



Manufacturing & Distribution Monitor  
Fall 2011 Report



Assurance ■ Tax ■ Consulting

## Preface

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**RSM McGladrey, Inc.**

Welcome to the fall 2011 edition of the McGladrey® Manufacturing & Distribution Monitor Report. Manufacturers, particularly in the durable goods sector, suffered from a number of challenges leading into the fall, including supply chain disruptions, continued high levels of energy and raw material costs, and falling business and consumer sentiment. Nevertheless, 43 percent of Fall Monitor participants say their businesses are thriving and growing.

Yet a number of concerns continue to plague the industry. In particular, the view that federal government gridlock is the highest risk to business growth increased more than 50 percent over the summer survey results.

In this quarter's Monitor, we focus on exporting and establishing a direct presence overseas, and look at the associated motivations and the challenges. Highlights of what we found include:

**Who is exporting**—While 71 percent of respondents overall report that they export to countries outside the U.S., a striking finding is the correlation between growth in exports and companies' health: 60 percent of those companies that are thriving have increased their exports, a significantly higher percentage than those companies holding their own. In other words, exporting sales is recognized by those thriving companies as a key driver for growth.

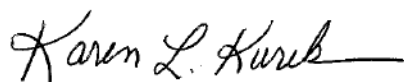
**Why they are exporting**—The most common driving force for middle market manufacturers and distributors to export is, not surprisingly, customer and/or key client demand. Opportunistic reasons were cited as a reason by a significantly smaller number of companies, but are still among the top four and closely related. The next most common reason that companies export is a more internal driver, long-term market growth, which factored into the decision to export for more than half of the survey participants.

**Where they are exporting**—There is a rising level of interest in exporting to various locations, notably Brazil, Central and South America. Brazil, in particular, appears to be next in line as the country in which middle market manufacturers see the greatest export growth potential. The new Free Trade Agreements with Colombia, Panama and South Korea will undoubtedly attract interest in those countries as well.

**Challenges to exporting**—The challenges that companies face when they initially export appear to change as that impulse evolves into strategy. Following the first foray into an offshore market, where challenges mainly relate to transaction processing issues, these challenges shift to more strategic issues, such as foreign competition and market acceptability, as the companies gain more experience with global expansion.

Once again, many thanks to our fall survey respondents for their time and insights, as well as to the industry and business associations that encouraged their members to participate.

Best regards,



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## Executive summary

### Overall outlook: Cautious optimism

In continuing the trend that began last spring, and despite a number of challenges in rising prices and falling sentiment, 43 percent of Fall Monitor participants say their businesses are thriving and growing. This third quarter survey shows no decrease in the number of businesses describing their companies as “thriving and growing” and no increase of companies that see themselves in decline. This cautious confidence is corroborated by the latest National Association of Manufacturers/IndustryWeek survey that found that 65 percent of NAM members were either somewhat or very positive about the current business outlook.

Although the percentages have been virtually identical, there has been some movement among those who are thriving and growing across the various industry sectors.

### Pessimism continues to rise

Overall, manufacturing and distribution executives are increasingly pessimistic about issues that extend beyond their company walls. Deficit concerns, the downgrade of U.S. debt and sovereign debt crises in Europe all contributed to the gloomy mood. Federal government gridlock, in fact, was number four on the pessimism scale in the summer survey; now it’s risen to the top of the list.

Yet for all the pessimism, executives appear to be optimistic about their own companies. This optimism may stem, in part, from businesses that are global in nature and not tied exclusively to the U.S. economy.

### Thriving and growing companies more likely to export

With 95 percent of the world’s population residing outside the U.S., a closer look at exporting seems particularly relevant.

Overall, 71 percent of respondents report that they export to countries outside the U.S., with a majority (52 percent) reporting increases in the past year. Industry sectors in the upper tier seeing the most export activity (i.e. Biotech, Industrial Machinery and Automotive) by and large produce highly engineered products, thus enabling them to distinguish themselves in foreign markets from locally produced products. The same cannot be said of those industry sectors with the least export activity, where products are generally commodities that can be manufactured and bought more cheaply in their respective domestic markets. These sectors include Building Materials, Food and Beverage, and Wood, Paper and Printing.

### Reasons and challenges evolve

The most common mechanism for middle market manufacturers and distributors to export appears to be a basic one: customer and/or key client demand. The next most common reason for a company to export is a more internal, strategic driver, long-term market growth, which plays a part in the decision as well for more than half of the survey participants.

The challenges that companies face when they initially export appear to change as that impulse evolves into strategy. The primary hurdles change from more transaction/process-oriented issues to other considerations that did not exist before, such as foreign competition and market acceptability.

## Target markets evolve

There is a rising level of interest in exporting to various locations, notably Brazil, Central and South America. Brazil, in particular, appears to be next in line as the country in which middle market manufacturers see the greatest export growth potential.

Because the Free Trade Agreements with Colombia, Panama and South Korea were signed in late October 2011, after the Fall Monitor was closed, it should be worth watching to see if exporting plans for the industry are directed towards these countries as a result of the agreements; in particular for South Korea, where distance and the difficulty of penetrating the market appear to have kept plans for exporting low.

Growth appears to be slowing for exports to China, where the market is getting ever-more sophisticated and thus harder to penetrate.

## Establishing a direct presence

Whether or not they export to foreign markets, the larger the company, the more likely it is to have a direct presence in a foreign market. Those companies in the lowest revenue tier are likely to be making their first step into foreign markets, while those with revenues over \$500M are already in foreign markets and are more likely to expand into additional markets. Perhaps this is because their experience has made them more globally savvy as well as comfortable getting established in new markets.

Typically, foreign market expansions start with establishing a foreign sales representation as opposed to a production facility. Those who fail or are unable to establish a direct presence effectively often fall into common traps due to inexperience or lack of expertise.

## Importance of emerging markets

Whether companies are establishing a direct presence, sourcing raw materials or exporting products, the importance of emerging markets for middle market manufacturers and distributors varies depending on the need. For U.S. companies today, there is interest in emerging markets in which to sell products as well as those where companies can offshore production to take advantage of lower costs.

## Exporting best practices

We have also compiled a comprehensive listing of best practices of those companies who have successfully navigated the exporting challenges of global expansion.

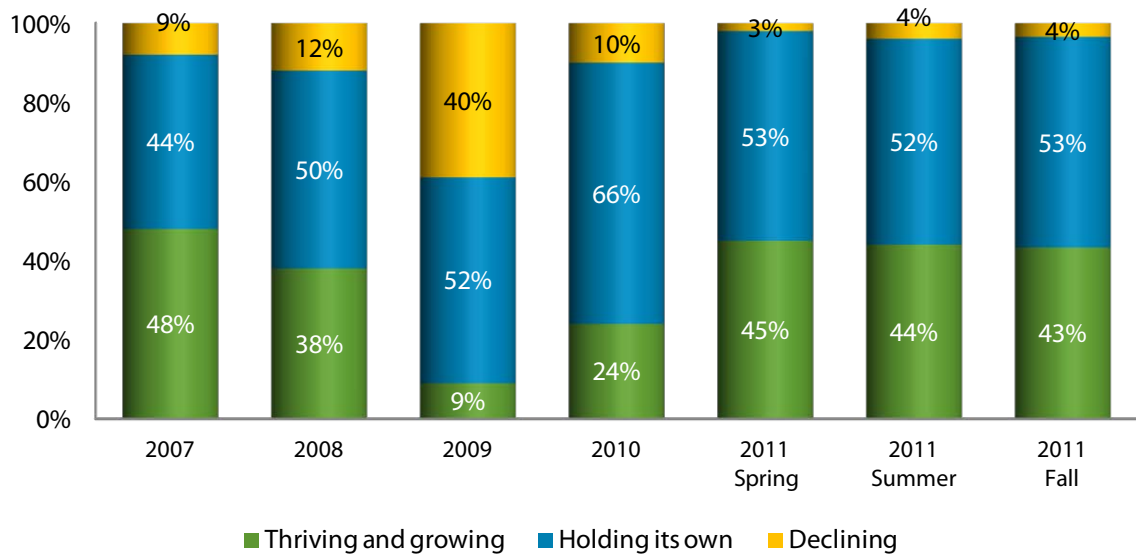
## Core McGladrey Monitor Trackers

### Stability in perceived company health

What best describes the general condition of your business at the present time?

Chart 1

#### Current condition of business



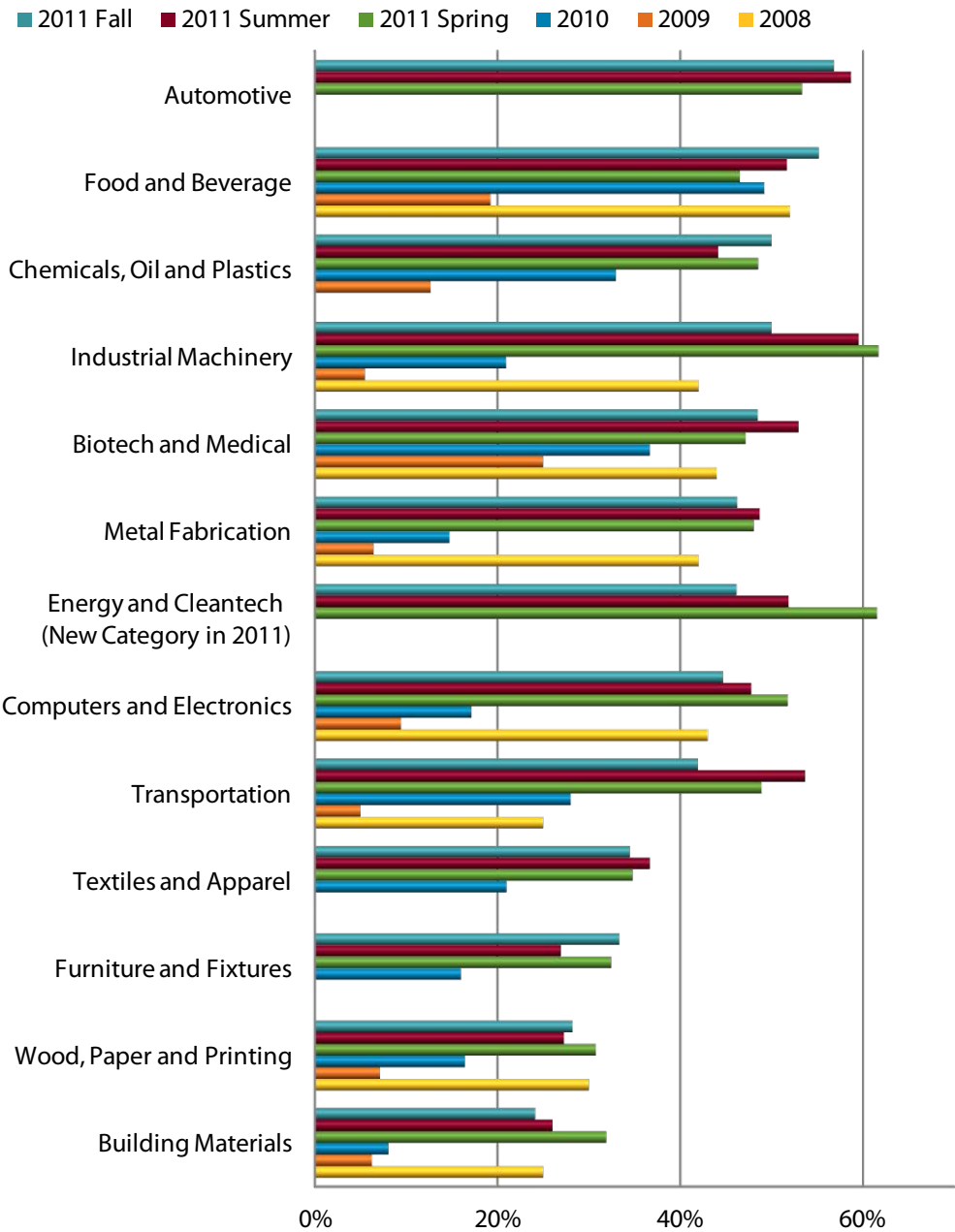
\* Some items may not add up to 100% due to rounding.

