million.

### #5: Labor and Workforce Management

Employee retention is critical during an economic downturn. Companies need to ensure that their compensation and benefits programs are competitive to retain employees, with an emphasis on rewarding top performers. It is increasingly important for companies to have recruitment and reward plans in place to attract and motivate critical talent – and maximize the return on a company's human capital investment.

Steve Sullivan, RSM McGladrey Director, Strategy and Human Capital Practice, said compensation planning needs to incorporate a company's overall business strategy as well as factors such as corporate culture and the current economic climate with the goal of maintaining a high-quality team.

As employers pass on health care and other costs to employees and the national Consumer Price Index ramps up, employees struggling to keep up with inflation and rising costs may not experience real wage growth.

Research shows that wage and affordability issues can be a huge distraction and stressor in the workplace.

To entice skilled workers, it's important for employers to offer competitive wages and benefits: Turnover can easily cost a company 150 percent of an employee's annual compensation.

#### #6: Health Care Costs

Health care costs continue to rise and many manufacturers in the midsized market expect health care costs to increase in the 7 to 10 percent – or even beyond 10 percent – range, said Cindy Wood, CLU, ChFC, FMLI, CPCU, RSM McGladrey Director, Health Care Consulting.

To control the ballooning costs, employers have increasingly begun shifting the expenses to employees. However, that practice has begun to taper off as it has become clear that increased benefit expenses can affect employee attraction and retention.

As a result, many employers are encouraging consumer-directed health plans (CDHPs), which offer employees more control. CDHPs are higher deductible plans coupled with a tax advantage savings plan – such as a flexible spending account or health savings account.

Other cost-reduction techniques include placing limitations on spousal coverage, implementing wellness and preventive programs to focus on long-term quality and controlling administrative costs by proactively managing insurers and third-party administrators.

Being extremely vigilant and performing audits and reviews to make sure claims are being accurately handled can yield a company 5 to 7 percent in overpayments that have been made to hospitals and physician providers, Wood said.

#### #7: Energy Management

Inflation is here to stay, and it's important to know which energy expenses are economically feasible today versus yesterday because costs change quickly, Murphy said.

Making informed energy decisions can be tricky. It requires understanding what affects local energy prices, and forecasting and budgeting appropriately. A balanced

energy approach includes a strong budget strategy, risk management, demand-side management and clever commodity procurement.

To control the energy budget, long-term options such as customized electricity contracts and on- and off-peak and seasonable blocks may help. Companies can often lock in a fixed price for energy for an extended period of time or when market prices reach a certain point, essentially paying for tomorrow's power at today's prices and providing long-term savings.

Managing and reducing internal energy use and using renewable, sustainable energy whenever possible also can provide savings. Green energy solutions such as solar power systems may qualify companies for renewable energy certificates.

#### #8: Tax Opportunities and Implications

Taking advantage of all possible tax relief opportunities is important – but not always the norm. Most companies, for example, could take the Research and Experimentation credit given for improvement and innovation, yet, last year, only 60 percent did, Murphy said.

Equally important to reaping pertinent tax breaks is knowing all requirements, said Dave Luzi, RSM McGladrey Managing Director, International Tax Services. Companies need to know whether foreign bank account reporting is required and being completed in a timely manner, or how a particular business activity will impact its tax position.

Also, companies are advised to plan for a probable accounting change with tax implications: convergence with International Financial Reporting Standards (IFRS). While most manufacturing companies won't be required to switch to IFRS in the near term, the process will require training and time, so companies should begin planning now.

Tax considerations vary from company to company and without being informed about tax breaks and restrictions, your company could stand to lose – or pay – a significant amount.

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## Keynote Presentations

Every year, we look to provide our Manufacturing and Wholesale Distribution Summit participants with industry insight and analysis from some of the region's top thought leaders. This year was no exception, with keynote speakers at each of our summits providing their unique perspectives on the impact of globalization and the slowing economy on the Midwest. In an effort to share all three presentations with you, we have summarized them below. We hope you find the information beneficial.

