Grant Thornton
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Supply Chain Insights

Grant Thornton Consumer and Industrial Products practice Part 1 of 3— May 2013

Going for growth in 2013 and beyond

Grant Thornton LLP collaborates annually with *World Trade 100* magazine on a series of three surveys concerning supply chain solutions. These surveys are intended to provide a snapshot of issues and opportunities for the industry. We hope this 2013 *Supply Chain Insights* survey (Part 1 of 3), along with targeted recommendations from Grant Thornton's supply chain professionals, offer insights to help you better evaluate your sourcing decisions.

World Trade WT100
The Benchmark for Global Supply Chain Business

With the economy looking brighter, today's supply chain leaders have revenue growth on their minds — and in sight. According to Grant Thornton *Supply Chain Insights* survey for 2013, many plan to hire more workers and invest in operational improvements. Some companies also expect to expand into new territories and introduce innovative products.

Conducted in partnership with *World Trade 100* magazine, the first in our three-part series of reports examining supply priorities and decision-making also shows that a baseline level of uncertainty and caution lingers. For some, hiring plans are falling behind a focus on cost-cutting. Companies are doing their best to hold on to existing customers, even if it requires providing value-added services that may erode margins. Tax reform and the possible repeal of certain business tax incentives are also causes for concern.

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With the economy looking brighter, today's supply chain leaders have revenue growth on their minds — and in sight.

Going for growth in 2013 and beyond (continued)

What operational improvements are being made within your organization to improve profit margins?	
Investing in operational effectiveness	62%
Maintaining its current operational structure and procedures	41%
Outsourcing a business process or function	28%
Insourcing a function previously outsourced	24%
None of the above	3%

Note: Sample size is 320. Respondents were able to select more than one answer.

What steps are you taking to grow revenues or margins?	
Expansion into additional states or countries	45%
Acquisitions of competitors	20%
Flexible payment terms and credit policy	19%
Light assembly/manufacturing (value-added service)	19%
Labeling (value-added service)	15%
Tagging (value-added service)	13%
Consigned inventory at the customer location	16%
Increasing product line	3%
Other	12%
None	12%

Note: Respondents were able to select more than one answer.

How leaders plan to grow revenues

A majority of survey respondents (62%) say they are focused on investing in operational improvements to enhance their profit margins, with the objective of getting more from their existing operations. Forty-one percent are maintaining the status quo when it comes to their operational structure and procedures. Outsourcing (28%) and insourcing (24%) also are cited as priorities.

"It's encouraging to see that nearly two-thirds of respondents are investing in their own operations," says Brian Larsh, Business Advisory Services manager. "We are seeing this pattern across the industry. Manufacturers and other supply chain leaders are very focused on enhancing their systems, improving their cash flow, focusing on inventory accuracy, shortening receivables and making better use of their cash."

While 28% are considering outsourcing, many share concerns that rising costs, especially for labor, are diminishing the benefits of sending work to far-flung locations.

"Manufacturers and other supply chain leaders are recognizing that there is a sizable cost to the loss of control over quality, delivery and changes in volume that come with outsourcing," Larsh says. "These factors are driving a growing number to bring manufacturing back onshore. In fact, we are seeing a number of clients pulling out of India and China, in favor of the United States and inland Mexico."

With growth a high priority in 2013, leaders of surveyed companies say they are pursuing it through a number of strategies. Forty-seven percent are trying to become more essential to customers by performing value-added services such as labeling, tagging and light assembly. Forty-five percent are moving into new territories. One in five is acquiring competitors.

"The value-added services are a particularly interesting trend," says Larsh. "Many manufacturers and other supply chain leaders are trying to differentiate themselves from competitors by doing more, sometimes for the same price. In some cases, they can raise prices. But more often than not, they are providing value-added services to maintain prices and margins."

In considering the cost of value-added services, it's useful to ask a number of questions:

- Is the company accounting for these services correctly?
- How much is the company spending on direct and indirect labor?
- Is the company including these value-added activities in their total cost to deliver?
- Does the company's financial system allow for proper costing and roll ups?

