



*A manufacturing renewal is quietly developing in the United States. We are re-emerging as a best value manufacturing nation and we are now very competitive with low labor cost countries.*

*Verto Partners has been tracking this "re-birth" and compiling information regarding emerging trends that currently support and will enable US manufacturing growth to accelerate in the coming decade. Any Company considering their own plans for manufacturing and/or sourcing manufactured components outside of the US should reconsider those plans in light of this developing trend. Furthermore, any non-US company considering manufacturing for the American market should consider investing in the United States.*

## **The Re-Birth of "Made in America"**

By [Lance Wimmer](#) and [Dick Lindenmuth](#)

### **Historical Perspective**

After WWII the United States was the only fully operational manufacturing nation. "Made in America" had real meaning in the late 1940's and 1950's. Compared with other industrialized nations, the US came out of WWII with a 40 year sustained productivity and manufacturing advantage. This advantage included an indigenous supply of iron, coal, and infrastructure. The United States invested in interstate highways, bridges, telephone networks, trains, airplanes and basic infrastructure. Many Americans were employed by such major US manufacturers as GE, Westinghouse, US Steel, RCA, Ford and many others. American goods were accepted as the top standard world-wide. And, American manufacturing practices were increasingly being emulated by other nations.

The Deming Award (honoring W. Edwards Deming) was established in 1950 to recognize Japanese individuals and companies for advances in quality improvement. The Deming Award became the top goal for Japanese industry. In

1955 the Japan Productivity Center was established in Tokyo. Leaders from the United States (notably Mr. Deming) established programs such as quality circles, just-in-time, continuous process improvement, all designed to focus on lowering manufacturing costs by improving throughput and quality. Interestingly, at the time, these programs did not receive any significant traction in the USA since "Made in America" was considered the best!

Late in the 1960's the USA was being challenged as the number one manufacturing nation in the world by both the Japanese and the Germans.

There were very few American companies that had established manufacturing operations overseas. The Singer Sewing Machine Company (one of the few) had established manufacturing and sales operations in many countries around the world as early as 1904. IBM, on the other hand, was just beginning to expand outside of the United States.

The decades of the 70's and 80's saw significant increases in the exportation of US manufacturing jobs overseas. It started primarily because Mexico and others offered low cost labor advantages. However, countries such as Singapore, under the benevolent leadership of Lee Kwan Yew, extended the benefits by combining low cost labor, 10 year tax benefits and other special treatments for companies willing to invest in manufacturing in their countries. Beginning in 1965 the Singapore offerings showed success and other nations started to develop similar offerings to attract manufacturing investment.

David Heenan, points out in his book "*Flight Capital*" that for the first time Irish Americans going back to Ireland for jobs outnumber Irish immigrating to the United States.

Each time a new country offered its "flavor" of investment incentives manufacturers flocked to the new opportunity.

### **The China Juggernaut**

China, bolstered by a large market and a large workforce, was the most recent nation to enter the picture. China is dedicated to becoming a world economic leader. In the past two decades China has undertaken a massive improvement in its infrastructure building roads, highways, bridges, dams to support a growing commercial and manufacturing economy to employ its huge population.

Countries with progressive leadership will always seek ways to employ their people to produce goods and services for internal consumption and for export. China is doing what Mexico and Japan did before China. The consequence for the US and other world nations is that we see more goods stamped "Made in China", "Made in Mexico" and "Made in Japan" and fewer stamped "Made in America". As the US consumes more and more product made by foreign manufacturers using foreign labor our domestic labor becomes increasingly underutilized, less skilled and jobless.

Even worse, as US manufacturing companies set up manufacture in foreign countries, we dissipate US manufacturing technology by sending our experts to make sure that foreign manufacturing processes are the most modern, with top raw materials, trained labor and continuous improvement processes.

An article published in the [\*The New York Times, January 21, 2012\*](#) describes Apple, Inc's recent decision to assemble and produce iphones and ipads in China. *"Apple's executives believe the vast scale of overseas factories as well as the flexibility, diligence and industrial skills of foreign workers have so outpaced their American counterparts that "Made in the U.S.A." is no longer a viable option for most Apple products."*

As a result, when US manufacturers build manufacturing operations in foreign countries, the US is helping build up foreign economies at the expense of our own and we undermine our US labor and technology resources as well.

How has China gained so much so quickly? Primarily because China has a massive population that, initially, was willing to work for less than 10% of the comparable US labor cost. In addition, the Chinese government has held down the value of the Yuan currency, thus making China goods less expensive in world markets. The Chinese industrialization process is a juggernaut that is gobbling up the world's natural resources so much so that it is will be difficult for many nations to catch up.