Perceptions of current business conditions remain positive for the third quarter of 2011, showing no decrease in the number of businesses describing their companies as “thriving and growing” and no increase of companies that see themselves in decline. Fall figures continue to show a strong surge in perceived business health over 2010 and a significant turnaround from 2009.

There is no change in the proportion of thriving companies in the overall sample from the summer, although some 70 percent report a “softening” of confidence from the summer. Some individual sectors, however, do show significant shifts over the last three quarters. Most sectors have somewhat fewer thriving companies than they did in the summer, with Industrial Machinery and Transportation showing the greatest declines. Only Food and Beverage, Chemicals, and Furniture have a higher percentage of thriving companies than in the summer.

Chart 2

"Thriving and growing" by industry segment



**Summer Ranking**  
 Industrial Machinery  
 Automotive  
 Transportation  
 Biotech and Medical  
 Energy and Cleantech  
 Food and Beverage  
 Metal Fabrication  
 Energy and Cleantech (New Category in 2011)  
 Computers and Electronics  
 Chemicals, Oil and Plastics  
 Textiles and Apparel  
 Wood, Paper and Printing  
 Furniture and Fixtures  
 Building Materials

The **Automotive** sector has climbed into first place this quarter. Earlier this year, the sector suffered the impact of the tsunami in Japan and the ensuing disruption in the supply chain. In the last two quarters, however, this sector has strengthened as vehicle production has seen a steady increase in the U.S. According to Ward's Auto, 7,181,000 vehicles were produced in the U.S. this year as of Oct. 31, 2011. This is a 9.7 percent increase over the previous year.

The **Food and Beverage** sector has seen a steady increase over the past two quarters in companies reporting that they are thriving and growing. According to Cristin Singer, practice leader of Food and Beverage for RSM McGladrey, Inc., the positive outlook of Food and Beverage executives may be attributable to “the recession-resistant nature of the space and the high number of profitable, growing and innovative companies out there, especially around niche products and markets.”

The rise in popularity of private label products, where middle market manufacturers tend to work, accounted for 19 percent of total food and beverage sales in the last fiscal year, their highest level ever. In addition, prices of corn futures for December 2011 delivery surged 68 percent in the past year and touched a 10-week high in late August, as recent spring floods and moderate droughts in the Midwest are expected to reduce harvests; soybean and wheat prices continue to rise as well. As input costs

The rise in popularity of private label products, where middle market manufacturers tend to work, accounted for 19 percent of total food and beverage sales in the last fiscal year, their highest level ever (“Public Growth for Private Label,” Food Processing, July 2011).

“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.

continue to rise, food companies see an increased demand for private label products.

The **Chemical** sector moved from eighth place in the summer survey to third place this fall. This can be partially attributed to the easing in crude oil prices over the past few months. Additionally, there has been an uptick in acquisition activity in this sector. Driven by private equity funds that sat on the sidelines in 2009 and 2010, new funds are looking to make platform acquisitions, and a

slew of strategic players looking to diversify their business into growth markets, Chemical industry M&A appears to be on pace to healthy levels seen prior to the financial meltdown, according to McGladrey Capital Markets.

**Industrial Machinery** saw a decline from summer to fall of about 10 percentage points. According to Chad Moutray, chief economist at NAM, this should not be surprising, as recent durable goods data shows a definite weakness in new orders and shipments. He notes, however, that this sector is beginning to turn around, as is the larger durable goods sector. Driven by the weaker global economy, machinery has benefited from exports more than many other sectors.

The **Energy and Cleantech** sector experienced a steep drop in thriving and growing companies—from the spring to the fall reporting only 45 percent, down from more than 60 percent—the biggest decline from spring to fall of all the segments. Any generalizations made regarding the reasons for this drop that are based on the survey results must be viewed with caution, as the survey population that experienced the downturn is rather small. However, this decline may be attributed to the large number of companies in this sector that rely on federal funding, which has recently been under scrutiny.

According to Bob Glazik, a partner with McGladrey & Pullen, LLP, the drop from thriving and growing for these companies may be due to concerns about the economy as well as uncertainty regarding government regulations, which are important to the renewable energy community. In addition, many federal and state credits and incentives programs for energy-efficient products have expired, been reduced or eliminated and, along with them, consumer demand.

“Energy prices have eased but remain highly elevated, and the industry itself is under assault because of proposed new energy taxes. There are also potential PR spillovers from Solyndra and other “green” companies that might have a chilling effect on sentiment.”

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

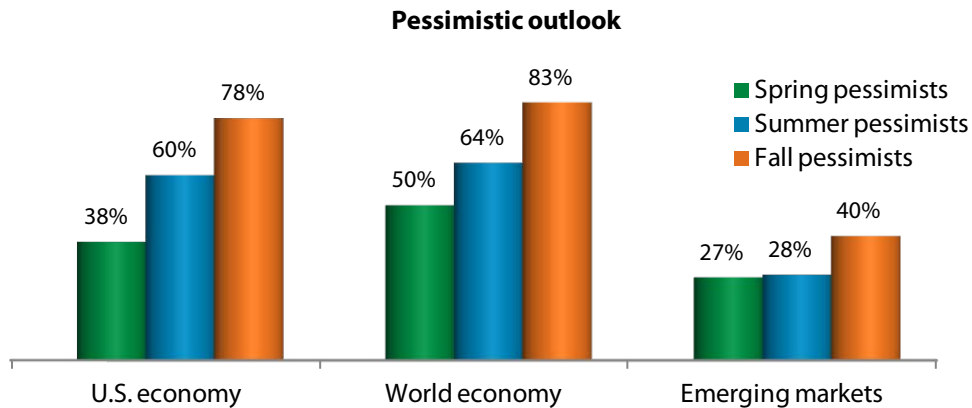
Globally, there is an increasing amount of acquisition activity to accelerate growth in the Energy and Cleantech sector, including renewable energy. Despite recent high-profile failures of some solar energy organizations, the United States represented 32 percent of total deal volume for renewable energy, according to McGladrey Capital Markets, and was driven by market demand rather than government incentives.

The decline in the **Transportation** sector may be due to survey participation by manufacturers of leisure transportation vehicles or those supplying them, who continue to be battered by the economy, and a low level of consumer confidence and spending.

### Pessimism continues to rise

*How optimistic are you about overall economic growth prospects for the following over the coming 12 months?*

Chart 3



In general, respondents tend to be more optimistic about their own companies and their industry compared to their views on the broader economy. An exception to this is found with Building Materials, Wood/Paper/Printing, Furniture, and Textiles executives who were more likely than others to be pessimistic about their companies and their industries. This may be due to the lower percentage of these companies that export as well as their ties to and reliance on the U.S. housing market.

For the majority of respondents, when looking at elements outside of their control, pessimism remains high. Pessimism is significantly more pervasive in the fall than in the summer, which was strikingly more pessimistic than the spring figures. The survey was fielded in late September/early October, when issues of government gridlock and the sovereign debt crisis in Europe were having a global impact. Undoubtedly, the continuingly uncertain prospects for the U.S. economy contribute to the rise in pessimism.

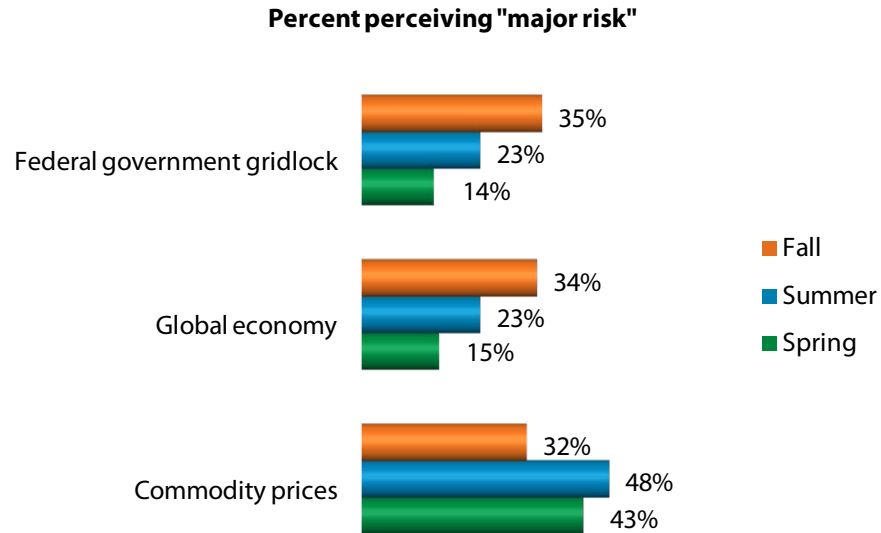
While a majority of executives continue to be optimistic about emerging markets, the incidence of pessimism is up 28 percent in the summer to 40 percent in the fall. Yet even the optimism towards emerging markets may be tempered with the easing of growth in China, where after reaching an impressive 10.3 percent in 2010, economic growth will slow to an average of 8.5 percent a year in 2011-15, according to the Economist Intelligence Unit.

