1 Global Manufacturing and the New Economy

Manufacturing is an integral part of a web of inter-industry relationships that create strong regional and national economies. Manufacturing sells goods to other sectors in the economy and, in turn, buys products and services from them.

Manufacturing spurs demand for everything from raw materials to intermediate components to software to financial, legal, health, accounting, transportation, and other services in the course of doing business. According to the Bureau of Economic Analysis, every $1 of final demand spent for a manufactured good generates $0.55 of GDP in the manufacturing sector and $0.45 of GDP in nonmanufacturing sectors.[7]

Critical Issues

● The most fundamental strategic questions facing manufacturers today are about customers, and the fundamental ways in which customer expectations have changed.

● Manufacturers who maintain a narrow-minded focus on price and efficiency will do so at their peril—because widespread commoditization of products, due to the emergence of manufacturing competitors around the globe, is causing product-related prices and margins to fall in industry after industry.

● Providing a package of total value—including service and other non-product attributes—will be the key to survival for manufacturers adapting to 21st century competition.

Manufacturing in the 21st century requires new strategies. Those who develop them will see top line revenue growth, while those who don't will find themselves in a race to the bottom, where commoditization erodes profits and ultimately closes businesses.

What will be required for Wisconsin to be competitive in manufacturing? In short: Manufacturing businesses cannot continue to run "as usual."

1.1 Globalization Is Here to Stay

Manufacturing has changed dramatically in the last 20 years, and will continue to evolve rapidly over the next generation. To survive, manufacturers will have to adapt their businesses to a new reality of global economy: Customers and potential customers increasingly want very different things from what they used to demand. Customers across a wide array of industries—perhaps having been trained by the software industry, where new features are added every year while the price stays the same—now *expect value to increase continuously.* What's more, customer expectations are leaping from one industry to others. As a result, the most fundamental strategic

[7] Manufacturing in America: A Comprehensive Strategy to Address the Challenges to U.S. Manufacturers, U. S. Department of Commerce, January 2004, p. 14. See www.ita.doc.gov/media/Publications/pdf/manuam0104final.pdf

questions facing manufacturers today are about customers—and the fundamental ways in which customer expectations have changed. Market dynamics have reduced most customer interactions to discussions of "price" without reference to "value."

Yet even though customers focus on price in negotiations, they increasingly select vendors on non-price value attributes, a fact that few leaders and even fewer companies understand. Even worse, most leaders have failed to recognize how deeply advances in information technology, logistics, and management techniques have affected their customers' expectations. In market after market, real prices—those adjusted for inflation—have declined steadily over the last 20 years. In high-tech markets the trend is even more impressive: calculators that sold for hundreds of dollars in the 1970s are now giveaways at trade shows, and computing power that cost millions of dollars then is now available for under $300.

Manufacturers' focus on price has driven extensive commoditization of products and prices, even in markets where complexity and customization should differentiate. With margins in freefall, manufacturers often cut corners to survive, instead of increasing real and perceived value, which is what today's customers really want. Increasingly, dissatisfied customers demand even lower prices, driving ever more commoditization. In many manufacturing industries, CEOs despair of ever being able to raise prices again—or of investing in the future.

Can manufacturers change the customer conversation from price to value?

Yes, but doing so requires a fundamental reorganization of the customer relationship, by providing a customer-value package *wrapped around* the core product or service, and negotiating what the package offers:

- Improved quality/reliability/timeliness of delivery and service;
- Reduced total cost of ownership/procurement/business relationship;
- Reconfigured solution bundles, of which the core product or service may be a small part;
- Transparent access to information, serving the end-customer and supporting the product; and
- Provision of valuable business expertise, even if unrelated to the core product or service.

Changing the discussion from price to value increases margins dramatically—because adding more customer value does not mean proportionally more investment. It also enables manufactures to grow customer loyalty as customers increasingly value the relationship, not merely the product or service.

To make the price-to-value argument stick, a manufacturer must reorganize all processes and customers' interactions around a value-added strategy. This requires five key initiatives:

(1) Develop a systematic, continuous methodology to understand what customers *really value*. For example, half of U.S. heads of households are too tired to prepare an evening meal. "Tops Markets LLC eliminated most of its greater Cleveland Sandusky store butchers and introduced a line of Tender Choice beef and a companion line, Tender pride pork, both produced by Excel, a subsidiary of meat giant Cargill. A

Tops spokesman explains its reasoning: "It's a trend." The Tender Choice program "allows us to go to a wider variety of cuts, with a longer shelf life because they've been packaged already. It really fits today's lifestyle."[8]

(2) Focus intently on building relationships instead of products, broadening the value proposition from merely having preferred products to becoming a preferred partner. Consider, for example, a consumer who orders a computer from Marlow, New Hampshire-based PC Connection. If the customer calls before midnight, PC Connection will fully configure a new computer—including the addition of accessories and loading software—and then deliver the computer to the customer's home the next day.