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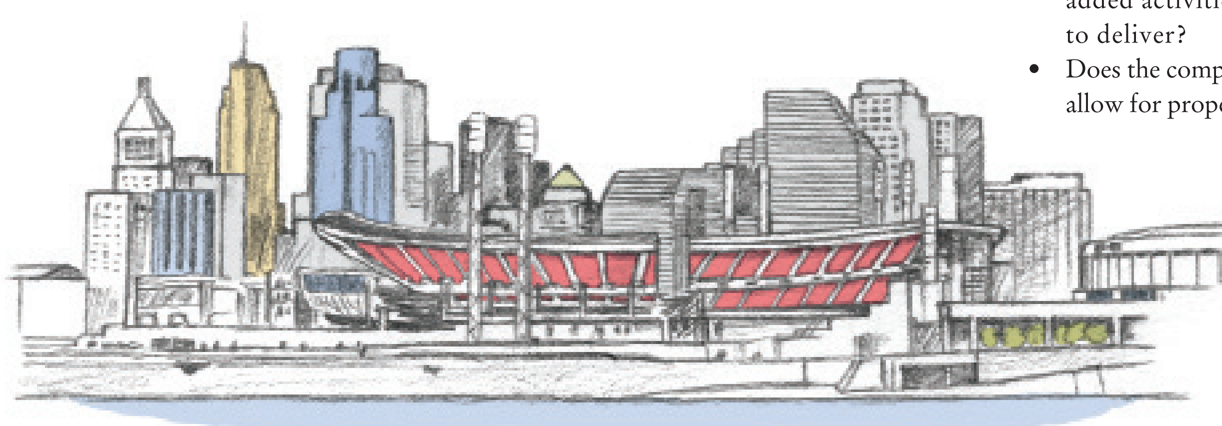


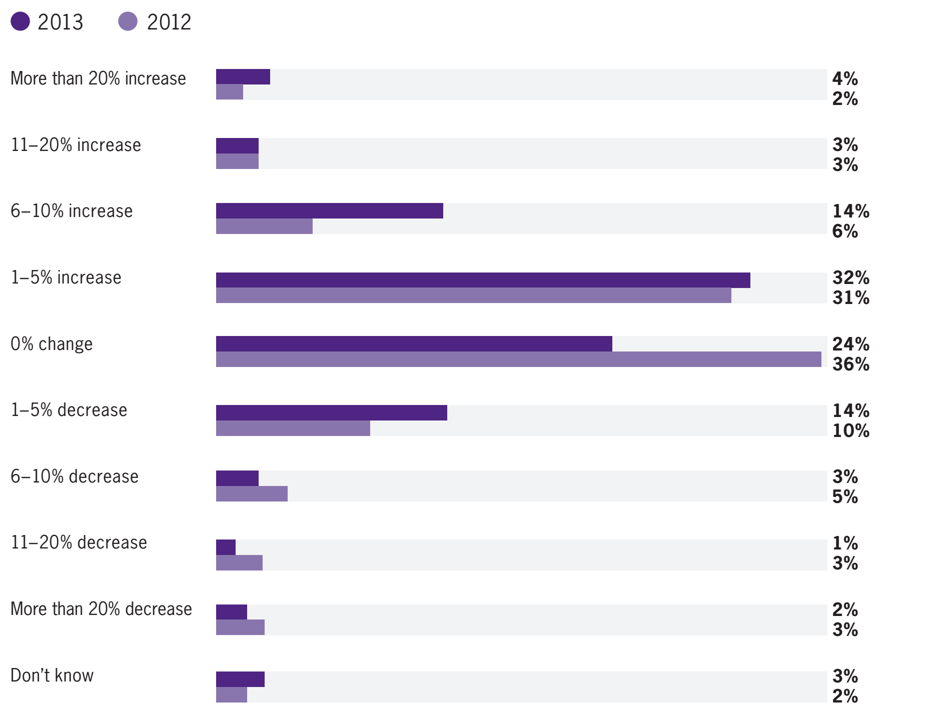
Going for growth in 2013 and beyond (continued)

Continuing to squeeze operations

Even with a focus on revenue growth, most survey respondents are still trying to make do with less. In fact, 52% say cost-cutting and finding efficiencies are more important than hiring. Only 14% say hiring is a more important strategy than cost-cutting.

Please indicate if cost-cutting and finding efficiencies are more important than hiring, with regard to keeping your company growing?	
Cost-cutting and finding efficiencies are much more important	24%
Cost-cutting and finding efficiencies are somewhat more important	28%
Neutral	33%
Hiring is somewhat more important	11%
Hiring is much more important	3%

How much of a change are you expecting to see in employee headcount comparing 2012 to 2013



Note: Sample size in 2012 was 317. Sample size in 2013 is 320.

Who's hiring?