– Karen L. Kurek

*Manufacturing and Wholesale Distribution Leader, Great Lakes region  
RSM McGladrey Inc.*

### Is Globalization the Midwest's Saving Grace?

**Richard C. Longworth** *Senior Fellow, Chicago Council of Global Affairs, and author of Caught in the Middle: America's Heartland in the Age of Globalism*

Although the Midwest — the historical heartland of America — for years was known for its farms and factories, its communities are now facing unfamiliar forms of progress thanks to globalization.

Globalization means we're competing with factory workers in China, office workers in India as well as innovation itself. The Midwest is making and exporting more goods than ever before, but manufacturers are not employing as many workers as they once did.

Middle-American communities will have to redefine themselves by looking at biofuels, polymers and migrant workers as a way to stay competitive and by integrating factory farms, new industries and an immigrant workforce within their economies in order to be successful on a global level.

Globalization is affecting all facets of Midwestern life, from factories to schools to the way we work to the way we live, but it's also posing new opportunities and new challenges that may be the

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### RSM McGladrey Lifetime Achievement Award Winner



**William R. Rose**

RSM McGladrey presented its 2008 Lifetime Achievement Award to William R. Rose, CEO of Rose Packing Company Inc., for his outstanding commitment and service to the Chicago business community.

Without Mr. Rose's commitment to innovation, Rose Packing Company Inc. might not exist today. He designed machines that revolutionized the way the company did business, resulting in improved labor costs and increased efficiencies.

Mr. Rose has become a leader in the food services industry by recognizing the importance of technology in staying competitive. His leadership and commitment to advancement extends to his civic involvements as well:

- A past president of the Chicago Midwest Meat Packers Association (1960-1962, 1964-1965)
- One of the founders of the Village of South Barrington
- His contributions helped build the Barbara B. Rose Elementary School in the Barrington School District
- Developed the Glen of South Barrington neighborhood

#### About the Award

The RSM McGladrey Lifetime Achievement Award recognizes distinguished business executives who have demonstrated outstanding leadership in business and civic involvement, and who, through their efforts, have made a significant contribution to the community and set an example for the leaders of tomorrow.

key to how the region will prosper once again.

### **Just How Challenging Is the Economy?**

**Grant Black** *Assistant Professor of Economics, Indiana University South Bend*

With its heavy reliance on the manufacturing industry — about 18 percent of employment is tied to manufacturing compared to less than 10 percent nationwide — Indiana is feeling the profound effects of a struggling economy. Since August 2007, manufacturing employment has dropped 3.2 percent, or more than 17,000 jobs — 13,900 of which were just lost since March 2008.

Still, Indiana is faring relatively better than its neighboring states, with an unemployment rate that is a bit lower and an export growth rate that is exceeding even the national rate of export.

Since nearly 20 percent of Indiana's manufacturing employment is related to exports, exporting plays a key role in the state's economy. Last year, Indiana exported \$25.9 billion in goods, up 14.4 percent from the previous year, making the state 12th in the nation in export sales. In fact, Indiana is one of only nine states that has a ratio of export sales to state GDP of at least 10 percent.

With its dependence on manufacturing and exporting in a slowing global economy, it is all the more important for the state's manufacturers to increase efficiency to become more competitive, improve their financial standing and invest in local economic development.

### **Economic Outlook for 2008-2009**

**Don Nichols** *Professor Emeritus of Public Affairs and Economics, University of Wisconsin-Madison*

In this current economic downturn, falling home values and the credit crunch have led to a decrease in consumer purchases in the U.S. Though there are signs of stabilization in some parts of the country, many other regions remain severely impacted.

Fortunately, it may be something happening globally — exporting — that may be the key to getting us out of our current economic crisis.

Export activity is helping to reduce the effects of the downturn. Since mid-2003, the percentage of our GDP from total exports has steadily increased, with only a slight decline in exports this year. In order to further strengthen our local and U.S. economies and become more competitive on a global level, regions need to