“Made in the USA”: It’s a tagline that’s seen more often these days — and with good reason.

Proximity to the customer — which allows small to midsized American manufacturers to provide customized products, value-added inventory management and quick delivery — is helping fuel a manufacturing revival.

Despite the relatively high costs associated with U.S. production, economic indicators demonstrate that the manufacturing sector is showing healthy growth. Seven years after the financial crisis, U.S. manufacturers in general — small and midsize producers in particular — have more than made up for ground lost during the crisis and are now out-performing the economy overall. The ISM manufacturing composite index (which measures U.S. economic manufacturing activity) shows solid expansion over the past 27 months.

Many factors have contributed to the resurgence of U.S. manufacturing, including rising labor costs overseas and productivity improvements here at home, which have allowed manufacturing output per employee hour to more than double over the past two decades. As a result, industrial production growth now stands at 4.5 percent, above real GDP growth of 2.4 percent through the fourth quarter of 2014.

Another indicator of the strong long-term outlook is a shrinking manufacturing cost advantage between China and the U.S., which Boston Consulting Group estimates at less than 5 percent.

Greater access to commercial and industrial credit — which has increased at a compounded annual rate of 14.3 percent in recent months and has seen double-digit growth since 2011 — has also fueled expansion.

Source: Federal Reserve System
The healthy U.S. manufacturing economic data and recent interviews with Bank of the West small- and medium-size manufacturing clients show that being close to the customer is a powerful advantage. It helps brands consistently provide faster and more responsive service and better products than overseas competitors. As U.S. consumers and businesses demand more customization and faster delivery, this advantage is likely to intensify.

“The reason we are manufacturing here in the U.S. is so that we can be fast in our response time with our customers — both in the product development cycle and also in the product delivery cycle,” notes Darren Bianchi, CEO of fluorescent pigments manufacturer Brilliant Group Inc. “We can control the product and make it better, and that’s our differentiation in the market. If we outsourced production, we’d lose all our flexibility.”

Service

One way U.S. manufacturers use proximity to make products better is by competing on service. A case in point is Feral Productions, a manufacturer of custom parts for the defense and biomedical industries. According to owner Robert Potts, Feral Productions has grown by meeting customer requests, no matter how demanding. “If a customer has an eight week job that they want in two weeks, you find a way,” says Potts. “There are weekends. It’s all about service. If you do that, customers will always come back.”

And they have. He says his business this year is continuing its double-digit growth rate of recent years.

Speed and Inventory Management

Another way businesses leverage proximity is by helping customers manage inventory and speed-to-market. According to Jerry Kwok, owner of Spectrum Label Corporation, the goal is “to provide a product that is not just a commodity — one that can’t just be outsourced.” Spectrum, which manufactures labels for food, pharmaceutical and nutritional products, helps clients minimize their inventory level, which can significantly reduce the cost of doing business. Being close to the customer allows Kwok to “design a program to make sure they have exactly what they need when they need it.” Teams work in close collaboration with customers to plan production, this allows Kwok to enter into purchase agreements for raw materials and minimize price increases that may be passed along. It also allows him to “turn on a dime,” meeting customers’ urgent needs.

“We operate out of one of the highest cost areas in the world for a manufacturing facility,” Kwok says. To stay competitive, Spectrum has to deliver something extra. “Foreign competitors can’t really manage inventory. Being close to the market, we can deliver inventory in days as opposed to weeks.”

Raw Materials Management

Equally important as proximity to the customer is closeness to suppliers and raw materials, as Rebecca Fleenor, CEO of Fleenor Paper Company, knows well. “Though our overall payroll is huge, our raw materials are probably 85 percent-90 percent of the cost of our finished goods,” says Fleenor. Proximity to suppliers — or short supply chains — is part of Fleenor’s growth strategy. By forging close relationships with materials providers, Fleenor and other growing manufacturers are able to provide flexible delivery schedules, environmentally friendly products and superb customer service.
Quality
Linked to raw materials management is product quality. Doug White has been making bicycle parts since the late 1970s as owner of White Industries, which sells directly to cycling shops across North America and to distributors in Europe, Asia, Australia and New Zealand. Key to White’s market success is product quality. “We compete because we have a name and reputation that goes beyond price,” he says. “We have to charge more than the large Asian companies or the other companies in the United States that have their products made in Asia. That’s how we do it, by reputation and good people.”

Reputation Management
Over the next few years, quality and reliability are likely to play an even bigger role in market success, as lead-times continue to shrink and consumers share information about product failures through social media. Customers are also paying more attention to reputational issues such as factory safety, HR policies, environmentalism and job creation. “We cannot compete with low costs and countries that don’t manage their environment and don’t care about the people who work for them,” says White. The upside is a reputation for responsibility, reliability and quality.

A good reputation opens doors, both domestically and internationally. “If you sell internationally and make your product in the U.S., you’re golden,” says Brilliant Group’s Bianchi. “There’s an implicit trust that the product is what you say it is. And that’s not the case for manufacturers in all other countries.”

New Product Development
Continuous access to customer feedback additionally drives innovation and successful product development. As Bianchi explains, “With the products we make in the U.S., we’re able to be much more flexible and innovative. When you manufacture here there’s a feedback loop that makes the product development cycle much shorter. When you manufacture overseas, you lose time and ideas in translation. You lose the iterative process that’s core to good product development.”