More than 90 percent of automotive executives are pessimistic about the U.S. economy, while 84 percent are optimistic about their own company's prospects. This seeming dichotomy may be understood in light of the industry's global nature (see Chart 7); automotive manufacturers and their suppliers don't need to rely solely on the U.S. economy.

## Perceived risks to growth

Please indicate the level of risk you feel the items below will present to your business growth in the coming 12 months.

Chart 4



Government gridlock and the global economy are up dramatically over the summer figures, in line with breaking news over the past few months, representing a 50 percent increase in those perceiving high risks to growth. Companies with the lowest revenues in the survey were more likely to see high risk in government gridlock than others. It should be recalled as well that the summer figures represented a 50 percent climb over the spring percentages. This comes when the job approval ratings for elected officials across the board are at all-time lows.

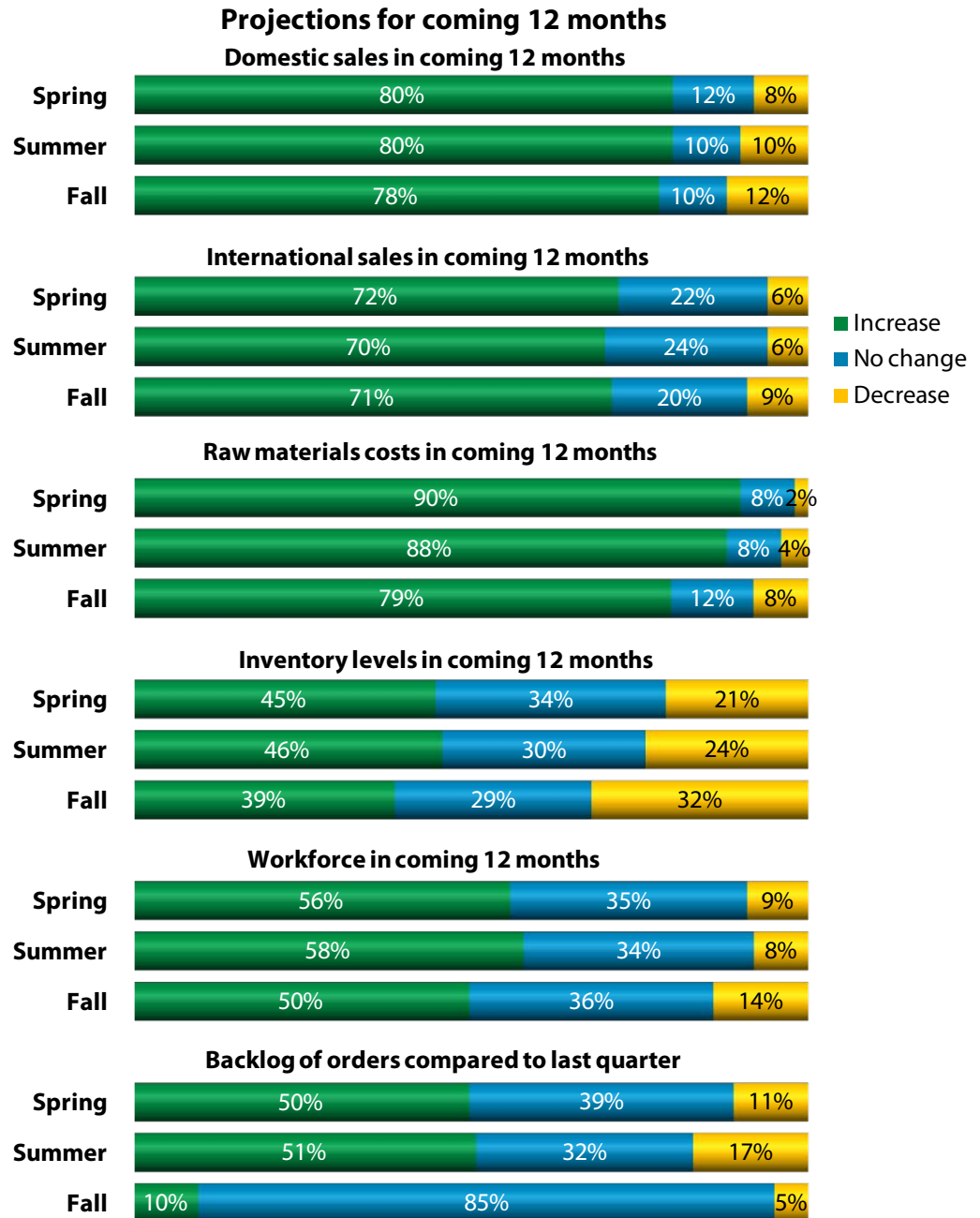
Notably, the perception of higher commodity prices have receded most of all and are down by 16 percentage points (representing a 33 percent difference). While commodity price increases have eased in recent months, as we saw in the Summer Monitor, many manufacturers are confident these rising prices can be passed on to customers.

# McGladrey Monitor quarterly benchmarks

## Key indicators for coming 12 months

What percent change, if any, do you anticipate to your company's domestic sales in the coming 12 months?

Chart 5



\* Some items may not add up to 100% due to rounding.

## Fall 2011 Manufacturing & Distribution Monitor

Consistent with the sentiment of participants who reported their companies are thriving and growing, for the third quarter in a row the overwhelming majority of participants anticipate growth in both domestic and international sales. Although raw material price increases have eased a bit from the previous two quarters, nearly 80 percent are nevertheless expecting their input costs to rise.

Expectations for increases in the industry workforce vacillated between 50 percent reporting an increase in the spring, up to 58 percent in the summer, then back down to 50 percent in the fall. The drop in the fall expectations may be attributable to a number of factors. Management may be suffering from a 'search fatigue' due to an inability to find qualified workers, a common issue in the industry. With backlogs appearing to level off, and continued uncertainty regarding the U.S. and global economies, companies may also have grown wary of hiring until economic indicators are less volatile.

"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."

- Karen L. Kurek, *National Manufacturing & Distribution Practice Leader, RSM McGladrey, Inc., Chicago, Ill.*

However, it should be noted that 50 percent of the respondents continue to report they will expand their workforce by an average of 7 percent in the next 12 months; and many of these companies have open positions they cannot fill due to a skill gap in the U.S. workforce. This is a disturbing fact given the continued high level of unemployment in the country.

Notably, the expected orders backlog dropped to 10 percent from 50 percent in the summer across the board, with fewer in all industries reporting increased backlog numbers. The two biggest drops are seen in Furniture and Fixtures, which dropped from 69 percent reporting an increase in summer to 11 percent for the fall, this is likely due to the sector's close ties with the anemic U.S. housing market; and automotive which dropped from 67 percent to 7 percent, as respondents who participate in the Automotive sector were able to substantially work off their backlogs in the third quarter due to their supply chains returning back to normal, resulting in their ability to fill back orders.

Somewhat encouragingly, the shift is not toward declining backlogs but toward a plateau, with 85 percent reporting no change from the previous quarter. Additionally, the number reporting a decrease in backlogs is down significantly from 17 percent in the summer to 5 percent in the fall figures.

## Fall focus topic: International expansion and exporting

### Exports by industry

Overall, 71 percent of respondents report that they export their products to customers in countries outside the U.S., which translated into 16 percent of their total company sales. The majority of exporters are manufacturers, who are significantly more likely than distributors to export (78 percent vs. 41 percent) and who naturally show a higher percentage of sales from exports than distributor exporters (17 percent and 13 percent, respectively). This should not be too surprising, given that distributors generally find it more profitable to operate within geographic regions.

As noted above, for respondents who reported they export, 16 percent of their total company sales are export sales. Interestingly, industry sectors that report the highest percentage of export sales are Computers and Electronics; Industrial Machinery; and Biotech and Medical. Companies in these segments tend to offer products that are higher dollar value items with differentiated engineering features.

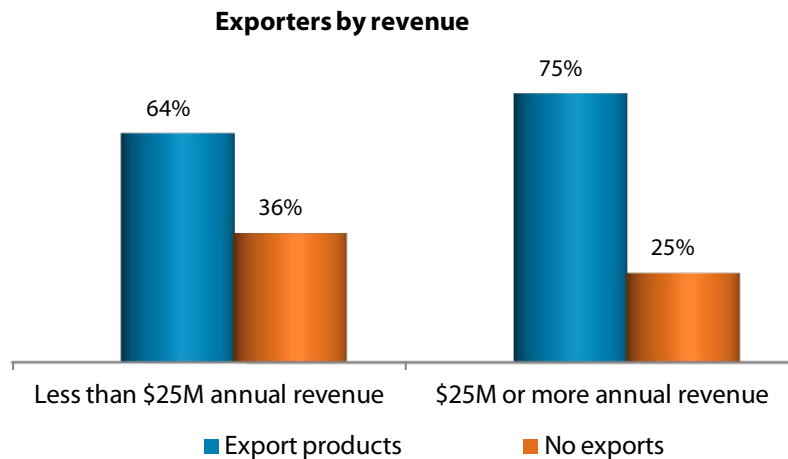
Company size is also significant. Smaller companies with revenues of less than \$25M are less likely than others to engage in exporting.