### **The Case for the Re-Birth of "Made in America"**

What does "Made in America" mean and why is it so important? There was a time when imported products connoted poor quality and US made goods had the competitive edge for the consumer's dollar. More recently, imported goods no longer have the poor quality stigma and, dollar-for-dollar, US manufactured goods

have had difficulty competing. Over time we have lost our US "Made in America" competitive edge.

However, every day we are seeing more and more evidence of a re-birth of the "Made in America" theme. We believe this is largely to do to a "leveling of the competitive playing field" primarily associated with labor and transport related costs becoming increasingly more favorable for US manufacturing. Our thesis is simply this; when you take into consideration all of the costs and related factors of manufacturing products in a foreign country verses on US soil and then factor in a large pool of unemployed US labor plus revitalized federal, state and local incentives and tax breaks, "Made in America" is at least on parity with foreign manufacturing, if not better. "Made in America" is good for US manufacturers and it helps to boost our domestic economy.

Factors weighing in favor of US manufacturing would include:

- The foreign labor cost advantage is becoming less significant. Demands for a higher standard of living by trained labor in foreign countries has steadily pushed up the demand for higher wages. For example, labor rates in Shenzhen and Guangzhou provinces of China have increased significantly. These regions are the original regions that attracted foreign manufacturing investment in China.
- The ten year tax advantages provided by foreign countries to bolster their manufacturing base have expired in many cases.
- The increasing value of the Yuan, artificially depressed for years, has begun to increase the cost of China's goods and services relative to other currencies.

The following hypothetical example portrays many of the additive cost factors that must be considered when a US company is deciding on domestic or foreign manufacturing. The underlying assumption is that the product is being distributed to end users in the US market and that the foreign source is China. The example could be shoes, steel products or any manufactured product. For simplicity we used "widgets" and assumed monthly sales of \$250,000.

In this example, the hidden or "true cost" of manufacturing outside the US of products destined for US soil is not just based on labor and tax incentives. What are the true costs? Sourcing, raw materials, production costs (including labor),

capital costs, environmental/OSHA costs, inspection quality control costs, storage costs, transportation including packaging/breakage, insurance, inventory costs, US warehouse costs, local quality control costs, local transport costs, time costs including time to a Chinese port, time to load on the ship, time on the water, time in port clearing customs, time to US destinations.

In this example the following assumptions are used:

- tax incentives have expired and foreign labor costs are only 1/3rd the US labor rates,
- foreign manufacturing overhead – supervision and plant and equipment costs are about 60% of US costs
- raw materials are the same for the foreign country and the US.

Considering the above, the product leaves the China factory at 23% less cost than the comparable US factory cost; the US gross margin is 20% and the China gross margin is 39%

Now consider the additional hidden or “true costs”:

