



The Return of Manufacturing Investment

**Firms look to shore up operations and
business systems as markets reemerge**



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Last year's downturn dramatically changed investment habits for midmarket manufacturers: capital dried up, budgets withered, employees took furloughs or buyouts, and equipment and technology upgrades were put on hold. Even within industries that fared better than most (e.g., food manufacturers, which saw shifts but not steep declines in demand), lack of capital was a growth constraint. The question for executives now is: What impact will the cuts we made to survive have on our ability to grow in 2011 and beyond?

Savvy manufacturing executives have been using the market lull of the economic downturn and stop-and-start recovery to get their corporate houses in order, stabilizing their processes, facilities, and business systems so they're better equipped to manage rapid growth when it returns. In doing so, they've been asking: Were we as productive as possible prior to the recession? Were our systems fully leveraged then? And how will two years of incredibly tight budgets and aging technologies affect reliability and effectiveness of our operations going forward?

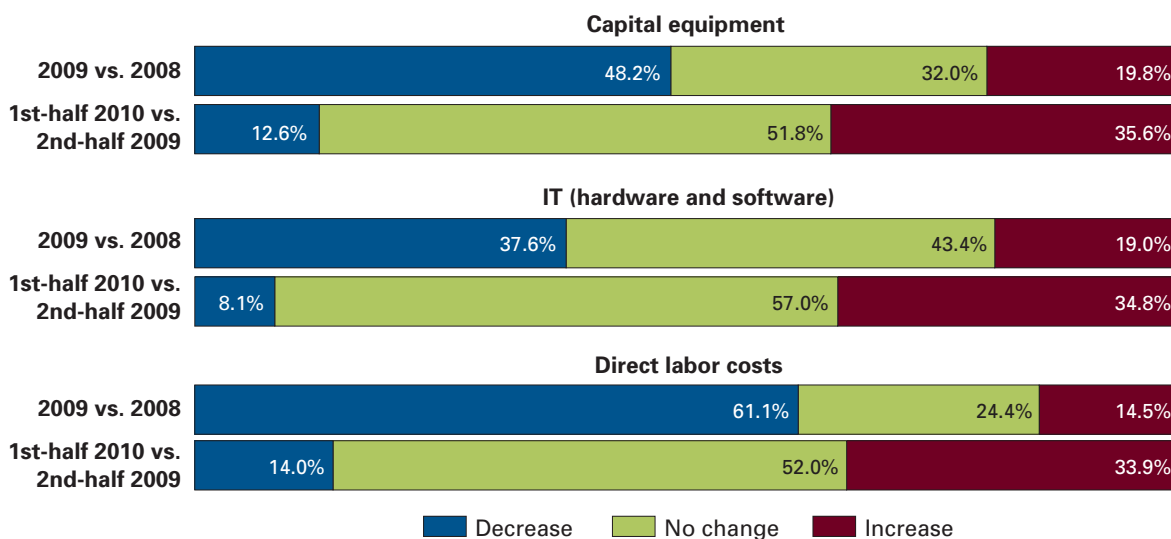
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Business Investments Shift from Stabilization to Growth

In the second quarter of 2010, the *Manufacturing Growth Study*¹ found signs that manufacturers intended to increase spending on capital equipment, IT and labor, reversing investment habits of the previous 12 months (Figure 1):

- Capital-equipment spending: 48% decreased spending and 20% increased spending in 2009 vs. 2008, but 36% projected an increase in first-half 2010 vs. second-half 2009.
- IT hardware and software: 38% decreased spending and 19% increased spending in 2009 vs. 2008, but 35% projected an increase in first-half 2010.
- Direct-labor costs: 61% decreased spending and 15% increased spending in 2009 vs. 2008, but 34% projected an increase in first-half 2010.²

Figure 1: Change in Investments



Source: Manufacturing Growth Study

¹ "Manufacturing Growth Study: Strategies for Recovery and Renewal for 2010 and Beyond," The MPI Group, September 2010.

² Ibid.