*Does your company currently export products directly to customers in countries other than the U.S.?*

#### Industry sectors with more than 20 percent of sales from exports

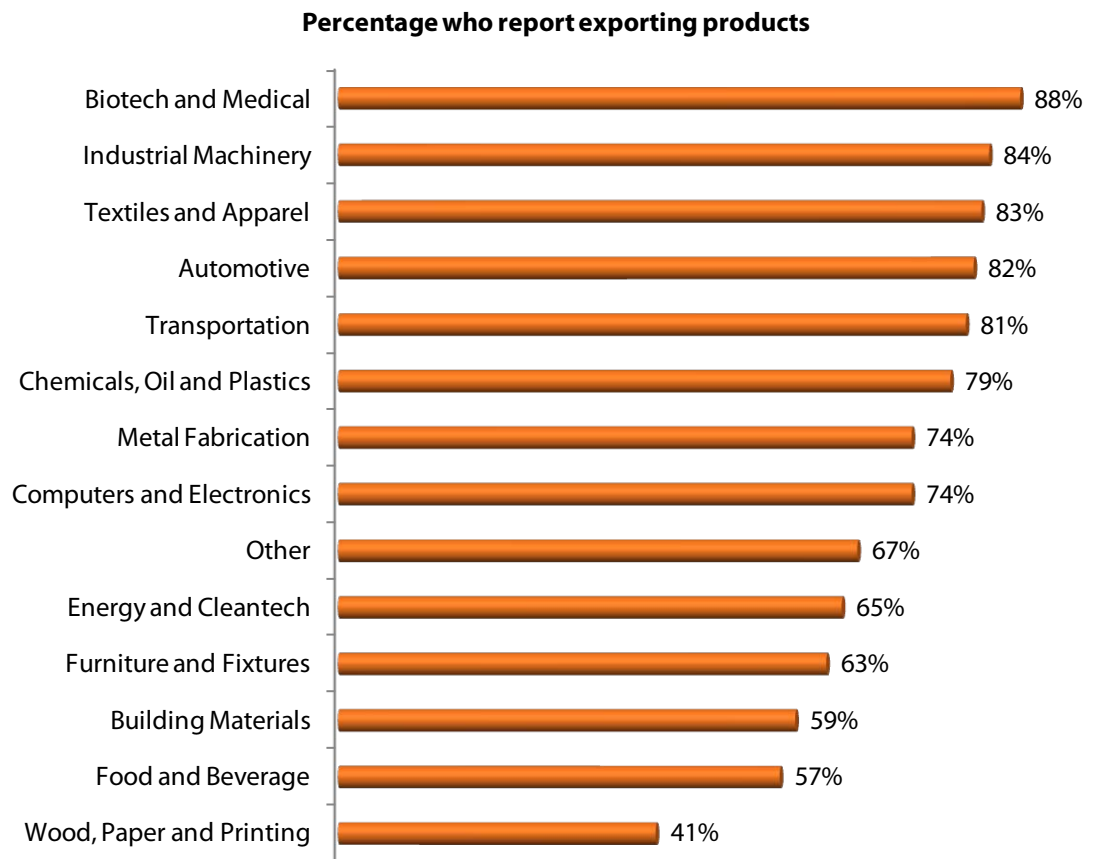
- Computers and Electronics
- Industrial Machinery
- Biotech and Medical

Chart 6



We also took a closer look at companies that export, broken down by industry segments:

Chart 7



The percentage of those among the industry sectors that export may be divided into tiers. It's notable that the industry sectors in the upper-tier—Biotech, Industrial Machinery, Textiles, Automotive, Transportation, and Chemicals, Oil and Plastics—by and large produce highly engineered products, thus enabling them to distinguish themselves in foreign markets from locally produced products. Management at middle market companies in these sectors where some 80 percent or more of their peers are actively exporting may want to take a serious look at the reasons they are not joining the competition in this area.

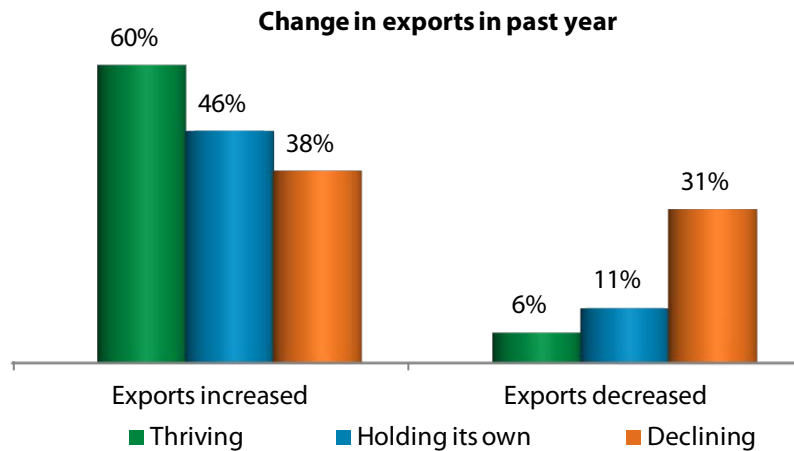
More broadly, for companies of all sizes, the August 2010 to August 2011 increase in exports of goods compiled by the U.S. Department of Commerce (the latest figures available as of this writing) reflected increases in industrial supplies and materials (\$9.7 billion); automotive vehicles, parts, and engines (\$1.6 billion); foods, feeds, and beverages (\$1.3 billion); among other subsectors.

The same cannot be said of those industry sectors in the lower tiers—particularly Building Materials, Food and Beverage, and Wood, Paper and Printing—where products are generally commodities that can be manufactured and purchased more cheaply closer to home. These products also tend to be more difficult to export.

## Change in exports

How have your company's export sales changed in the last year? [Asked of 362 who currently export]

Chart 8



"Companies with robust exporting tend to be thriving and growing; if you're not exporting, you might be at risk of declining."

- Matt Dollard, Director, RSM McGladrey International Office, Chicago, Ill.

While the majority of exporters (52 percent) have seen increases in exports, a striking finding is the correlation between growth in exports and companies' health: 60 percent of those companies that are thriving have increased their exports, a significantly higher percentage than those companies holding their own. In other words, exporting sales is recognized by those thriving companies as a key driver for growth.

## Current and forecasted export markets

*Which, if any, of the following markets do you currently export products to, and which will you begin to export products to within the coming 12 to 18 months? [Asked of 362 who currently export]*

**Table 1: Current and intended export markets**

Market	Currently exporting	Will export in coming 18 months
Canada	82%	1%
Mexico	54%	3%
Western Europe (Other than Germany, Netherlands or U.K.)	38%	6%
United Kingdom	38%	3%
China	37%	3%
<b>Brazil</b>	<b>29%</b>	<b>9%</b>
Australia & New Zealand	34%	4%
South America (Other than Brazil)	31%	6%
Central America	30%	5%
Germany	32%	2%
Middle East	29%	4%
Eastern Europe	28%	4%
Japan	28%	1%
Southeast Asia (includes Taiwan)	25%	3%
India	21%	6%
Singapore	22%	1%
South Korea	20%	2%
Netherlands	19%	2%
Russia	13%	4%
Central Asia	13%	1%
North Africa	7%	2%
Sub-Sahara Africa	5%	3%

Canada and Mexico are the most popular countries for the respondents to engage in export sales. This corroborates the data collected by the Global Trade Atlas, where Canada and Mexico are the top two trading partners for all of the export sales generated in the U.S.

Some industry sectors are more likely than others to export to one market or another, but there are few arresting patterns in the data. The rising level of interest in exporting to various locations, particularly Brazil, Central and South America, is notable. Brazil appears to be next in line (following Mexico in the 1990s and China in the past decade) as the country in which middle market companies see the greatest export growth potential. Global Trade Atlas statistics from the U.S. Department of Commerce for exports mirrors the popularity of exporting to Brazil overall, putting it among the top 10 partner countries—even competing with those countries that have entered into a Free Trade Agreement with the U.S.

“Brazil is today’s ‘new China’ but, 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, RSM McGladrey, Inc., Chicago, Ill.

Because the Free Trade Agreements with Colombia, Panama and South Korea were signed in late October 2011, after the Fall Monitor was closed, these statistics do not reflect the probable impact those agreements may have on export strategies. It should be worth watching to see if exporting plans for the industry are directed towards these countries as a result of the agreements, in particular for South Korea, where distance and the difficulty of penetrating the market appear to have kept plans for exporting low.

Understandably, it is easier for larger organizations to break into markets in China, Japan and South Korea, which all require large scale, long-term investments. Indeed, respondent companies with revenues less than \$25M are less likely to export to those markets.

Growth appears to be slowing for exports to China, where the market is getting ever-more sophisticated and thus harder to penetrate. The slower growth of the well-developed markets in Japan and South Korea makes it difficult for exporters to establish a presence in these countries.

Among those markets where current or planned exporting is in the low double digits, exports to Russia appear they are about to expand by almost one third, although total exports are still low relative to other markets, casting doubts on whether Russia really belongs to the same group as the other “BRIC” countries (i.e., Brazil, Russia, India and China).

Across all markets, manufacturers are more likely than distributors to export or plan to export. The differences are smallest, however, for markets close to the U.S., and there is almost no difference when it comes to Canada.

## Doing business in Brazil

With its growing economy and emergence on the global scene, Brazil is attracting companies from all over the world looking to take advantage of potential business opportunities. But Brazil also poses myriad challenges for foreign-based companies. To help you navigate the tips and traps of setting up shop in Brazil, the following are highlights of some fundamental areas to consider provided by Cicero Alencar, managing partner of RSM International’s member firm in Brazil, ACAL:

- **Cultural differences**—Brazil’s currency, the real (R\$), is non-convertible. The country also has extremely protective labor laws.
- **Currency exchange control**—Brazil has one of the most sophisticated banking systems in the world as well as strict and heavy regulations.
- **Business environment**—Contrary to its banking system, Brazil’s business is conducted in a ‘paper-based’ support environment. Tax incentives and benefits are offered in certain areas and industries.
- **Labor law**—Mandatory charges and benefits cost no less than 62 percent of nominal monthly salaries to employers.
- **Corporate law and accounting principles**—The most common corporate structure for Brazilian subsidiaries of North American companies is limited liability company (LTDA). Foreign partners must be represented by a resident proxiar.

To learn more about doing business in Brazil and around the world, go to [www.mcgladrey.com/international](http://www.mcgladrey.com/international).

