Invest in yourself

Manufacturers: Reinvest savings into your company to gain an advantage

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WEBSITE: Check out the results of our Northeast Ohio Manufacturing and Distribution Survey. Visit skodaminotti.com/MFG.

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The state of manufacturing in Northeast Ohio is economically cautious, according to Jon Shoop, CPA, principal at Skoda Minotti.

"Many manufacturers see that there are sales to be made and business to be had, but they're hesitant to go out and spend on capital improvements or people," he says.

Manufacturers in Northeast Ohio had a strong first half in 2016, but the second half tapered off, he says. Some of those businesses feel that the warm winter last year accelerated orders in the first half — orders that enabled construction starts, for instance — which in turn cannibalized orders from the second half.

"There has been more strategic and financial M&A buys," Shoop says. "There is money to be spent and manufacturing is seen as a hot target. Buyers, including companies and private equity firms, are buying manufacturers and getting value out of those businesses. Owners of manufacturing companies that are approaching an exit and have groomed their business in preparation can expect a payday."

He says there's also a trend toward additive manufacturing, with the proliferation of 3D printing shifting the focus away from piecework and low wages.

"The process lends itself to a more innovative environment than in China where the competitive advantage is low cost of production."

Smart Business spoke with Shoop about the state of manufacturing, the industry's challenges and its opportunities.

What challenges should manufacturers expect to face this year?

Some of the main challenges manufacturers face are sales competition, rising material costs and lack of available skilled labor.

Workforce continues to be a challenge, especially as reshoring — bringing jobs that had been outsourced to other countries back to the U.S. — continues to be the trend. There are educators, associations and public entities that are working to provide solutions, but the response hasn't been fast enough to outpace the problem.

Sales competition is another challenge that is directly related to the quality of a company's innovation and product diversification models. Manufacturers must create opportunities in existing markets that are nontraditional to gain an edge in sales. For example, some manufacturers are doing contract manufacturing or manufacturing as a service in addition to their standard offerings. Some companies have begun taking, processing and shipping other manufacturers' orders as a way to diversify business to create more sales opportunities.

Manufacturers are also contending with rising material costs, either through a rise in commodities prices or vendors raising prices. The reflex response is to improve processes to increase efficiency. But that approach, in the long-term, isn't sustainable. Instead, a cost-plus approach to pricing ensures manufacturers aren't giving efficiencies away. The revenue gained through improving processes should then be reinvested in the company.

Why should manufacturers emphasize sales over cost savings?

Sales dollars are more impactful when reincorporated into the organization. A 1 percent sales price increase has been shown to improve earnings before interest and taxes (EBIT) by 10 percent. Manufacturers should focus on costs and find ways to reduce expenses, but they also need to focus on their sale price.

What is the relationship between price increases and market share and how can the two be balanced?

Reducing prices just to keep market share is a mistake as it will most likely have a negative impact. A price cut — let's say a 3 percent reduction in sales price to hold the line and maintain market share — reduces profit by that same 3 percent. That's a 30 percent reduction of profit on a 10 percent return, which would decimate profitability. Instead, consider removing other value-add items or services — ask for cash in 10 days rather than 30 or require customers to pay freight, for example.

Manufacturers should invest in people, training, capital equipment, technology and strategic acquisitions rather than compete to be the lowest-price option. Banks have money to lend, so put cash to use and look for tax credits or incentives to reduce out-of-pocket expenses on those investments. ●