Economic data reported in the months since the *Manufacturing Growth Study* have generally confirmed its predictions. For example, U.S. Commerce Department data on nondefense capital-equipment orders (which exclude aircraft) rose 2.1% in May from April and was 18.4% above its year-earlier level, prompting Justin Lahard and Kris Maher of *The Wall Street Journal* to write, “Spending on such capital goods fell sharply during the recession, and even now, businesses remain cautious as they eye turbulence in Europe and worry that the recovery could still stumble. But with demand for goods around the world continuing to rise, that uncertainty is being trumped by concern about getting left behind.”³

International Data Corp. (IDC) projected annual IT spending in 2010 to grow by 6% (constant currency) to \$1.51 trillion. IDC cites a first-half 2010 rebound driven by capital spending on new hardware infrastructure as businesses, governments, and consumers addressed pent-up demand for new PCs, servers, storage, and network equipment. Hardware spending for the year is projected by IDC to increase by 11% to \$624 billion, software by 4%, and services by 2%. Stephen Minton, vice president of Worldwide IT Markets and Strategies at IDC, says, “While the high growth rates recorded by many vendors in the first two quarters of 2010 are partly a reflection of how bad things were in the same period of 2009, there’s also no doubt that it partly reflects a very real swelling of pent-up demand for hardware replacements and upgrades.”⁴

How do recent IT spending habits compare to past investments? Minton says IDC research still indicates caution “about committing to new, long-term IT projects” and that contingency plans to suspend projects are at the ready.⁵

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Upgrading IT Systems for the Future

This apprehension about the future is often at odds with immediate business needs. Companies with growth opportunities may need to upgrade their IT systems and applications, but remain wary of large, multiyear investments (nonetheless, 5% of participants in the *Manufacturing Growth Study* were planning to purchase an ERP system and 36% were planning to upgrade ERP⁶). Why? In many cases, these firms may lack the IT staff to support new efforts. IT unemployment remained high at 5.4% in the second-quarter 2010, despite representing the lowest percentage since 2008, according to Bureau of Labor Statistics; in total, 232,000 IT professionals remain unemployed.⁷ At many firms this tension can mean that non-IT executives are more involved than ever in IT decision-making, preferring IT investments that generate immediate ROI — usually measured in increased sales or improved operations.

Other IT investment trends are at work as well. The economic downturn gave savvy manufacturers an opportunity to pause and reassess their infrastructures, allowing firms that had made major IT acquisitions prior to 2008 to stabilize their systems and processes. Provided they see clear economic signals, many firms will likely move forward with new IT following two years of consolidation. Then, too, with many firms now finding opportunities to acquire or divest business units — 18% of manufacturers rated mergers and acquisitions as highly important or important to their company over the next six months⁸ — an ability to quickly onboard or divest units/divisions with existing IT infrastructures will become a key challenge for many IT departments.

³ Justin Lahard and Kris Maher, “Seeing Economic Rebound, Firms Step Up Spending,” *The Wall Street Journal*, June 25, 2010.

⁴ “IT Markets Beat Expectations in First Half of 2010, But Double-Dip Recession Might Spoil the Party, According to IDC’s New Black Book Forecast,” IDC, August 3, 2010.

⁵ Ibid.

⁶ “Manufacturing Growth Study: Strategies for Recovery and Renewal for 2010 and Beyond,” The MPI Group, September 2010.

⁷ Chris Murphy, “Unemployment Jumps for the First Time Since 2008,” *InformationWeek*, July 13, 2010.

⁸ “Manufacturing Growth Study: Strategies for Recovery and Renewal for 2010 and Beyond,” The MPI Group, September 2010.

New Technology Objectives Emerge

Business collaboration platforms (which enable individuals within a company or across companies to share information and work collaboratively), virtualization (by which virtual software or hardware is utilized rather than actual assets put in place), and mobile access are popular initiatives for manufacturers, according to the *Manufacturing Growth Study*.⁹ CIOs and other IT executives and managers were even more likely to rate these initiatives highly.¹⁰

Business collaboration platforms, such as Microsoft's SharePoint and IBM's Lotus, offer at-a-glance dashboards for business intelligence that can satisfy the demands of all but the most technical staff (design, engineering). Virtualization allows companies greater flexibility in their IT investments and infrastructure. Mobility is a trend that is quickly forcing companies to explore two different paths:

- Consumer-grade mobility, such as iPad and iPhones, for which it's difficult to justify ROI (but which captures the attention of customers, and of executives willing to explore its potential).
- Productivity mobility, which enables easy access to data, information and functionality for staff working away from desktops: service, warehouse, shopfloor staff, etc.

The good news is that the two paths of mobility are converging (i.e., less expensive devices with barcode readers built in).

Another IT initiative attracting manufacturer attention is cloud computing.¹¹ Two-thirds of manufacturers participating in the *Manufacturing Growth Study* (67%) reported that they would use cloud computing for at least one application, alone or in conjunction with on-premises applications, in the next six months.¹²

Of the five initiatives covered by the study, none offers a better combination of flexible growth amid cautious spending than cloud computing. It offers economies of scale and quick, efficient delivery of applications to employees worldwide, adjusting user volumes as workloads increase or decline, without major investments in hardware, software and staffing. Not surprisingly, the cloud computing market is in flux, with major IT players placing large bets alongside myriad startups even as observers suggest that industry standards (especially security) need better definition.