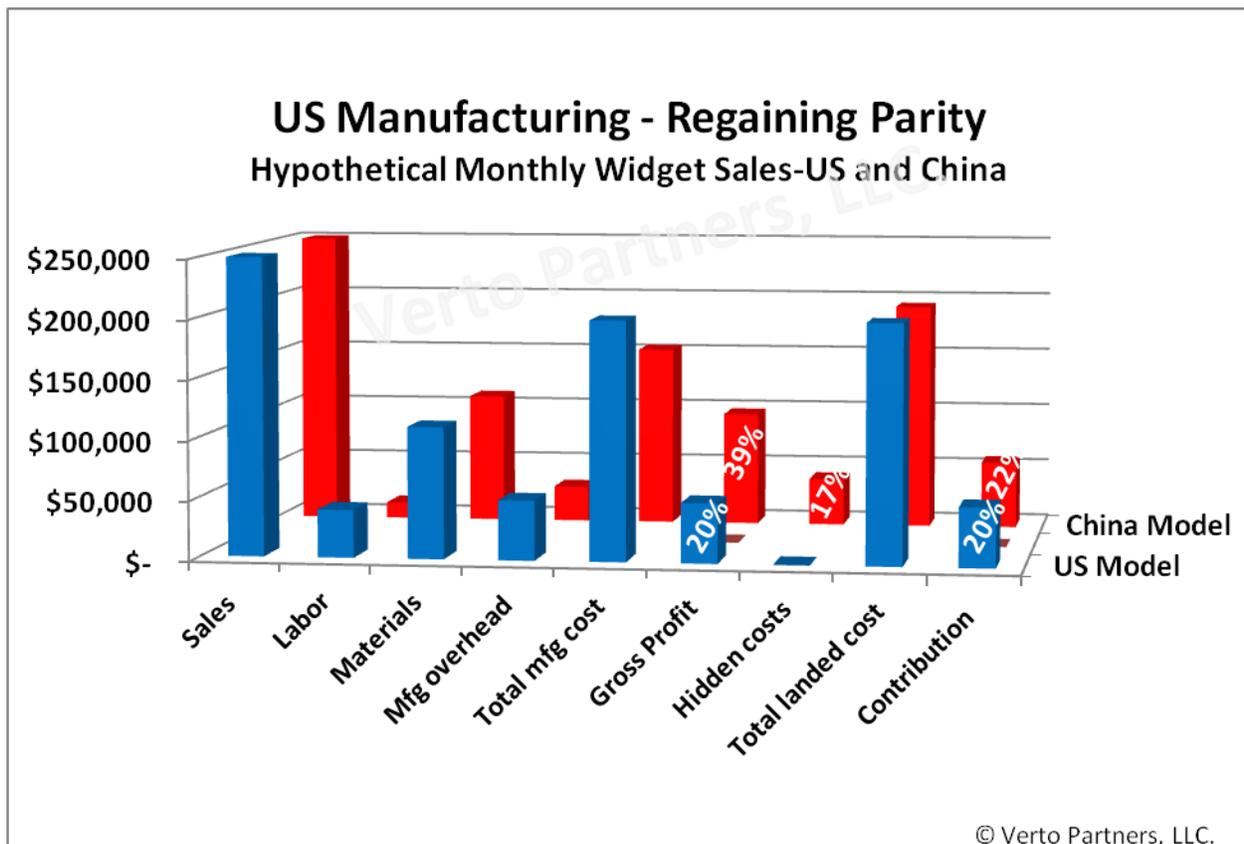
- **ocean freight, customs, insurance** – the finished product is in China to be loaded on a ship for a US destination (Los Angeles, Savannah, New York), then to clear a port in the US to be loaded for transportation to a receiving station for customs inspection. These costs can range from 5% to 10% of sales
- **warehouse, quality inspection** – after products arrive in the US port city awaiting customs clearance they are held in temporary warehouse which adds another 2% of sales to the cost
- **US local transportation** – transporting the product from a factory within China to the debarkation port and from the US embarkation port to its final US destination costs another 3% of sales.
- **53 days of “in transit” inventory** - if the average time on the water is 45 days and we assume 3 days to clear customs and 5 days to load, transport and unload the goods we have 53 days of “inventory in transit”.

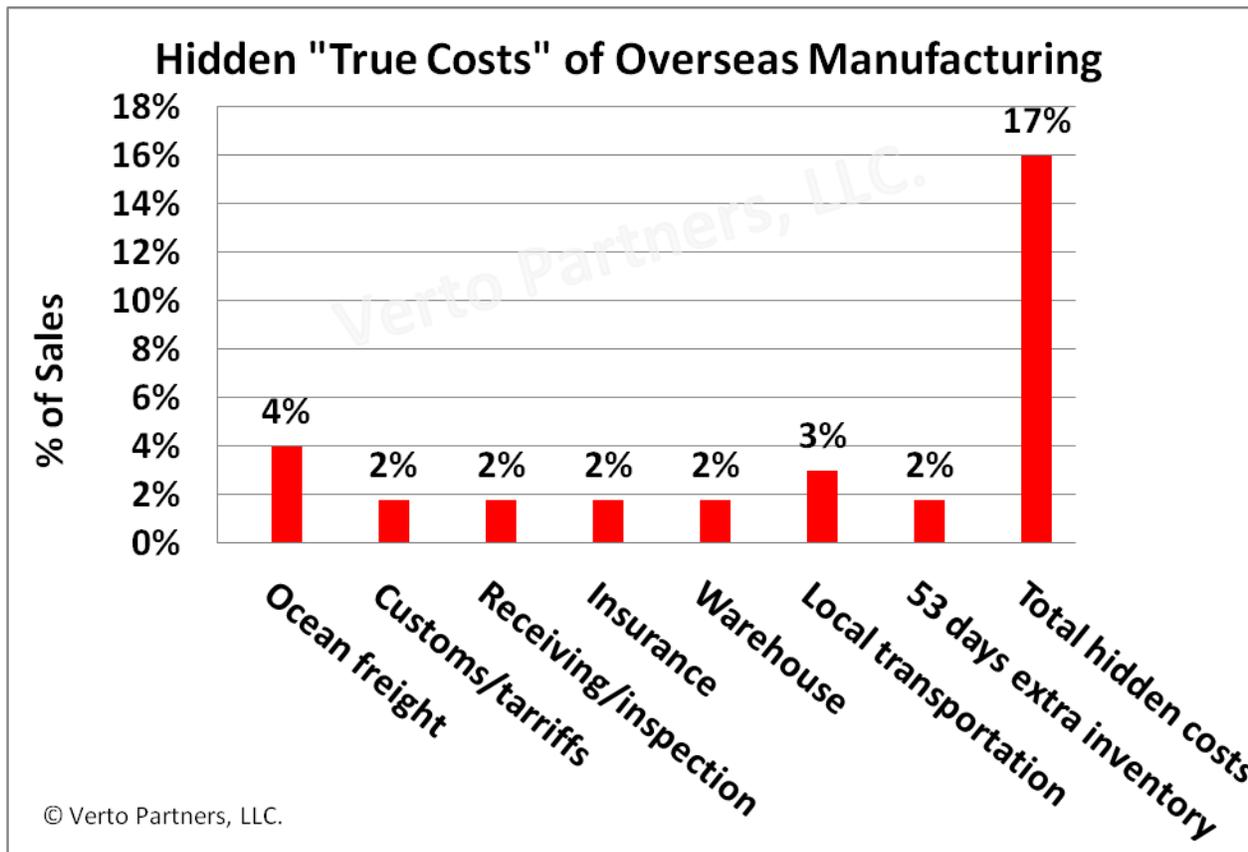
This means that, when compared to manufacturing the same products in a US just-in-time manufacturing facility, there is a need to stock 53 additional days of inventory. And, these additional 53 days do not take into consideration such things as ocean shipping delays, missed shipments, breakage, quality mishaps and the like. Even more inventory may be required in critical production situations where imported parts delays threaten to hold up production lines.