Even with the emphasis on cost-cutting, there is ample good news for hiring in 2013. More than half of respondents (53%) plan to add employees in 2013, up from 42% who had plans to do so in 2012. The largest organizations are planning to hire more conservatively — 40% of companies with more than $1 billion in annual revenues plan to increase headcounts by 1% to 5%. Smaller companies are more likely to grow their workforces by 6% to 10%. The smaller companies may have ambitious growth plans or new products to roll out, and are realizing they don't have enough people to fulfill those plans, notes Larsh.

Twenty-one percent of companies with annual revenue of $100 million to $250 million plan to grow in this range, compared to only 6% of companies over $1 billion.

Spotlight on IT priorities

Companies' IT priorities reflect a growing recognition that they need to take better care of their customers as well as effectively manage their supply chains. The most common IT initiative respondents are planning in 2013 is "sales force automation or another customer relationship management (CRM) application." Thirty-five percent are pursuing this type of initiative in 2013, up from 21% in 2011. Next in line are new mobility apps to serve customers, with 27% investing in these, up from 23% in 2011.

Twenty-two percent are investing in supply chain performance-related technologies, including logistics and warehouse management, while 17% say they want to replace their enterprise resource planning (ERP) systems.

"The interest in new enterprise systems seems to be primarily due to changes in their business models and continued growth of the business," says Steven Sparks, partner of Business Advisory Services. "We have seen many of our clients use an ERP replacement project as an opportunity to change the business model and improve underlying processes."

"Many of our clients are still running custom-developed software, and its flexibility is really impeding sales, marketing and the operations of the business," he says. "Whether a CRM or an entire ERP platform, the push to change how companies go to market and fulfill new orders is a deciding factor to install new systems."

In addition, 5% are pursuing other types of IT investments such as business intelligence solutions and electronic data interchange enhancements.

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Tax structures, rates and reform

The basis of proposed tax reform is that companies would trade off existing tax benefits for a lower statutory rate. Respondents who have an opinion about tax reform are largely in favor of the repeal of tax incentives in exchange for lower rates. Nearly four in 10 say they would support this concept, compared to 6% who oppose it. (Grant Thornton's *Fall 2012 CFO Survey* found that 75% of CFOs said they support a repeal of incentives in exchange for a lower rate.) Interestingly, only 45% of respondents ventured an opinion on the subject.

"This reflects the widespread uncertainty right now about tax reform," explains Mel Schwarz, partner and director of legislative affairs in Grant Thornton's National Tax Office. "Congress has a long way to go in educating the public if they want to count on support for tax reform as an initiative."

Informal estimates prepared by the staff of Congress' Joint Committee on Taxation suggest that giving up virtually all of the current domestic business tax benefits would get U.S. corporate taxpayers to approximately a 28% rate, notes Schwarz. Yet, 73% of respondents say that only a 25% or lower rate is the highest rate they could find acceptable.

"It may turn out to be a heavy lift to convince businesses to support tax reform," Schwarz says. "This doesn't mean tax reform won't happen, but it shows that there is a lot of work to be done to convince companies in the supply chain sector that it's a good idea. There will be winners and losers in any kind of tax reform. Supply chain leaders have a strong concern that tax reform may not be in their favor."

Among the tax incentives that could be considered for repeal as part of tax reform are the last-in, first-out (LIFO) inventory method and accelerated depreciation. "If these benefits are repealed, those companies that are LIFO users and make regular investments in depreciable property may face higher taxes, even if the rate is reduced," says Schwarz.

LIFO is more common among retailers and wholesalers than those in the transportation and distribution activities of supply chains. Forty-four percent of respondents say repealing LIFO would affect them, while 42% say eliminating LIFO would not affect them. Fifty-three percent say LIFO is more important to their companies than such tax incentives as bonus depreciation. "This, in concert with the tax reform issues facing pass-through entities, may be hard on supply chain companies," Schwarz notes.

Pass-through entities should have particular concerns about tax reform, Schwarz says, adding, "It remains a mystery how pass-through entities are going to be taxed if tax reform goes