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James Harris and Steven Nunn of Accenture write in *Forbes*, "Whether being denounced as a threat to business or hailed as its savior, cloud computing has become a major force, one capable of transforming the world of information systems and the organizations that use them. Yet cloud computing is part of an even bigger story: the fundamental re-creation of the traditional enterprise operating model." The authors predict that the agility provided via cloud computing will "transform business in several areas, including IT, the workplace and business processes."¹³

⁹ All were rated 3, 4 or 5 by approximately half of *Manufacturing Growth Study* participants (5 = "highly important" and 1 = "not important" over the next six months).

¹⁰ "Manufacturing Growth Study: Strategies for Recovery and Renewal for 2010 and Beyond," The MPI Group, September 2010.

¹¹ Rated 3, 4 or 5 by 23% of *Manufacturing Growth Study* participants (5 = "highly important" and 1 = "not important" over the next six months).

¹² "Manufacturing Growth Study: Strategies for Recovery and Renewal for 2010 and Beyond," The MPI Group, September 2010.

¹³ James Harris and Steven Nunn, "Cloud Computing's Great Promise," *Forbes*, June 30, 2010.

Conclusion

Most companies are still uneasy about where the economy is going, and continuing up-and-down news is unlikely to assuage those concerns. Savvy leaders, though, have tuned out the external noise, instead looking inside their firms to make them stronger. They've been using the past year and a half for gap analysis, building an infrastructure that will support growth as economic recovery takes hold. More specifically, these leaders seem focused on three key "I" objectives:

Identify: Senior executives have never had so much on their plate: stay afloat, retain loyal workers, satisfy increasingly demanding customers. But you can't do everything. The smartest leaders are spending time with their customers, suppliers and employees to determine what truly matters — those initiatives that will make their organizations relevant now *and* in the future. They're also putting effort into making hard decisions on prioritizing which initiatives can be launched today, and which can wait until 2012 or later. Most importantly, they're setting key objectives and targets around those initiatives and actively supporting them with time, money and resources.

Invest: There's never been a more difficult — but critical — time to invest, in three key areas:

- **Equipment:** Is your production equipment ready to reliably produce quality products at the higher rates growth will demand? Tight credit might limit your ability to invest in new machinery, but many manufacturers have found creative ways to compensate, including refurbishment of existing equipment or purchases of used machines.
- **Employees:** Are your employees' skills ready for the increased speed and agility that growth will demand? You'll need engaged, knowledgeable staff to hit the plant floor running when new orders hit, not looking for instruction manuals and harried supervisors. Savvy executives are getting ready in two ways: first, by training existing employees now, and, second, by developing processes to efficiently integrate new hires and temporary employees when demand surges later.
- **Information Technology (IT):** Is your IT system ready for the strains that growth will create? Many firms cut IT budgets during the downturn, leaving holes in functionality and ease-of-use. Forward-thinking managers are addressing these gaps now instead of waiting for a crisis; they're managing costs by looking to cloud options that can grow alongside their businesses with less upfront investment.

Improve: There's no sense identifying and investing in new growth opportunities if you're just going to use the same old processes – in supply-chain management, in production, in customer service — that limited growth in the past. Leading firms are readying themselves for the future by implementing process improvements throughout their organizations (i.e., not just on the plant floor). They're mapping how each process, function and department creates customer value, eliminating waste now so that they're ready for increased sales later. They're finding, too, that these efforts not only save time and money, but improve employee morale as well — as everyone and everything begins to work more productively.

Many firms are already transitioning from “the year of stability” to “the year of ROI,” with increased appetites for investments that boost growth. What about you?

About The MPI Group

The MPI Group — including the Manufacturing Performance Institute — is a Cleveland, Ohio-based research organization specializing in strategy, research, analysis and communications. The MPI Group (MPI) offers world-class research techniques, tools and execution, and a deep understanding of business management, manufacturing, IT and operational challenges — based not just on its leaders' expertise, but on privileged access to leading CEOs and deep analysis of MPI's proprietary database (one of the world's largest) of detailed financial, operational and strategic metrics collected from thousands of facilities and firms around the globe. One recent effort, the Next Generation Manufacturing Study, uses insights gathered from more than 2,500 executives to outline a path to the future for firms in this critical sector.

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MPI is led by John R. Brandt, former editor and publisher of *IndustryWeek* and *Chief Executive* magazines, and George Taninecz, a well-known researcher and author specializing in strategy and process improvement.

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