What is the cost of 53 days of extra inventory? In this example, 53 days of inventory equates to an inventory value of \$353,000. At an annual cost of capital of 15% this equates to a cost of about 2% of sales.

The total of all of these hidden, or **true costs** of foreign manufacturing can easily add up to 20% or more of product sales which, in our example, nearly "levels the playing field" for the US manufacturer.

Economists are already recognizing that with the rise in China labor rates and the decline of US labor rates, or at least slowing their growth, parity is predicted in the near term and is here for some manufactured products today.





This example does not necessarily reflect every US manufacturer's operating characteristics; however, with the pendulum swinging increasingly in favor of US manufacturing, it creates a compelling argument to re-consider manufacturing operations in the US, particularly for products that are consumed in the US.

There are many signs of a manufacturing renewal. Caterpillar has stated that wage and benefit costs at their rail-equipment plant in Illinois are less than half of those at their plant in Ontario, Canada. The Euro/Dollar and the Euro/Yen relationship are also encouraging Europeans and Japanese to open or expand existing facilities in the USA. Bridgestone, a Japanese Company, is investing over \$1 Billion to expand their tire manufacturing operations in the United States. This move also permits Bridgestone to service its US and Latin American customers at significantly lower transportation costs versus servicing these customers from as far away as Tokyo.

ABC nightly news with Diane Sawyer has attracted attention with its report on "Made in America". Over the Christmas holidays they stated that out of the \$700 plus dollars the average American spends on Christmas gifts that if only \$64 per gift giver would be used to purchase goods made in America that it would put 2000 Americans back to work.

## **How can we accelerate the re-birth of “Made in America”?**

We need to find ways to re-instill pride in American skilled labor and American made goods. We need to find ways to train our labor force and put the skilled labor back on our soil. We need to find ways to encourage American manufacturers to reconsider building their factories on US soil. We need to provide incentives and subsidies to manufactures that train American labor and create American jobs. We need to educate American manufacturers to the “true cost” of overseas manufacturing. We need a “blue print” for action incorporating leadership initiatives encompassing government, manufacturers and labor. In short, we must take steps to set a course of action that stems further deterioration of domestic US manufacturing.

The combination of increasing labor costs overseas, the “true costs” of manufacturing great distances from US markets, a focus on improved US manufacturing technologies and supply chain capabilities, a focus on re-training our labor, the dollar value versus the Euro, high unemployment in the United States all add up as factors to support the re-birth of “Made in America”.

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*Verto Partners, LLC ([www.verto-partners.com](http://www.verto-partners.com)) is a performance improvement firm serving the middle market as advisors to management, as interim management or in Board of Directors roles. Verto works collaboratively with management bringing the capabilities of highly skilled operations practitioners with a goal to significantly “move the shareholder/owner value needle”. Our track record with financial sponsors, lenders and companies is unparalleled.*

***Verto is undertaking initiatives to assist its clients with the development of “blue prints” for building their US manufacturing base of business. Our objective is to help awaken our country’s productive spirit, training and putting our skilled American workforce back to work. As a part of that initiative, we are building a database of federal, state and local subsidies and tax incentives aimed at restoring jobs in America. And we are also identifying and including those selected investing and private equity sources supporting this initiative as well.***