

For Immediate Release: July 21, 2009

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## **BAKER TILLY SURVEY INDICATES MANUFACTURERS CAUTIOUSLY OPTIMISTIC ABOUT MID-YEAR ECONOMIC OUTLOOK**

### ***FIRMS WAITING FOR REBOUND IN CUSTOMER DEMAND TO AVOID POSSIBLE CUTBACKS AND LAYOFFS***

**MADISON, WI – July 21, 2009** – As the economy struggles to gain momentum, 57% of manufacturing executives are cautiously optimistic about the outlook for the next six months and nearly two-thirds (70%) are planning to keep staff levels steady, according to a survey released today by Baker Tilly, the 17<sup>th</sup> largest CPA firm in the U.S.\*

While many executives are guardedly positive, the level of optimism is shallow and there are deep pockets of pessimism, especially among small companies.

Executives are more pessimistic about the outlook for the manufacturing sector than the economy with slightly less than half (47%) expressing optimism. The key factor dampening the manufacturing outlook is the lack of customer demand, which was cited by nearly half of respondents (45%) as the greatest challenge to the expansion of their company.

The survey also measured the potential effect of a U.S. cap-and-trade program. Survey results indicate support among executives is surprisingly broad but not deep while opposition is sizeable and intense. If a cap-and-trade program increases energy costs, it could have a major effect on manufacturers with executives saying they would consider passing on costs to consumers, cutting back production, reducing employee benefits and laying off staff.

“The deep uncertainty about the economic outlook is reflected in the manufacturing sector, which is divided on prospects for the rest of 2009,” said Brad DeNoyer, partner and manufacturing industry lead at Baker Tilly. “Many manufacturers see reasons for cautious optimism but there is a pervasive ‘wait and see’ attitude regarding demand. The good news is manufacturers plan to delay more layoffs as long as possible, but they will need to find a way to aggressively cut costs if customer demand does not rebound soon.”

#### **Economic Outlook**

While nearly six in ten manufacturing executives have a positive outlook for the U.S. economy for the next six months, the optimism is guarded and the pessimism is deep. A smaller percentage (9%) is very optimistic as compared with those (15%) who are very pessimistic.

Manufacturing executives are more pessimistic about their own sector than the overall economy. Again, the level of pessimism is deep rooted. Only 3% are very optimistic about the sector outlook while 16% are very pessimistic.

Executives from small manufacturers are significantly more likely than medium- and large-firm executives to have a very pessimistic outlook on both the U.S. economy and the U.S. manufacturing sector. The major regional difference is that Midwest executives are more likely than Southern to have a very optimistic outlook.

About half of executives (49%) said they expect their firm's performance to decline, with 12% of those executives saying their firm is in danger of failing. Executives from small firms (14%) were much more likely to report a danger of failing than those from medium (2%) or large firms (3%).

Executives generally plan to hold the line on staffing levels during the next six months. Seven in ten executives expect their firm to have no net change in staff while 20% plan to have a net reduction and 9% plan a net increase.

Over the next year, executives will consider a wide range of actions in response to the current economy:

- Reduce operational costs (80% of executives)
- Look for tax advantages (66%)
- Increase diversity of products or customers (65%)
- Seek price reductions from suppliers (65%)
- Reduce labor costs (51%)
- Reduce production (41%)
- Reduce marketing and advertising (21%)
- Seek a business partner or investors (18%)

"Manufacturers clearly prefer reducing operational costs rather than cutting benefits or laying off staff," said DeNoyer. "And many firms are seeking to grow their business by expanding into new product niches and reaching new customers. But with profit margins so tight, it will be hard to avoid the more difficult choices if the economy continues to struggle for an extended period."

The major challenge facing executives is raising demand for their products. Choosing from a list of eight challenges, nearly half (45%) of executives said customer demand was the greatest barrier to expansion of their firm. Other issues cited as the greatest challenge include the availability of loans and credit (14%), business taxes (10%), trade policy and foreign competition (9%) and complying with government regulation (6%).

Despite the pressure to reduce costs, executives said they are continuing to invest in their companies. The most common investments are in quality improvement systems (51%). Other areas of investment include:

- Research and development (48%)
- Capital improvement (40%)
- Skills training (36%)
- Green programs (31%)
- Risk management (28%)
- Foreign manufacturing capabilities (13%)

Among executives with plans for mergers and acquisitions, most (86%) report no change in their plans, 12% plan to increase activity, and 3% plan to decrease it.

## Cap-and-Trade Program

The survey also measured the potential effects of a national cap-and-trade program, which is a key component of HR 2445, The American Clean Energy and Security Act of 2009, recently passed by the House of Representatives.