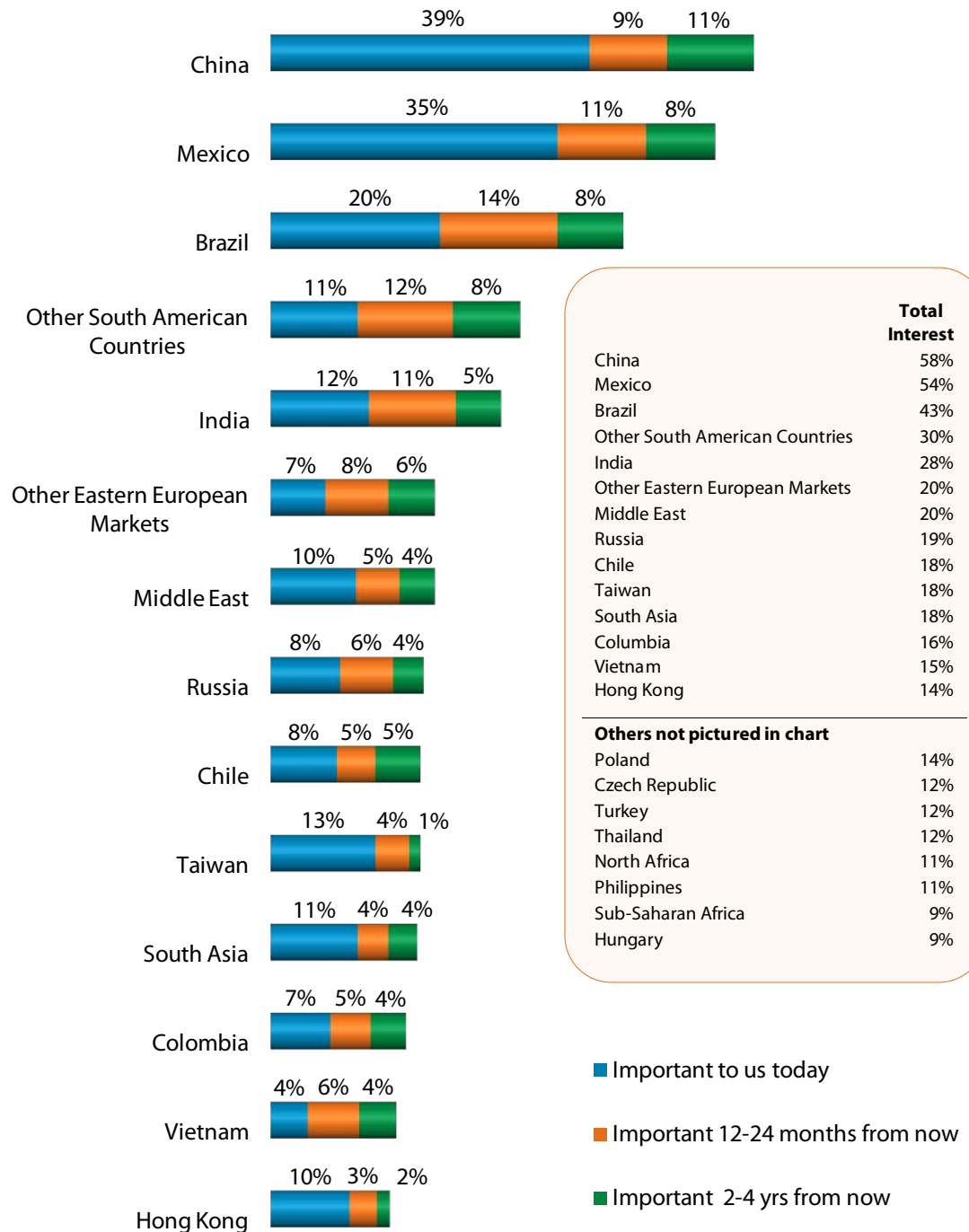
- Cicero Alencar, International Contact Partner, ACAL – Member of RSM International, São Paulo, Brazil

## Emerging markets: Which are important today and tomorrow?

Over the next four years, when do you expect these emerging markets will be important to your company?  
[Total Sample]

Chart 9

### Current and future importance



Whether companies are establishing a direct presence, sourcing raw materials or exporting products, the importance of emerging markets for middle market manufacturers and distributors varies depending on the need.

In particular, Brazil is rising quickly as an export market and South America in general is high on the list for U.S. companies. The signing of the Free Trade Agreements with Colombia, Panama and South Korea will undoubtedly attract interest in those countries as well.

For U.S. companies today, for example, there is interest in China as a market in which to sell products rather than to offshore production there to take advantage of lower costs. The opposite is true of Mexico, still an important market, but principally for production, yet, like China, manufacturers go to the rest of Latin America to export products.

Taiwan and Hong Kong enjoy moderate growth today, while interest in Vietnam is rising.

### Top three initial strategic priorities for exporting

*Please tell us which of these strategic maneuvers were your top priorities. [Asked of 361 who currently export]*

**Table 2**

	Thriving and growing (n=166)	Holding our own (n=183)
Long-term market growth	54%	37%
Served specific customer demand/key customer asked	52%	57%
Strategic decision	40%	30%
Opportunistic reasons (can include networking introduction)	15%	17%
Began a joint venture	7%	0%

The most common mechanism for middle market manufacturers and distributors to export appears to be a basic and logical one: customer and/or key client demand; opportunistic reasons were cited as a reason by a significantly smaller number of companies, but are still among the top four and closely related. These are understandable and common reasons for the initial forays into exporting, but they are not foundations for long-term growth.

Companies that take a strategic approach to exporting are following a best practice and tend to be thriving and growing. The next most common impulse is a more internal driver, long-term market growth, which plays a part of the decision as well for more than half of the survey participants. It's also worth noting that among the companies that say long-term market growth was a key reason for exporting, 54 percent are thriving and growing. Companies that make strategic exporting choices tend to be more successful than others. See Appendix 1 for additional details by industry segment regarding strategic drivers for exporting.

It's also worth noting that among the companies that say long-term market growth was a key reason for exporting, 54 percent are thriving and growing.

## Strategic impulses and challenges

What challenges/barriers does your company face, if any, in relation to exporting or export expansion?  
 [Asked of 362 who currently export]

Chart 10



For many companies, these challenges can be overcome; for others, they are barriers that prevent exporting at all.

According to the U.S. Department of Commerce, 97 percent of all U.S. exporters are small- and medium-sized enterprises. Most export to only one foreign market and have fewer than 20 employees.

The challenges that companies face when they initially export appear to change as that impulse evolves into strategy. Following the first foray into an offshore market—where a client orders a particular product—the challenge is focused more at the transaction level (e.g., shipping, transportation, freight; see chart above). Subsequent strategic moves into additional foreign markets offer different challenges. This transactional mindset and its primary hurdles change from more process-oriented issues to a strategic mindset and new considerations that did not exist before, such as foreign competition and market acceptability.

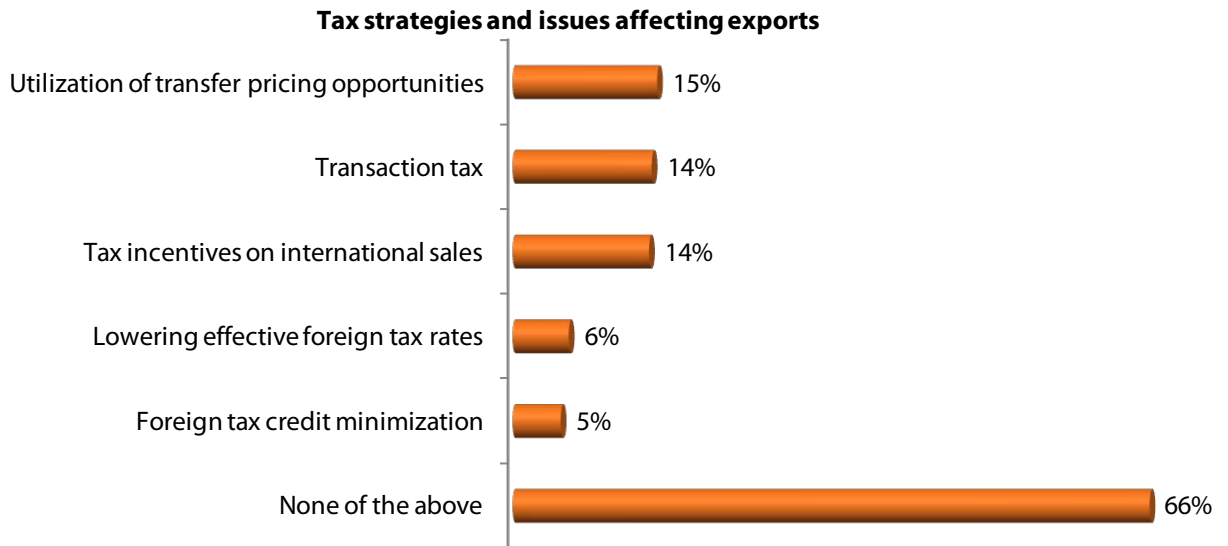
Other survey data also reveals these are and remain the most difficult to handle. In other words, there is no way around those issues for exports and there is no easy fix—exporters have to become adept at dealing with them. In order to make a successful leap into a new market without the safety net of certain profits, companies need to complete comprehensive due diligence on that market beforehand. Fortunately, a globally savvy management team can transfer many of the lessons learned in the first market to future targets.

See Appendix 2 for additional detail by industry segment for challenges to exporting.

## Tax issues

Which of the following export tax strategy or tax issues are having an impact on your current export business today?  
[Asked of 362 who currently export]

Chart 11



Publicly traded companies and companies with revenues over \$500M are more likely to report that lowering effective foreign tax rates is having an impact on their current export business (22 percent and 25 percent).

One conclusion that may be drawn from the response from two-thirds of the executives who report no impact from any of these issues is that they may be missing opportunities. Due to either a lack of understanding or utilization, existing tax incentives and benefits do not appear to be triggering strategic decisions to export. But an absence of utilization doesn't necessarily translate into a lack of impact. By not taking advantage of these incentives, companies could be leaving money on the table.

"It's not uncommon for companies that are beginning to implement their export strategies to overlook the many tax incentives and credits that may be available to them. Yet these incentives could have a significant impact on their plans, let alone their bottom lines. By taking advantage of these incentives, many companies could be saving a great deal of money."

- Larry LeBlanc, Managing Director, International Tax Services, RSM McGladrey, Inc., Vienna, Va.

## Perceived barriers to export trade for non-exporters

If your company is not currently exporting product, what problems or concerns, if any, are inhibiting export commerce? [Asked of 151 who do not currently export.]

Chart 12

### Initial obstacles to exporting activity



Although these reasons for not exporting are not surprising—given that they are virtually the same barriers faced by those who do export—they are nevertheless a transactional rather than a strategic perspective. It's difficult to take the first step towards exporting without an invitation—the order from an existing customer that forces companies to cross borders. Yet if customers aren't telling you to export, it's a strategic imperative to seek them out and discuss the possibility with them. Over the past year, the Monitor surveys have shown a strong correlation between companies that are exporting and companies that are thriving and growing.

"Exporting, if done well, means increased sales and profits. It means overcoming low domestic growth and minimizing the effect of seasonal sales fluctuations. Increasingly it is a way of keeping up with the competition."

- Mathew D. Woodlee, Senior International Trade Specialist, U.S. Commercial Service, U.S. Department of Commerce, Minneapolis, Minn.

For many companies, these challenges can be overcome; for others, they are barriers that prevent exporting at all. But as we've seen, exporting plays a significant role in the fiscal health of manufacturing and distribution companies.