(3) Reexamine your product and customer value proposition, and bundle it with other products/services. Automakers, for instance, are incorporating a range of information and entertainment options, from DVD players to real-time traffic reports to Internet access. Why? Because the automotive industry's ultimate product may no longer be a car or even safe and secure transportation, but instead a one- or two-hour daily experience in the automobile. As another example, Harley-Davidson's Parts and Accessories division "introduced 1,137 new accessories in its ever-expanding array of ways for customers to customize their personal motorcycles. New riding gear and fashion apparel from the Harley-Davidson MotorClothes line underscored the positioning of General Merchandise as the fashion and function leader in motorcycle apparel."[9]

(4) Put information management – about product/services/value and customers – at the core of your customer value proposition, delivery data, information, products, and services whenever, however, and wherever customers want it. To illustrate, in a just-in-time environment, information about a shipment or service delivery date is often more valuable than the shipment or service itself – because a missed delivery may shut down a customer's operation. Information about shipments or service deliveries gives customers the power to schedule, to plan, and to deliver outstanding service to *their* customers.

(5) Develop a systematic, continuous methodology to evaluate products and customer-value propositions as well as the value packages offered by competitors, and invent and implement new concepts in customer-value creation. At Starbucks, for example, quality coffee is only the first level of customer value. By adding grocery store availability of high-end coffees and coffee drinks, Starbucks debit cards, and Internet access with pay-as-you-go or unlimited-usage charges at retail locations, the company managed to grow from a coffee stand in 1971 to a global corporate power with more than $4 billion in revenue in fiscal year 2003. And, Starbucks' Ken Lombard has added to these products and services with CD sales of popular musicians and singers, creating an additional revenue stream.[10] By doing so, Starbucks has also boosted

[8] Joe Crea and John S. Long, "Chew on the Meaning of 'Fresh,'" *The Plain Dealer*, Sunday, June 12, 2005, p. A20.
[9] We Ride With You. Harley-Davidson 2004 Annual Report, p. 3. See http://investor.harley-davidson.com/annual.cfm
[10] Daniel McGinn, "Leadership for the 21st Century—Fresh Ideas," *Newsweek*, June 13, 2005, p. 52.

productivity: customers can add a CD to their purchase, which may cost 3 to 4 times their coffee.

Through these practices, manufacturers create wealth by opening up new revenue streams, answering the perennial question, "What are we going to do to survive?"

1.2 How Can Wisconsin and Its Manufacturers Compete?

World-wide manufacturing trends argue compellingly that manufacturers who succeed will do so by meeting the increasing customer demand for high-end products and services, not the mass production of low-cost, high labor commodities. The Federal Reserve Bank of San Francisco reported these observations:

> Comparing states with and without job recoveries, we find no significant difference in productivity growth. The results indicate that differences in demand (output) rather than differences in productivity growth have been the main primary drivers of job growth across states.
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> . . . If the acceleration in productivity growth had been due largely to cautious employers pushing the existing workforce harder, we would expect to see some negative correlation between employment growth and productivity growth across states—in other words, either faster employment growth and slower productivity growth or vice versa. The idea is that, if a firm had confidence to expand employment, it would be less likely to engage in stopgap measures to raise productivity.[11]

This position on the interrelationship among employment, gross product, and productivity by the Federal Reserve Bank of San Francisco concludes that data at the state level from 2001 through 2004 showed ". . . no statistically significant relationship between productivity growth and employment growth across the U.S. . . . Indeed, it appears that the states' employment growth rates in recent years have been related to output growth, rather than to productivity growth." In effect, productivity gains can meet demand, but companies experiencing substantial demand hire new workers.[12]

In short, any state's manufacturing industry benefits competitively from productivity growth, but it is overall growth in a state's manufacturing gross product—more demand for its manufactured goods—that ultimately leads to a state's manufacturing prominence.

This suggests that as a strategy, a state's manufacturers must distinguish themselves from their competitors with customer-value packages *wrapped around* the core product or service. The market reward is preferential purchase from those companies that best meet their customer's desire for continuous value improvement in products or services. This is how manufacturers must compete in the new global economy.

California's *Bay Area Economic Forum* said bluntly what we might see on this new pathway:

[11] Federal Reserve Bank of San Francisco, pp. 1-3.
[12] Federal Reserve Bank of San Francisco, p. 3.

". . . the global manufacturing footprint of the future, even for a single company, likely will involve a mix of locations, with 'basic' high-volume production [i.e., commoditization] offshore and 'customized' production maintained domestically."[13] Some industries will not fit this pattern because they will be tied to their location, such as food production and delivery in California, or logging and paper manufacturing in Wisconsin.

The consequences of these trends are immense. By almost any measure—gross product, productivity, capital expenditures, employment, or foreign exports—manufacturing and its related industries comprise almost one half of the total U.S. economy. In general, domestic manufacturing is clearly leaving behind years of high-pay, low-skill jobs (textiles, apparel, and toys) and turning toward high-skill, high-pay industries (aerospace, office and computing equipment, communications equipment, drugs and medicines, and medical, precision, and optical instruments.) The transition calls for careful analysis of global (customer) trends and local business climate compositions to develop statewide and regional strategies that minimize the loss of the outgoing high-pay, low-skill jobs to low-pay, low-skill countries and to maximize, rapidly, the plans and resources to grow high-skill, high-tech, high-pay industries.

[13] Bracketed comment is the Study author's. .Bay Area Economic Forum, "Introduction," One Million Jobs at Risk: The Future of Manufacturing in California, March 2005, p. 2. See www.cmta.net/multimedia/at_risk_jobs_20050301.pdf.