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ACHIEVING SMART GROWTH:

A Guide for U.S. Manufacturers

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In the world of manufacturing, growth can seem daunting.

Investments of time and money for expansion tend to be big: new equipment, bigger facilities, more staff on the production floor and back-office, contracts for more raw materials, and added inventory to carry. Perhaps the biggest hurdle is the strain on cash flow, as dollars fly out the door to fuel growth and surging sales translate into more accounts receivable. Rapid growth has the potential to tear at the seams of a small and mid-size manufacturer.

And yet, when evaluated strategically and managed effectively, scaling can produce powerful financial benefits for the business, employees, and owners.

With insights from a few of our manufacturing clients and the Bank of the West Small Business Growth Survey, **we help to answer two questions:**

- *What is smart growth?*
- *What are some steps for a small or mid-size manufacturing business to achieve it?*

WHAT IS SMART GROWTH?

Rarely do we pause to ask, "Is growth healthy for my business?" Without a solid plan, the answer may be, "No."

One of the pre-eminent experts on the topic of smart growth, Professor Edward Hess of University of Virginia's Darden School of Business, has shown that it is more difficult than many of us realize to create value through growth. His research[1] has found (1) many businesses lose money as they expand, (2) companies that grow at an above-average-pace year after year are rare, (3) many businesses assume greater risks when they get bigger, and (4) "improve or die" is far more accurate than the common mantra of "grow or die."

This isn't to say manufacturers should not grow, but rather that we should shy away from preconceived notions about the right path for any business and rely on a well-thought-out plan, whatever path a business takes.

Before taking the growth path, a manufacturer needs to ask the right questions:

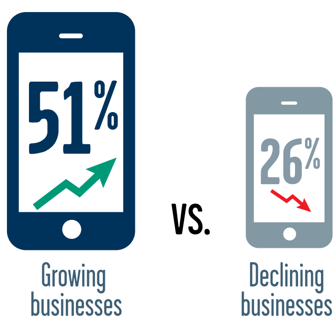
- Is there an ideal size for my business so I'm competing in my sweet spot and where administrative costs do not become a drain?
- What is my greatest profit opportunity: expanding sales or increasing operational efficiency (e.g., acquiring new machinery, accelerating collections, or managing inventory)?
- How do I ensure increased sales lead to higher profitability?
- How long can we grow, and how prepared are we for potential slowdowns?
- What levers do I have to help manage cash flow during growth periods and lulls?

What is clear is that smart growth will look different for every manufacturer, depending on unique circumstances. In some cases, the smart path may mean maintaining your current size, and in other cases making investments today may lead to huge bottom-line growth tomorrow. The answers to the right questions can create a firm foundation for manageable and profitable growth.

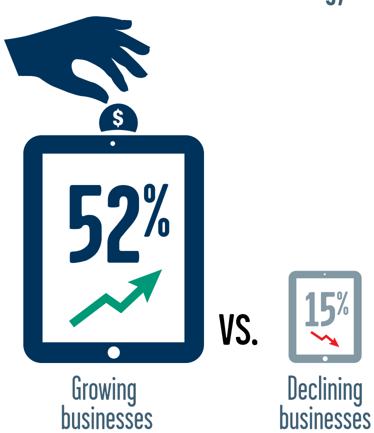
HOW DO YOU ACHIEVE SMART GROWTH?

GROWING BUSINESSES ARE MORE LIKELY TO:

Understand the importance of technology



Increase investment in technology



Source: Bank of the West Small Business Growth Survey

Plan.

Frequently, growth just happens. Other times it needs serious planning. Time and again, we find the manufacturing businesses that are expanding most effectively have a growth plan[2] that defines objectives, provides the strategy and tactics for achieving growth, and identifies the risks. These plans are reviewed and refined quarterly, if not monthly, as goals are met or missed and circumstances change.

Invest.

Look for opportunities to invest in your business that will increase profitability over time. Small and medium-size businesses clearly understand the value of investing in their companies. As the U.S. economy has strengthened, three out of four business owners invested in their operations in the past 12 months, and a similar ratio intend to invest in the coming year, according to the Bank of the West Small Business Growth Survey[3] .

Investment plans vary from manufacturer to manufacturer, but our research and conversations with manufacturers point to a common theme: Investing in technology makes a difference.

The Bank of the West Small Business Growth Survey found that growing companies are twice as likely as declining businesses to say investing in technology is extremely or very important to success in the next year. More than half of growing businesses indicate that they have increased their technology budget over the past 12 months.

Tales of tech investments by our manufacturing clients back the numbers.

"We're constantly searching to evolve all aspects of our manufacturing, including the engineering process with new software development," said Nancy Mercolino[4], president of Ceilings Plus, a Southern California manufacturer of ceilings and wall panels for large-scale projects, such as airports and museums."We're able to do more – design 30% more interesting, progressive, and parametric designs now, and still be 30% faster doing it. Manufacturing really consists of making the product as well as engineering the product."

The ability to engineer innovative products combined with skills at making those products have allowed Ceilings Plus to grow rapidly, both domestically and internationally.