"With 95 percent of the world's population residing outside of the United States, it is imperative for U.S. -based manufacturers to look outside the U.S. market to expand their sales through export activity."

- Frank Vargo, Vice President for International Economic Affairs, National Association of Manufacturers

## Business reasons for not exporting

Please indicate whether any of the following business reasons might contribute to why your company isn't currently exporting. (Asked of 151 who do not currently export)

**Table 3**

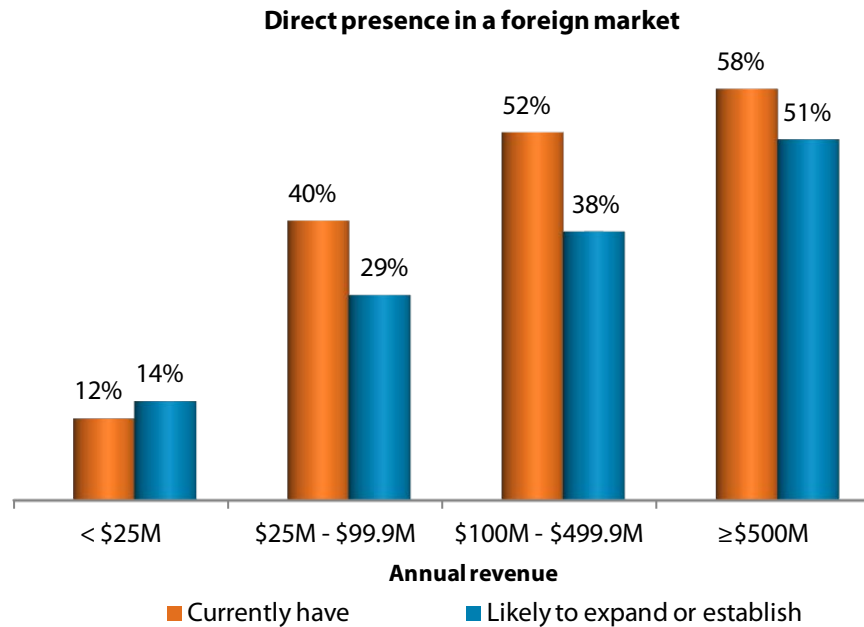
We need to develop networks in the countries in question	26%
We need more information on the market(s) in question/Not sure what to do	24%
We're unsure whether our products/service would be successful	23%
We need to find/hire the right management expertise/experience	13%
We're worried about not correctly adhering to regulations	10%
Additional sources of funding are needed	10%
We lack understanding of accessing credit risk	8%
We're concerned about tax risks	6%
We are concerned about political risk/ social instability	5%
Other	51%

The three primary business reasons given for not exporting include lack of networks in the countries where export would be desirable, lack of knowledge concerning potential export markets and the steps necessary to export, and fear that the company's product might not be successful in an export market. Perhaps not surprisingly, companies with revenue less than \$25M annually are more likely than larger companies to feel they need additional sources of funding to overcome these deficits of information.

## Establishing a direct presence in foreign markets

Does your company currently have a direct presence or business involvement partnership, joint venture, sole or partial ownership in one or more foreign markets?

Chart 13



Whether or not they export to foreign markets, we asked participants if they have established a direct presence (office, plant or representative) or business involvement (partnership, joint venture, sole or partial ownership) in one or more foreign markets.

It is not surprising to see that, once again, the larger the company, the more likely it is to have a direct presence in a foreign market. Those companies in the lowest revenue tier are likely to be making their first step into foreign markets, while those with revenues over \$500M are already in foreign markets and are more likely to expand into additional markets. Perhaps because their experience has made them more globally savvy as well as comfortable getting established in new markets.

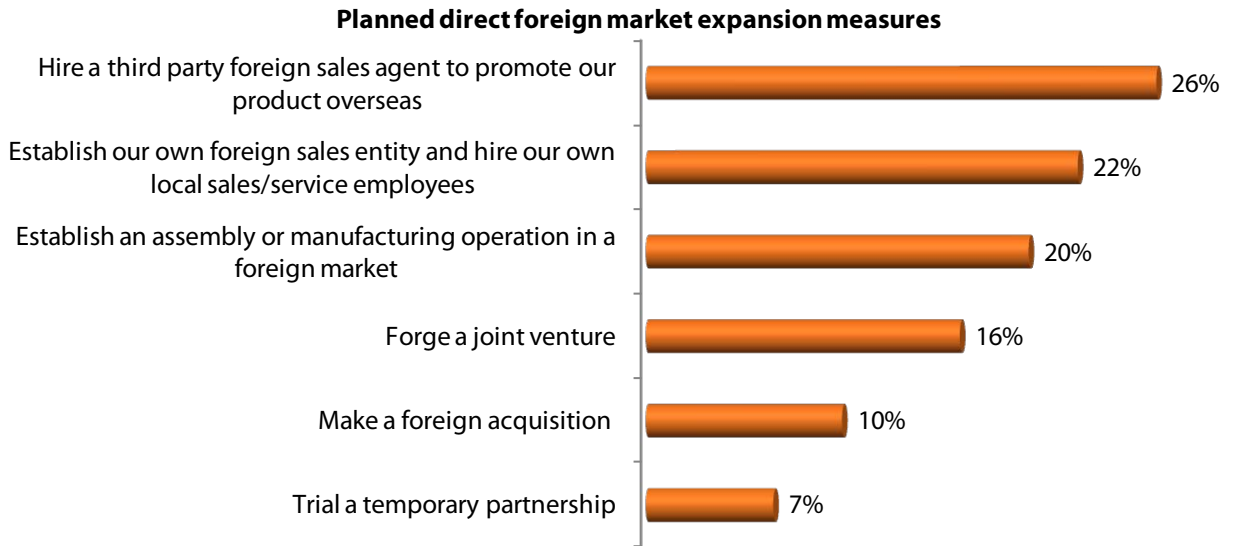
Overall, 32 percent of companies in the survey report that they have a direct presence or business involvement in one or more foreign markets. Among all survey participants, 27 percent report that their companies are highly likely or somewhat likely to establish their first or an additional direct presence in a foreign market in the coming 12 to 18 months. Manufacturers are twice as likely as distributors to plan expansion, as are companies that already sell to markets outside North America even more so. Manufacturers are also more likely than distributors to already have a foreign market presence.

Of the 348 executives whose companies do not have a direct presence in a foreign market, only 10 percent express a desire to establish one.

## Planned expansion initiatives and impediments

What specific expansion activities related to establishing a direct presence in a foreign market does your company plan to employ over the coming 12-18 months? [Asked of 165 who have a direct presence, plus the 34 who say they would like one.]

Chart 14



Typically, foreign market expansions start with establishing a foreign sales representation as opposed to a production facility, as the results indicate here. Next most frequently selected is establishing a physical presence, whether a sales/service outfit or a manufacturing facility. The bottom three measures are fraught with more risk, harder to make work and require the right experience to do so.

Ironically, finding and hiring the right management expertise with the right experience is also the number one impediment cited by survey participants to establishing a direct presence in targeted foreign markets. This impediment often leads companies to look for outside expertise such as consultants or other sources.

Interestingly, data shows there is also uncertainty about specific measures to expand in foreign markets over the coming 12 to 18 months. Perhaps a direct presence sounds like a good idea but is difficult for many executives to follow through on. Those who fail or are unable to establish a direct presence effectively typically do it alone with inexperienced management and fall into common traps such as going down a wrong path to registering an entity in the new country or working with inappropriate partners.

Wanting networks, more information, expertise, insight into potential market acceptance were all concerns for over 15 percent of the executives. Finding the right management with the right answers, however, would appear to be the best and most accepted place to start.

“Due to the differences in culture, business practices and regulations, certain tasks that are easy to complete in the U.S. could be difficult in other countries. For example, things such as additional capital contributions or intercompany loans to fund new manufacturing facilities may be easy to accomplish in the U.S. but require substantial registrations and government’s approval in China. Companies without experienced guides to foreign markets may fall out of compliance with local rules, resulting in extreme cases with being barred from doing business in that country. Thinking strategically means having the right expertise in place.”

- Frank Ji, Esq, National China Desk Leader,  
RSM McGladrey, Inc., Boston, Mass.

## Investigating foreign market expansion

When investigating a foreign market expansion, which activities does your company currently employ? [Asked of 165 who have a direct presence, plus the 34 who say they would like one.]

Chart 15



Statistically, the top two activities—following your customers and networking within the industry—are employed by many companies. This mirrors and reinforces earlier conclusions regarding the initial impulses and motivations for exporting, with the next-lower activities typically conducted by those companies working more strategically.

Interestingly, when it comes to market research it appears that very few companies utilize the best kept secret resource in the area, that is, the U.S. Department of Commerce. This may be because they are either unaware of the vast array of resources the department provides or it is not a trusted or preferred resource. Yet contacting the department is a good first step for those planning to export (see *Exporting best practices*, page 29).

Manufacturers are more likely than distributors to be proactive on most of these potential measures and tactics. Manufacturers are more likely to contact centers of excellence for advice.

Comparing activities with the relative importance given them reveals some interesting dichotomies. It appears experience teaches that the value of some activities is not realized until they are implemented.