One in three executives (32%) expressed support for a cap-and-trade program in which firms would be required to purchase credits for any pollution they emit. However, the support is soft with only 7% of all executives expressing strong support.

Survey results indicate that support increases among executives who are optimistic about the outlook for the economy and for the manufacturing sector. Executives at firms investing in green programs were also more likely to support a cap-and-trade program.

“I believe there is a general sense among manufacturers that something ought to be done,” said DeNoyer. “But our clients are telling us they want to make sure that it does not cost too much and that the timing is right. The survey indicates that executives who are more familiar with the concept are more likely to oppose it.”

Nearly six in ten manufacturing executives (59%) oppose a cap-and-trade program, including four in ten executives (41%) who strongly oppose it. Opposition was similar for a cap-and-trade program in which firms received free pollution credits, a provision of The American Clean Energy and Security Act of 2009.

International consistency was a key factor that increased levels of support. Four in ten executives said they would be more likely to support a cap-and-trade program that was adopted internationally. More than one-fourth (28%) of executives opposed to a U.S. program said international adoption would make them more likely to support a cap-and-trade program.

“Manufacturers are looking for a level playing field,” said DeNoyer. “For example, the labor-rate gap between China and the U.S. is starting to narrow but there is fear that a national cap-and-trade program could help spark a resurgence of U.S. jobs exiting the country due to higher energy costs. It will be difficult for manufacturers to offset higher energy prices with profit margins so tight.”

Executives said they would consider a wide range of responses if a cap-and-trade program was implemented and increased energy costs. The most popular option was trying to pass on costs to customers (82%) and delaying new capital investments (70%).

Executives also said they would consider:

- Taking a hit on revenue (57%)
- Reducing employee benefits (39%)
- Laying off staff (39%)
- Cutting back on production (31%)
- Move production elsewhere in world where there are few energy restrictions (24%)

## International Plans

Among executives whose firms derive some revenue from outside the US, eight in ten said most of their new customers over the next three years would come from domestic markets. However, more than one in four executives (27%) from large manufacturers plans for most of their new customers to come from outside the U.S. during the next three years.

Executives from large and medium firms said the poor economy has spurred them to consider global expansion. Four in ten executives from medium and large companies said the economic downturn has caused them to look for growth opportunities overseas and 42% of large firms are investing in foreign manufacturing capabilities.

“It’s clear that large and medium U.S. manufacturers are increasingly looking to global markets to diversify their customer base as the economy continues to be unpredictable,” said Alan Whitman, partner and international services lead at Baker Tilly. “We expect this trend will accelerate as firms focus even more on emerging economies such as China, Mexico and India.”

Executives involved in overseas activities said they plan to focus primarily on China (selected by 44% of executives) and Mexico (40%).

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Other markets that were cited include:

- Eastern Europe (27%)
- India (23%)
- Japan (19%)
- Brazil (18%)
- Russia (11%)
- Vietnam (5%)

## IFRS Accounting Standards

A large percentage of executives are not aware of the potential U.S. adoption of International Financial Reporting Standards (IFRS). More than six in ten executives (62%) are unaware that the U.S. is considering adoption. However, executives at large firms were much more likely to be aware (86%) as compared with small firms (32%).

Only one in four executives believes the adoption of IFRS would have some impact on their business, either positive or negative, although four in ten (41%) of executives from medium and large firms believe there will be some impact.

The expected effects of IFRS include:

- Increased reporting costs (40%)
- Retraining costs (19%)
- Greater Transparency (10%)

## Methodology

On behalf of Baker Tilly Virchow Krause LLP (Baker Tilly), KRC Research conducted a national telephone survey of 300 senior executives of U.S. manufacturing companies between June 2 and June 22, 2009. The sample was stratified to include sufficient interviews to analyze results between executives from small (n=148), medium (n=81) and large manufacturers (n=71). The sizing of each company was based on the number of employees; small companies have fewer than 100 employees, medium companies have 100 to 299 employees and large companies have 300 or more employees. Overall results were weighted to reflect the actual proportion of manufacturers of each size in the United States. The estimated margin of error is  $\pm 5.7$  percentage points at the 95% confidence level.

## About Baker Tilly

With staff totaling more than 1,300, Baker Tilly provides a wide range of accounting, tax, assurance and consulting services. The firm has offices in Chicago, Detroit, Minneapolis, New York and throughout Wisconsin.

Baker Tilly is an independent member of Baker Tilly International, the world's 8<sup>th</sup> largest network made up of 145 high quality, independent accounting and business services firms in 110 countries, with more than 25,000 professionals. The combined worldwide revenue of independent member firms exceeds \$2.95 billion.

\*According to Public Accounting Report's "Top 100 of 2008"

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