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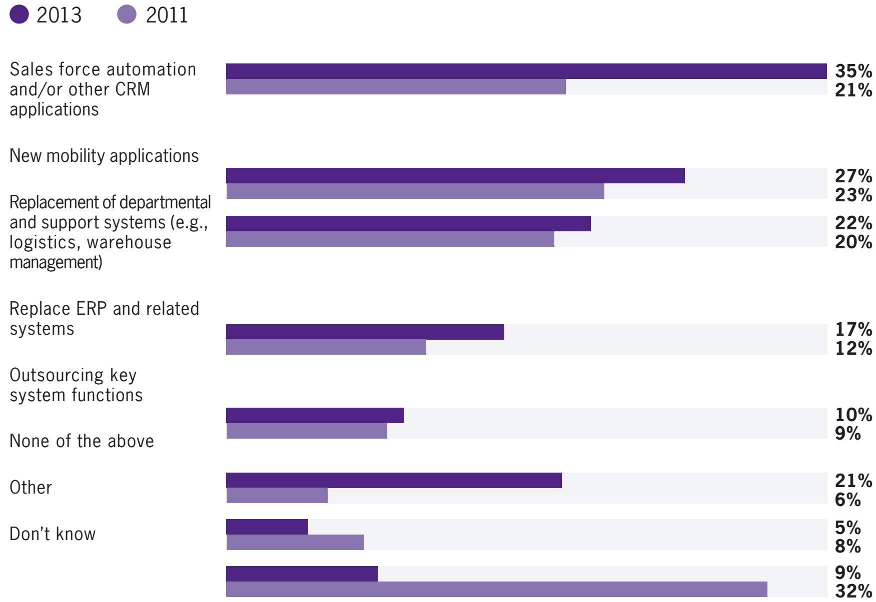
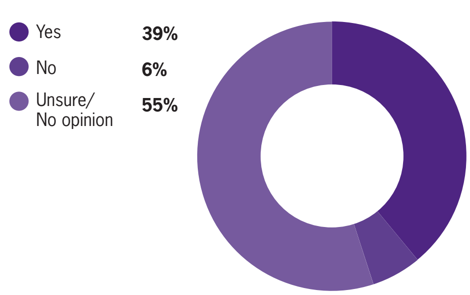
What major IT system initiatives do you have planned for a competitive advantage in 2013?[1]

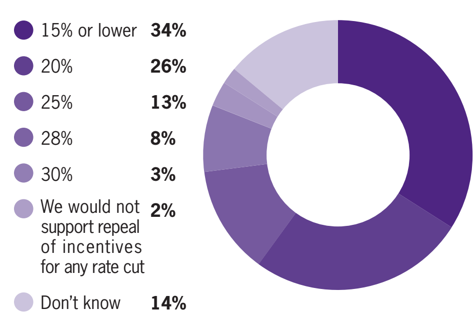


Note: Sample size in 2011 was 302. Sample size in 2013 is 320. Respondents were able to select more than one answer.

Does your company generally support the concept of tax reform that would repeal targeted tax incentives in exchange for a lower statutory rate?



If federal tax rates were reduced and nearly all tax incentives repealed, what is the highest tax rate your business would find acceptable?



Sample size is 143.

[1] Data for this item is compared to our 2011 survey, when we last examined this particular issue.

Pass-throughs grapple with tax reform

Pass-through entities such as partnerships or S corporations provide an important and simple governing framework for privately held businesses. The flexibility allows for easier governing framework, more alternatives in raising capital, and greater opportunities to fine-tune the share of responsibility and profit within a simple structure. Eliminating pass-through status would disturb business operations, reduce efficiency and increase overhead.

Grant Thornton takes the position that tax reform should maintain equity in the rate structure so that pass-throughs share in any rate reduction that comes from tax reform. Eliminating tax incentives to pay for a corporate rate cut without reducing individual rates will increase taxes significantly on pass-through entities owned by individuals and leave pass-throughs with a higher current tax rate than other types of businesses.

There are two primary options for providing equivalent rates for businesses. The first and simplest way is to reduce the individual and corporate rates in tandem. If tax reform is possible only on the business side, setting the rate on income earned through an active pass-through business no higher than the corporate rate would restore equivalency between corporate and pass-through earnings. Maximum tax rates have been used in the past to ensure certain types of income are not subject to disadvantageous rates.

The same tax rate should apply to all business enterprises, regardless of form. Different rates only invite the creation of complicated and inefficient structures and transactions designed solely to take advantage of the inconsistent rates.

through. Companies that operate as pass-throughs are concerned they might lose their tax benefits, but not share in the reduction in tax rates proposed for C corporations. That would be a terrible outcome for these companies."

It's worth noting that pass-through businesses represent a growing share of the economy. Based on the most recent IRS statistics, partnerships and S corporations were responsible for more than 34% of all business receipts in 2008, up from just 7% in 1980.[2]

Green fuels

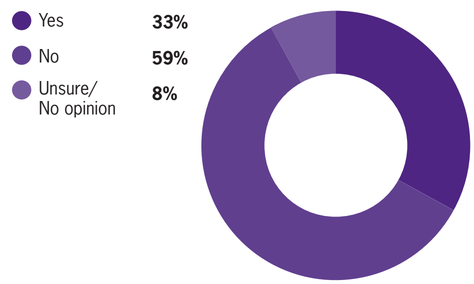
One-third of respondents say their companies use alternative fuels such as biodiesel or compressed natural gas to operate forklifts or other vehicles, while 59% use conventional fuels.