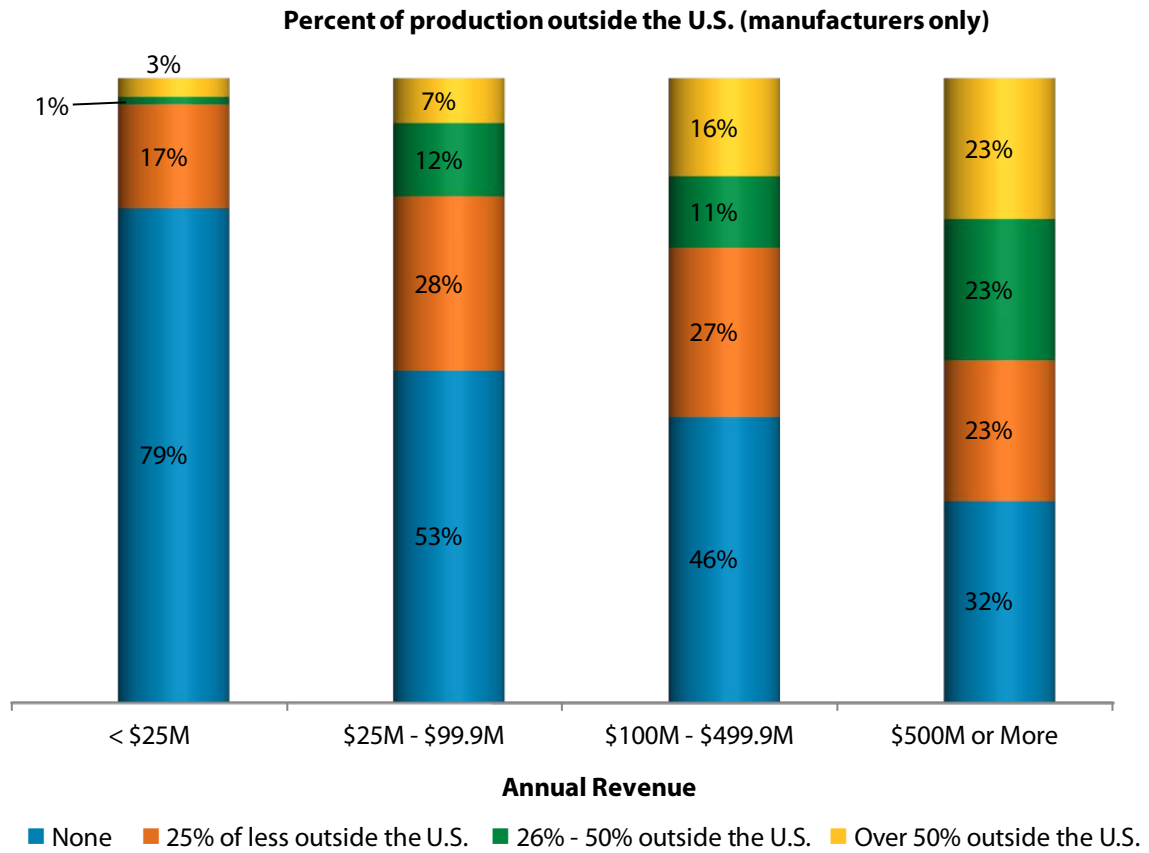
Customer demand is the driving factor when assessing the feasibility of foreign market expansion, with more than 80 percent who cited this as a key step reporting it as important or very important. On the other hand, only 19 percent, for example, noted that ensuring a business partner is in step and ready was an activity they took in

their company’s decision to expand into a foreign market. But among them, 78 percent placed a high value on that step. Additionally, only 15 percent contacted the U.S. Department of Commerce, yet 50 percent of them felt there was value in doing so.

### Percent of production activity outside the U.S.

Of your company’s production activity or operations, what percentage takes place outside the U.S.?

Chart 16



\* Some items may not add up to 100% due to rounding

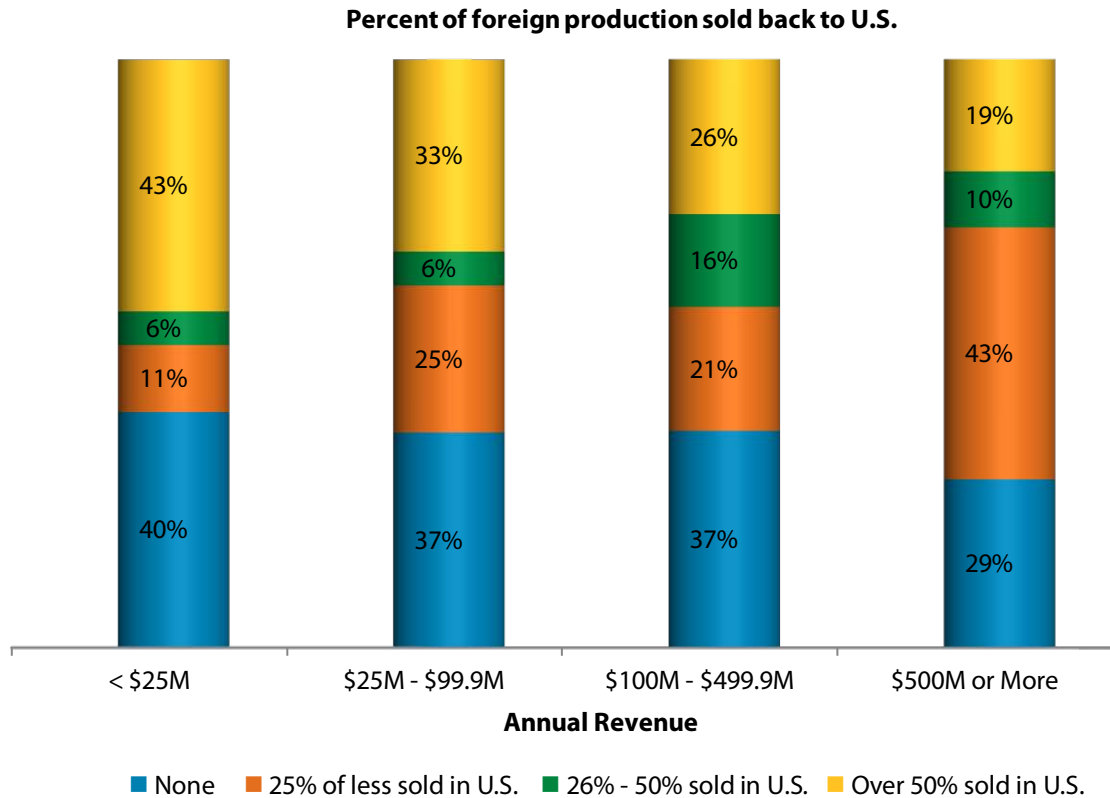
The larger the company, the more likely it is to have production facilities outside the U.S. Almost one quarter of the largest companies have more than 50 percent of their production offshore. Even among companies with revenues of less than \$25M, a surprising 21 percent produce outside of the U.S.—exemplifying just how globalized manufacturing has become, even among smaller organizations.

Almost one quarter of the largest companies have more than 50 percent of their production offshore.

## Percent of foreign production sold in the U.S.

*Of your company's foreign-produced goods, what percentage is sold in the U.S.? [Manufacturers with foreign production]*

Chart 17



An important distinction to understand is the motivation companies have to make foreign-produced goods. Are they trying to get closer to their offshore customers (and therefore a greater percentage of foreign-produced goods are not sold back to the U.S.) or are they looking to reduce production costs for material or labor (whereby a greater percentage is sold back to the U.S.)?

There is an interesting dichotomy at play for companies with revenues under \$100M—their foreign production is either primarily for selling back into the U.S. (43 percent and 33 percent) or none of their production is sold back into the U.S. (40 percent and 37 percent).

Companies with more than \$500M in annual revenue are likely to sell less of their foreign-produced goods back to the U.S. The majority of their production is for sale into non-U.S. markets.

By establishing production closer to their customer's foreign operations, U.S. companies can both realize production savings as well as compete on a local level, often making for a stronger U.S.-based company without necessarily taking jobs away from U.S. workers.

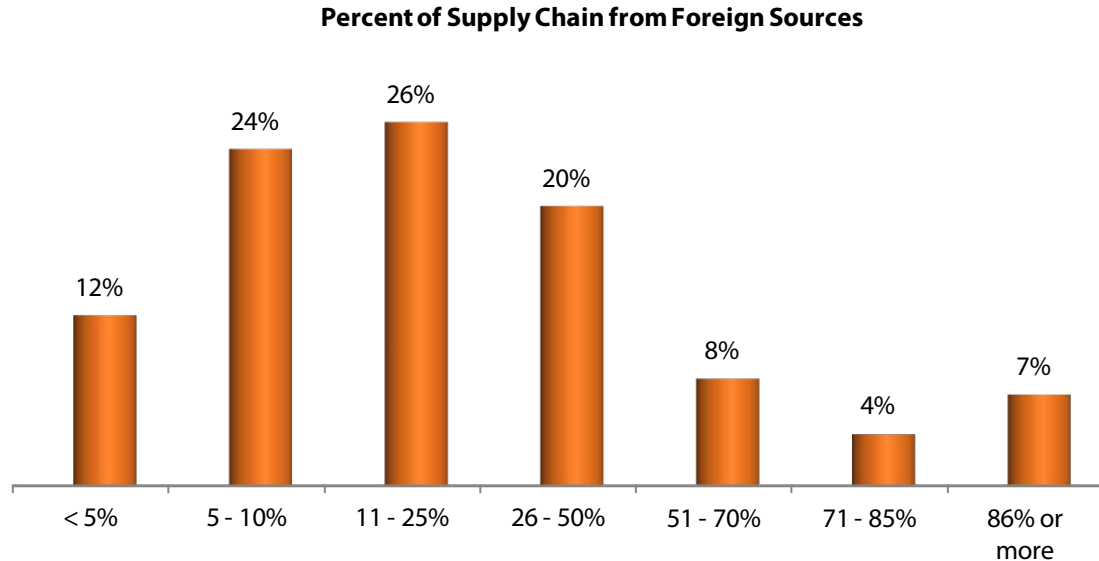
This would suggest that rather than simply approaching foreign production because it's less expensive, companies would do well to take a more holistic approach, strategically identifying countries where they can compete in the local market as well as produce cost effectively.

## Offshore supply chain procurement

An overwhelming majority of responding executives say their companies source some of their supply chain materials from foreign sources. Yet most (62 percent) are importing less than 25 percent of their raw material. The majority of materials and supplies come from U.S.-based sources.

*What percentage of your company's materials and supplies are purchased (imported) from foreign sources?*

**Chart 18**



Looking ahead, 43 percent say that foreign sourcing for their supply chain will increase in the coming 18 months (see Appendices for details). Nearly 60 percent say they are not going to increase foreign sourcing in next 12-18 months.

Broadly speaking, there is a wide divergence by industry segment on the impact of relying on foreign sources. Textiles and Apparel, Computers and Electronics, Transportation, and Furniture and Fixtures clearly plan to increase their foreign sourcing. Automotive is relatively torn, possibly due to a concern over natural disasters such as the tsunami in Japan having an impact on sources balanced with sources already being well-established globally.

If sourcing only from one country, a single natural or political disaster could be devastating. Worried they could be vulnerable, companies are looking at their foreign supply chains with a critical eye. Undoubtedly, companies may no longer look simply for more than one supplier, but also at diversifying their sourcing geographically.

### Exporting best practices

Following are highlights of best practices for exporting gathered from McGladrey specialists, items identified in the Fall Monitor as well as government resources.

- **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?
  - What 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. (EXIM); 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**—Understanding U.S. Free Trade Agreements (the U.S. is currently part of 14 FTAs) to overcoming 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 Feature U.S. Exporter (FUSE) and put 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.
  - Websites such as [export.gov](http://export.gov) provide information and assistance.
- **Know your market**—Approaching the sale of your product in another country the same way you approach it in 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.

