ISM Polls Show External Effects On Manufacturing And The Supply Chain

This article first appeared in IMPO's July 2013 *[1] issue.*

The Institute for Supply Chain Management held their 98th Annual International Supply Management Conference & Educational Exhibit April 28th through May 1st in Grapevine, TX. More than 2,000 professionals attended the ISM conference and several “instant” digital polls were held throughout the three-day period, taking a look at reshoring and tax concerns amongst members. Thomas Derry, the CEO of ISM, discusses the results of those polls and how they are affecting business and the overall economy.

Q: The recent ISM Survey focused on re-shoring and tax concerns. Were there any surprises in the data?

Derry: I wouldn’t say that I was surprised necessarily, but concerning the topic of nearshoring or reshoring, the results validated what we had been seeing in other places. About 30 percent of our companies said they were considering or planning to bring manufacturing back to the United States, and that seems to be pretty consistent with what we are hearing from other sources as well. If you are talking about very large companies, the number is a bit higher, and it’s a bit smaller when talking about smaller companies. Our membership represents that whole range, so if you want to talk about American industry in general, our number is a pretty accurate indicator of what companies might be planning to focus on in the next twelve to eighteen months.

Q: With 30 percent of respondents reporting that they are “likely” or “very likely” to reshore in the next year, what does this mean for American manufacturers? How do you feel that it will impact the supply chain and competitive outlook in America?

Derry: While 30 percent of respondents reported they may consider reshoring, it is important to remember that many of these decisions result from their company’s supply chain risk management strategies. The impact of the earthquake in Japan, floods in Thailand, and social responsibility issues like the recent garment factory fire and building collapse in Bangladesh were devastating. The increased cost of freight, along with the need for supply chain risk management, have driven decisions to maintain supply chains more closely to the point of manufacture. Rather than shipping components all over the world, many companies are considering duplication of factories to cut costs and manage risk.

This means a couple of things: on the one hand, the reason people are actively considering and making plans is that these plans are part of a risk diversification strategy. With a more global market, there are more natural disasters to contend with. Another aspect of it is dealing with social responsibility issues, especially in light of the recent headlines coming out of Bangladesh. Companies are also building closer to market because they are finding out that the total landed cost of a multi-national and complex supply chain can be more expensive than they had anticipated.

We are also not seeing the large differentiation in labor rates that was part of the main reason for offshoring twenty years ago. As labor rates are becoming more and more equalized across the globe, and as the other factors like natural disasters and the corporate responsibility movement enter the horizon, it all adds up to a pretty compelling case for most companies to bring manufacturing back to the states.

In terms of American manufacturing, I think that it will be episodic. You are not going to see the same numbers of jobs as we reshore, simply because the wave of automation in recent manufacturing. Jobs will be coming back here, but they will be different jobs than the ones that left twenty years ago. There is a whole new factor today as well: we are seeing states going to auction to woo a new facility to their state. That puts companies in a very different place than ever before. It is very competitive for these states to land these jobs because they are good jobs, oftentimes high technology jobs, and they bring a good tax base to the area as well. States are eager to land that kind of business.

Q: Higher taxes and weak economic climates seem to be a theme at the forefront of most company's worry list. What would have to change in the U.S. to help eliminate some of these fears? How will these fears translate into mergers and acquisitions or job losses in the next 6-12 months?

Derry: Higher taxes and the weak economic climate are a current theme on the mind of most CEOs. Many are concerned about the continued weakening of the European economy. With the weak economic climate, sequester, and higher taxes, many manufacturing companies have made major investments in automation, systems, and equipment for their plants. Currently, consumer spending is improving and the productivity gains for many manufacturers have provided high levels of profitability and increased levels of cash.

In general, I would say that the outlook that most companies have about their economic future is improving, albeit slowly. That will lead companies to eventually be in a position to make more of an investment in hiring, in product development, and in research and development. There is a constant discussion going on about the relative tax rates: U.S. tax rates are comparatively high compared to other countries. If you have a weak economic climate and high tax rates, it does tend to push investment decisions to other parts of the world. You also want to be close to the other customers around the world, positioning yourself and your product near emerging markets such as Brazil or China. The U.S. has to recognize that they are competing globally for this kind of work and that we have to be competitive in terms of the business climate that we create for these companies. The United States is just one of many possible good answers to the manufacturing question around the world.

When it comes to M&A, it is a very individual decision. Each company has their own idea as to how M&A is beneficial to them or how important it is to their overall growth strategy. It wouldn't surprise me to see an uptick in M&A activity. For one, it is a lot easier to acquire operations close to markets that you want to enter than it is to build them up from the ground. Companies also have a lot of cash available to them right now and they are looking for opportunities to put that cash to work.

Q: Why do companies have these cash reserves?

Derry: I really think it has been a risk management strategy. Companies have wanted to build a buffer of cash to protect their businesses against uncertainty. In March of 2009, things were pretty bleak. People were very intent on improving their cash position so that they would be in a position to withstand any unpredictable event that might occur.

Things have improved quite a bit since then, but companies are cautious by nature and want to be prepared. The rate of growth in adding to cash on corporate balance sheets has slowed very noticeably the last twelve months, but they are still sitting on record amounts of cash. They are not adding to it now, but the fact that it is still there indicates that they are comfortable where they are and are prepared to deal with anything that might pop up. If CEO confidence continues to improve, and there is less of a chance that they feel they will have to deal with unexpected events, I think you will see them become a little bit more focused on the investment side of their business, whether that means new product innovation or new plants being built.

As for the job numbers – it is hard to say. The economic recovery that we are still engaged in is notably different than other recoveries in that we are seeing more discouraged workers than we have in the past, and that job creation has been weak in comparison. I don't know that we are anticipating more job losses, but we are not seeing the kind of growth and creation of new jobs that we have seen in the past. That is why companies are still being a little cautious about bringing in new employees. The outlook is improving, but it is still weak in comparison. I wouldn't anticipate job losses, but I would anticipate weak job creation.

One more interesting development economically is a surge in the oil and gas industry and the chemicals industry. We are hitting the whole shale oil development in the western hemisphere and it has changed the fundamental underpinnings in the economy here in the United States. Companies are talking about building refineries and chemical plants here in the United States and we haven't done that in twenty years. It is a pretty fundamental change in the makeup of that industry, and it is one that is going to have significant repercussions on the future of our U.S. economy.

Links:
[1] http://digital.impomag.com/impo/july_august_2013#pg1