"Many of these companies have been using propane forklifts for warehousing and trucking for some time," says Randolph Smith, national Transportation practice leader. "In many food-related businesses, companies continue to use electric forklifts. Green energy is a topic of conversation among supply chain companies, but it has yet to really affect business decisions. The related tax incentives sometimes impact behavior, but rarely does the tax tail wag the dog."

As part of the fiscal cliff negotiations, Congress agreed to extend the alternative fuel tax credit through the end of 2013. The tax credit had expired at the conclusion of 2011.

"We have seen a number of companies using large amounts of propane but not taking advantage of related tax credits," Smith says. "It's important to consult a tax adviser with regard to credits they may be able to claim."

Do you use alternative fuels in your business, such as biodiesel or compressed natural gas for forklifts or other vehicles?



Among those companies that use alternative fuels, 58% say their forklifts run on these fuels. The largest companies are significantly more likely to use alternative fuels than smaller companies. For example, 45% of companies with revenues exceeding $1 billion use alternative fuels, compared to 23% of companies with revenues of less than $25 million.

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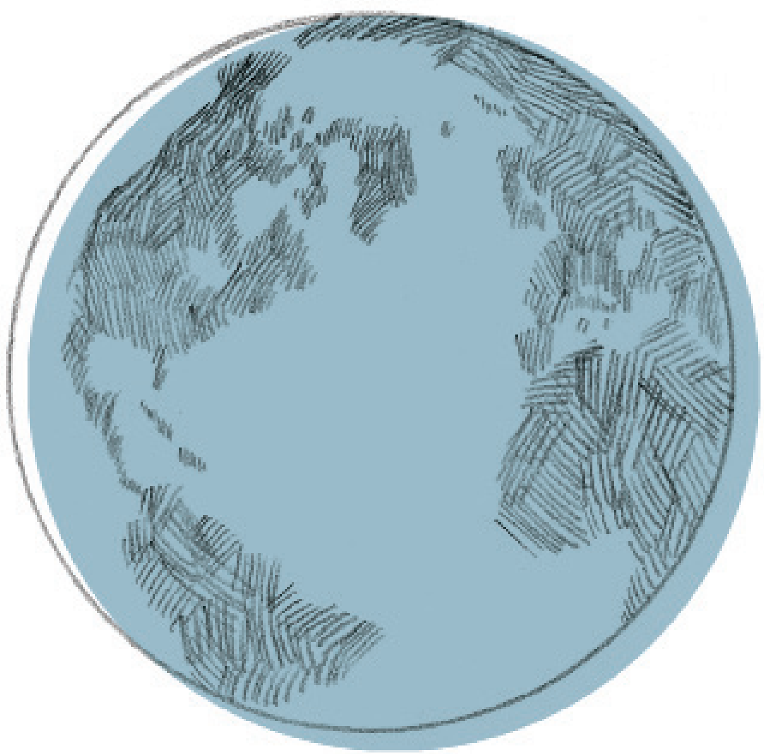
[2] www.irs.gov/uac/SOI-Tax-Stats-Integrated-Business-Data.

Conclusion

Manufacturers and supply chain leaders have their sights set on increasing revenue, even while economic uncertainties and concerns about tax reform linger. Unsettled conditions, however, are not keeping them from investing in operational improvements, hiring, expanding into new product lines and conquering new sales territories. For savvy companies in the supply chain sector, growth is in the cards for 2013 and beyond.



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About the survey

Grant Thornton partnered with Clear Seas Research, a subsidiary of BNP Media, to produce this original research on supply chain strategies. A total of 320 responses by readers of *World Trade 100* magazine were gathered from Feb. 25 through March 11, 2013.

About Grant Thornton's supply chain advisory services

Grant Thornton LLP provides a broad continuum of supply chain solutions, including commodity planning; sourcing process evaluations; pricing reviews; technology solutions; supplier assessments and action planning; risk response protocol analysis; inventory and asset management solutions; and consolidation and resource management.

About *World Trade 100* magazine

World Trade 100 is a business-to-business logistics journal delivering news and information to U.S. subscribers active in domestic and international trade. *World Trade 100* covers every aspect of the global supply chain, from the movement of products across the United States to the procurement from and delivery to international markets.

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