“You don’t have to be General Motors to engage in exporting—97 percent of U.S. exporters are small- to medium-size enterprises and most of them have fewer than 20 employees.”

- Karen L. Kurek, National Manufacturing & Distribution Practice Leader, RSM McGladrey, Inc., Chicago, Ill.

## Appendices

## Appendix 1: Strategic impulses for exporting

We'd like to know how your company initially became an exporter. Please select all of the following intentional strategic maneuvers that drove your company to initially enter the export trade. [Asked of 362 who currently export]

**Table 4**

	Total	Automotive	Biotech and Medical	Building Materials	Chemicals, Oil and Plastics	Computers and Electronics	Energy and Cleantech	Food and Beverage	Furniture and Fixtures	Industrial Machinery	Metal Fabrication	Textiles and Apparel	Transportation	Wood, Paper and Printing	Other
Customer demand or request	<b>66%</b>	64%	59%	53%	76%	74%	59%	61%	76%	58%	70%	67%	80%	63%	50%
Long-term market growth	<b>52%</b>	42	59	50	61	57	53	45	65	57	49	46	44	38	60
Strategic decision	<b>43%</b>	36	59	29	43	37	59	45	41	49	25	38	48	38	50
Opportunistic reasons	<b>23%</b>	17	21	12	30	26	18	24	18	20	22	38	36	25	30
New hire knew the market	<b>14%</b>	11	14	18	9	17	18	6	18	20	12	21	8	19	30
Margin improvement or short-term market growth	<b>10%</b>	3	7	15	7	6	29	6	6	11	14	13	12	13	0
Domestic market was saturated	<b>7%</b>	6	10	3	2	3	18	6	12	6	12	4	12	0	10
Had physical operations in that marketplace	<b>7%</b>	11	14	3	4	3	24	9	0	8	7	8	12	6	20
Acquired a foreign based entity	<b>7%</b>	6	7	0	4	9	0	3	12	9	6	4	8	6	10
Began a joint venture	<b>7%</b>	6	7	9	9	3	0	15	6	9	9	8	4	6	0
Wanted to tap only a particular market	<b>6%</b>	3	10	3	11	6	6	3	6	6	7	4	16	6	0
Foreign competitors encroaching on your market	<b>4%</b>	3%	3%	0%	7%	3%	12%	3%	0%	7%	3%	4%	4%	0%	0%

(Darker cells are higher relative percentages)

## Appendix 2: Challenges to those currently exporting

What challenges/barriers does your company face, if any, in relation to exporting or export expansion? [Asked of 362 who currently export]

**Table 5**

	<b>Total</b>	Automotive	Biotech and Medical	Building Materials	Chemicals, Oil and Plastics	Computers and Electronics	Energy and Cleantech	Food and Beverage	Furniture and Fixtures	Industrial Machinery	Metal Fabrication	Textiles and Apparel	Transportation	Wood, Paper and Printing	Other
Shipping/transportation/freight challenges	<b>42%</b>	33%	24%	44%	43%	31%	53%	52%	53%	49%	42%	50%	64%	50%	40%
Compliance with local regulations	<b>37%</b>	22	38	24	39	40	47	48	47	40	29	29	48	38	60
Understanding tariffs/duties/customs clearance	<b>32%</b>	36	24	24	37	46	35	39	24	30	23	38	40	31	30
Credit risk	<b>30%</b>	19	21	32	33	23	35	30	35	34	30	25	28	44	50
Cultural/language barriers	<b>25%</b>	22	31	6	22	34	29	0	24	35	25	21	32	25	50
Foreign competitors encroaching on your market	<b>19%</b>	28	24	15	11	20	35	9	24	27	19	17	20	25	20
Market acceptability of products	<b>19%</b>	8	17	21	17	20	18	24	6	18	22	42	16	19	10
Understanding market acceptability of products	<b>19%</b>	19	21	18	17	26	24	9	24	19	22	17	12	6	10
Competition from foreign importers	<b>17%</b>	25	14	18	15	14	18	15	24	17	19	13	12	19	10
Finding distributors/importers	<b>17%</b>	6	28	12	22	17	12	12	6	20	10	25	12	25	40
Trade financing/insurance	<b>13%</b>	3	0	15	11	20	24	12	24	15	14	8	8	19	10
Political risk	<b>11%</b>	14	17	15	11	14	0	15	0	10	16	8	8	13	10

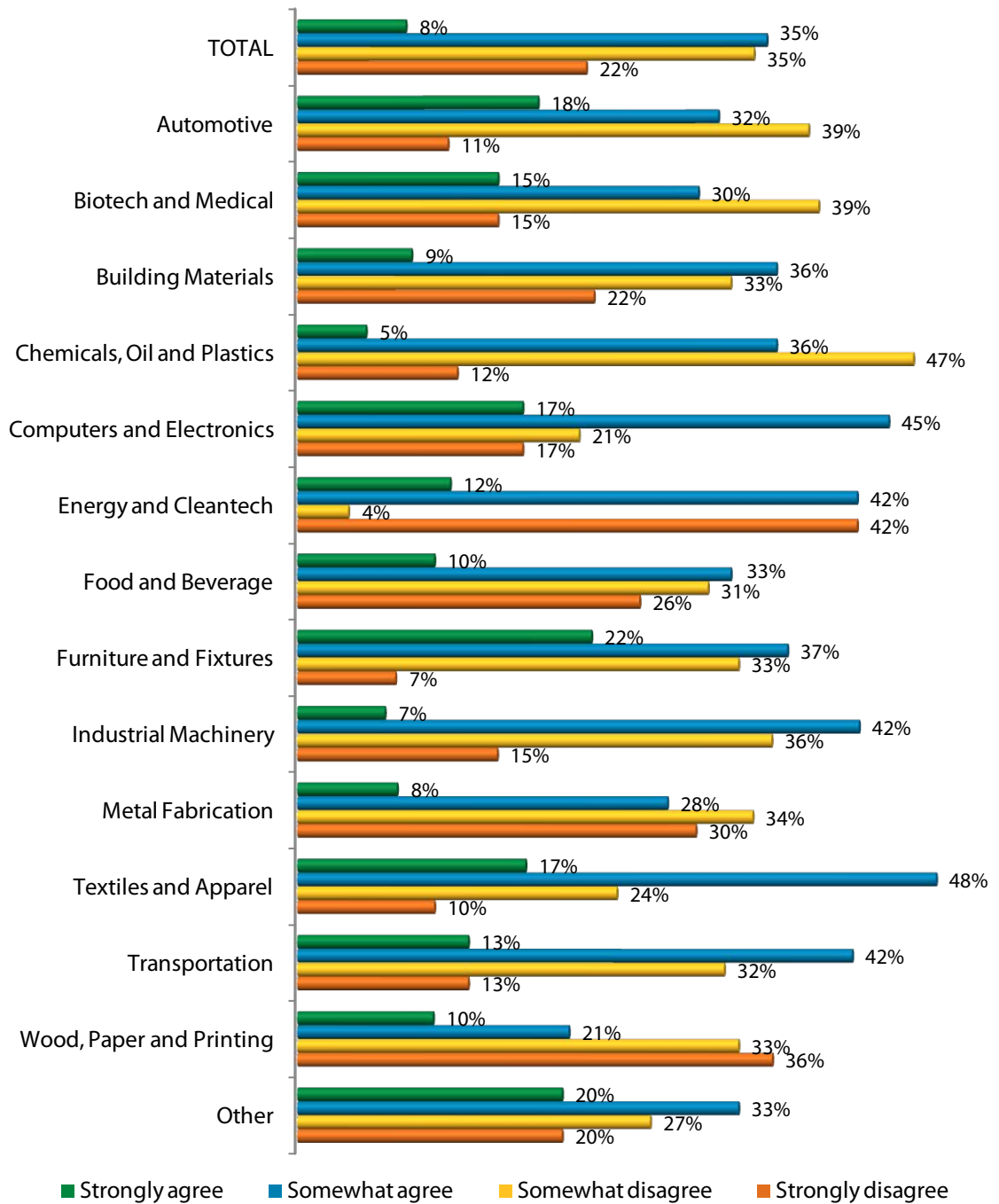
(Darker cells are higher relative percentages)

### Appendix 3: Agree that foreign sourcing will be climbing

How strongly do you agree with the following statement: "In our supply chain, we anticipate an increased reliance on foreign sources in the coming 12-18 months"?

Chart 19

#### "We will increase foreign sourcing in coming 12 to 18 months"



## Appendix 4: Fall Monitor respondent composition

The Fall Monitor accepted submissions from September 21-October 10, 2011

Manufacturing and distribution		
Manufacturing	292	57 %
Mostly Manufacturing, some Distribution	88	17 %
Distribution	44	9 %
Mostly Distribution, some Manufacturing	87	17 %

Titles and job functions		
CFO, Senior Finance Executive	216	42 %
CEO, President or Chairman	141	27 %
Chief Operating Officer	21	4 %
Chief Marketing or Sales Officer	9	2 %
Principal/Managing Partner/Partner	8	2 %
Executive Management	23	4 %
Finance Managers	74	14 %
HR Managers	4	1 %
Operations Managers	10	2 %
IT Managers	2	0 %
Legal Managers	0	0 %

Employees (full time)		
0-49	119	23 %
50-499	297	58 %
500-1,999	61	12 %
2,000 or more	36	7 %

Annualized revenue		
<\$25M	208	41 %
\$25M -<\$100M	162	32 %
\$100M - <\$500M	100	19 %
\$500+M	43	8 %

Ownership model		
Private or closely held	397	77 %
Private equity owned business	63	12 %
Publicly traded corporation	32	6 %
Division/Unit of Larger Co	21	4 %

Industries		
Industrial and Commercial Machinery	103	17 %
Metal Fabrication	87	14 %
Chemicals, Petroleum and Plastics	58	9 %
Food and Beverage	53	9 %
Computers, Electronics and Electrical Components / Appliances	52	8 %
Building Materials	46	7 %
Automotive (OEM and Aftermarket)	36	6 %
Wood/Paper Products and Printing	34	5 %
Biotech, Life Sciences and Medical Equipment/Supplies	33	5 %
Transportation Equipment (Other than Automotive)	29	5 %
Other	26	4 %
Textiles, Apparel and Accessories	24	4 %
Furniture and fixtures	22	4 %
Energy and Cleantech	18	3 %

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