Investments in new technology are also paying off for Foamtec, a maker of decorative architectural shapes from polyurethane. The company is upgrading the equipment at its Rancho Cordova plant in Northern California.

"I'm going to spend probably $30,000 or $35,000 on a piece of machinery, but it's going to cut my operating costs $15,000 to $20,000 a year," founder and owner Jeff Lemon said. "So you look at that as really a two-year investment, and you've made a quick return on your money. Not only is the machine going to cut costs, but it's also going to produce an even better quality product."

Less than a third of small businesses plan to acquire funding in the next year.

Source: Bank of the West Small Business Growth Survey

Fund.

This all leads to the question of funding. How does a manufacturer pay for an expansion plan?

Six years after the U.S. economy began to recover from the Great Recession, manufacturers and other businesses are still credit-cautious; they are relying on cash reserves. The Bank of the West Small Business Growth Survey found that while many small businesses are poised to grow, only 31% plan to acquire financing in the next year. Similarly, a Federal Reserve survey of companies of all sizes found that only 22% of businesses sought credit in 2014[5].

The common funding paths—cash or credit—have very different implications. Relying on cash saves financing and interest costs and may reduce risk. Relying on profits to grow imposes financial discipline and may help keep a business from expanding too rapidly and becoming over-extended. But, this may also constrain growth and limit a manufacturer's flexibility in good times and bad. Conventional lines of credit, commercial real estate loans, and Small Business Administration (SBA) loans have helped many manufacturers to expand in economic upturns as well as ride out rough patches or business disruptions.

CONSIDER THE EXPERIENCES OF TWO MANUFACTURERS:

Foamtec: A smart cash-flow story

Jeff Lemon funded the operations of his Northern California manufacturing business with cash flow until 2015 when he received a line of credit. The business has used the extra liquidity from that line of credit to actually improve cash flow — spending more up front to receive volume discounts from vendors, and investing in improved equipment that speeds up key processes.

"I've been able to produce a lot faster," Lemon said. "Instead of an order going out in 30 days, now it's going out in 15 days. I'm also able to collect a lot quicker. The money is just spinning faster now."

ST Fabrication: Smoothing ups and downs with credit

As soon as possible after Jesse Cherian acquired his steel beam manufacturing business in 2002, he secured a $150,000 line of credit. The funding source for his business located near Tacoma, Wash., has grown to a $1 million line.

The business has tapped the line during times of expansion when ST Fabrication needed cash to cover expenses on multiple long-term projects, and the line helped during unforeseen downturns, such as the federal government sequestration in 2013.

"We've encountered various slowdowns and various growth spurts," Cherian said. "We would not have survived either of those scenarios had we not had the capitalization that a line of credit provided when we needed it."

Looking at the future through the lens of smart growth can help a manufacturer identify the right path for the business. Once the decision is made to grow, developing a plan that lays out both the strategy for investing in the business and the strategy for funding growth can help position the company to take advantage of opportunities as the U.S. economy continues to expand.

Planning and managing growth is not easy, but a business owner doesn't have to go it alone. Take an SBA course or workshop, seek guidance from seasoned businesspeople at SCORE, or talk to a banker. Below are links to online resources that can provide guidance and support to manage and grow your manufacturing business.

RESOURCES WORTH A LOOK

Check out the many sites below that may help U.S. manufacturers achieve growth.

Business USA:

One-stop portal to federal government services for small and medium-size businesses.

Export.gov:

Online hub for government resources to help U.S. exporters.

Hollings Manufacturing Extension Partnership (MEP):

National Institute of Science and Technology's public-private partnership helping manufacturers develop new products, adopt new technology, grow domestically and internationally, and onshore production.

Minority Business Development Agency:

U.S. Department of Commerce site with information for minority-owned businesses.

Small Business Administration (SBA):

Information on starting, managing, financing, and growing a business.

SCORE:

A network of mentors advising entrepreneurs on starting, managing, and growing a business.

ENDNOTES

1. Edward D. Hess, "Everything You Know About Growing Your Business is Wrong". *Big Think.* 2011, online video clip <http://bigthink.com/videos/everything-you-know-about-growing-your-business-is-wrong >.

2. Don Mercer, "What Does Your SMART Plan Look Like?" *Bank of the West* (blog), 2014, <http://blog.bankofthewest.com/smart-plan-look-like/>.

3. "Bank of the West Small Business Growth Survey," *Bank of the West*, September 2015, <http://blog.bankofthewest.com/wp-content/uploads/2015/09/BOTW-Small-Business-Survey-Report.pdf>

4. Michelle Di Gangi, "Made Here: Going Global with U.S. Innovation & Quality" *Bank of the West (blog)*, 2015, <http://blog.bankofthewest.com/made-here-going-global-with-u-s-innovation-quality/>.

5. "Joint Small Business Credit Survey", *Federal Reserve Bank of New York*, 17 February 2015, <http://www.newyorkfed.org/smallbusiness/joint-small-business-credit-survey-2014.html>