Product Customization
As customers demand more customized products and services, having short, nimble supply chains that can adjust to changes in specifications quickly (e.g., color, materials, features) is a big advantage. Darin Strickler, CEO of Tactical Solutions, a maker of firearms and firearms components, believes close proximity and flexibility are keys to his company’s success. “Our products are very high quality, a lot of hard labor,” notes Strickler. “They are 100 percent made and sourced in the U.S., so we don’t wait for any overseas subcontracting. And because we’re close to the customer, we can do any color on many of our products. We are essentially a custom shop.”
CALIFORNIA SNAPSHOT

Despite being one of the most expensive states for manufacturers (due to real estate prices, regulation, taxes and labor costs), California in general — and Northern California in particular — are strong contributors to the “Made Here” movement.

FORECAST INCREASE IN INDUSTRIAL PRODUCTION (2015-2044)

Sources: U.S. Board of Governors of the Federal Reserve System (FRB), Moody’s Analytics (ECCA) Forecast

Since 2009, the California Manufacturing survey has shown composite growth above 50, which signals expansion:

Source: The A. Gary Anderson Center for Economic Research at Chapman University
CHALLENGES

Of course, the economic outlook for U.S. manufacturers isn’t without obstacles. In the near term, there are signs of weakness. Production of non-defense capital goods, excluding aircraft, recently dropped for the sixth consecutive month. This is the longest consecutive monthly decline since September 2012, when orders fell for seven months, culminating with the launch of QE3 at that month’s FOMC meeting. But a modest manufacturing slowdown doesn’t necessarily indicate an extended downturn.

Bank of the West sees three factors driving the recent downturn in manufacturing orders: (1) the rapid strengthening of the U.S. dollar; (2) the plunge in crude oil price and (3) the hard winter. The strong dollar is likely the most powerful factor — especially for larger, global manufacturers with multiple geographic operations and large exporting operations — and will have the most prolonged impact on the sector. U.S. goods exports are already 3.9 percent lower than a year ago. Even if orders pick up from here, manufacturing inventories appear too high, meaning businesses will need to slow production in the near term to work off the excess. This suggests that we can expect to see continued weakness in manufacturing indicators in the coming months.

U.S. manufacturers face longer-term challenges, as well. The U.S. has more safety and environmental regulations than most countries and corporate tax rates are often higher here than abroad. Wages are also relatively high, while workers with technical skills are in short supply. These factors, combined with rising health care costs and the strong dollar, are a concern for U.S. manufacturers as they look to expand (or at least maintain) their customer base and profits.
KEYS TO SUCCESS

To win in this environment, U.S. small and midsize manufacturers will have to leverage the powerful advantage at their disposal: They are close enough to the market to forge deep customer and supply chain relationships, which in-turn improve service, speed-to-market, raw material management, quality, corporate reputation, customization and, ultimately, new product development.

Other lessons shared by U.S. manufacturers include:

1. “Don’t grow too fast”
   counsels bicycle parts maker Doug White. If you don’t manage growth well, you’ll lose customers and suppliers. Then you’ll have excess capacity and not enough work.

2. “Keep your overhead low”
   advises paper manufacturer Rebecca Fleenor. “I see manufacturing plants wanting to have sweet digs” and, often, they can’t. “You have to be somewhere where rents are affordable... and where there’s access to good labor.”

3. “Pay attention to cash flow”
   recommends fluorescent pigments maker Darren Bianchi. “We’re self-funded, so we’re limited in capital and our growth has to be stepwise. We need careful cash-flow planning because we’re buying things ahead of when our customers are paying us.”

4. “Make capital purchases wisely”
   advises label manufacturer Jerry Kwok, “because competition is investing in better equipment to add efficiencies and gain capabilities. The trick for us is to spend wisely.”
For U.S. manufacturers that achieve these goals and provide products designed around customer needs, the outlook for “made here” is promising. That’s partially due to the global economic improvement. But it is also in part due to the particularly bright outlook for small and midsize U.S. manufacturers.

Unlike some of their large-scale counterparts who may be negatively impacted by the strong dollar, small and midsize manufacturers are somewhat insulated from currency fluctuations overseas. Smaller producers are typically more dependent on U.S. customers, and economic data suggests that the U.S. consumer has rebounded and will continue to help fuel domestic growth.

Bank of the West Economics forecasts GDP growth at 2.7 percent for 2015 as a whole and 3.0 percent for the rest of the year, after a sluggish Q1 start partly due to “bad” winter weather.

**SMALL BUSINESS SNAPSHOT**

Small manufacturers are well-poised for the recovery because of the health of the U.S. consumer, limited reliance on exports and close proximity to the customer:

- Small business optimism has returned to pre-recessionary levels
- Hiring plans remain slightly lower than 2005 levels, due most likely to increased investment in technology and innovation

**NFIB SMALL BUSINESS OPTIMISM**

Source: National Federation of Independent Business
A Bright Future

Amazing things happen when manufacturers listen to their customers and operate closely enough to them to innovate, customize and iterate.

As the decade unfolds, the climate for U.S. production is likely to remain positive but somewhat volatile. While there are signs of a resurgence for small and midsize manufacturers, regulation, rising labor costs and cyclical demand may continue to pose a threat to the sector’s recovery. Despite this, well-run U.S. small and midsize manufacturers have location and strong business models on their side. They compete on quality, speed and customization. They listen and learn from their customers. And they buy materials from trusted suppliers who hold themselves to high quality and delivery standards. Well-managed small and midsize manufacturers are likely to succeed as long as they stay close to their customers, pay attention to cash flows, make purchases wisely and grow at a rate that allows them to maintain high quality and service.

It’s a good moment and business climate for products “Made in the USA.”