MANUFACTURERS' OUTLOOK 2015

Building towards growth

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PLANT
ADVANCING CANADIAN MANUFACTURING

Sponsor's message

PLANT magazine's Manufacturers' Outlook 2015 study provides manufacturers across the country with insight into the industry and an opportunity to express their opinions on what they anticipate in the coming year. It also gives them a forum for sharing their views on what has transpired over the past year and how they have reacted. We continue to proudly partner with **PLANT** in developing and sponsoring this year's study.

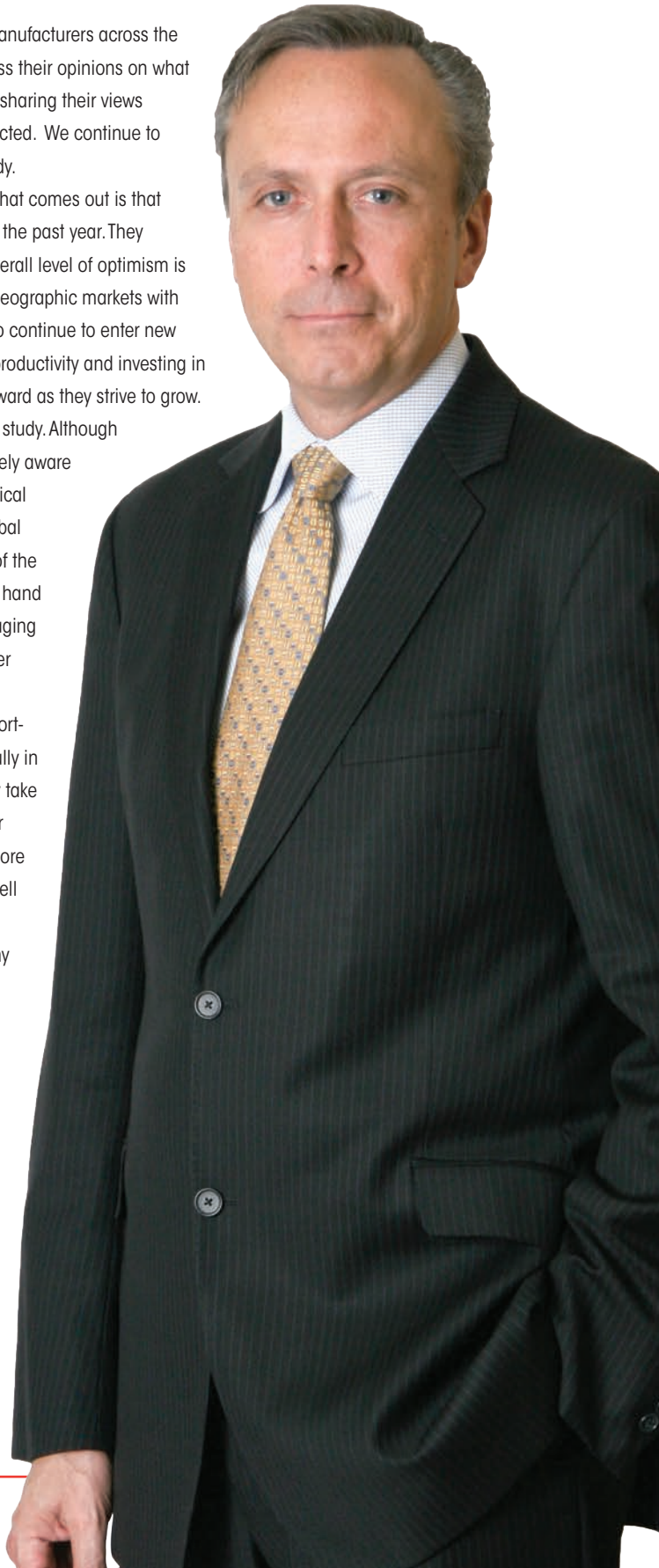
When we interpret the survey results overall, one of the main themes that comes out is that Canadian manufacturers have not changed their views significantly over the past year. They continue to believe that their industry is in growth mode, although the overall level of optimism is slightly more cautious this year. Manufacturers are expanding into new geographic markets with an emphasis on the re-emerging economy in the United States. They also continue to enter new lines of business and invest in new employees. Focusing on increasing productivity and investing in innovation will continue to be very important to manufacturers going forward as they strive to grow.

There are also a number of challenges that come to light through the study. Although Canada is known for producing quality products, manufacturers are acutely aware that controlling costs while continuing to produce at a high quality is critical to maintaining and enhancing competitiveness in the Canadian and global markets. And, as manufacturers consider the opportunities in a number of the emerging global markets, there are a several challenges that go hand in hand with those opportunities – understanding the foreign supply chain, managing the impact of foreign currency fluctuations and anticipating the consumer preferences in foreign countries, are just a few that come to mind.

Clearly many manufacturers in Canada have been very focused on short-term goals to ensure that their companies continue to operate successfully in the near-term. While this is understandable, it is also important that they take a step back to consider the longer-term prospects and business plans for their companies. Those who will profit most will be those who become more sophisticated in their longer-term approach to planning and executing well thought out strategies and risk management processes.

Historically, Canadian manufacturers have been successful on so many fronts. There is no question in my mind that they will continue to be just as successful in the future as they take full advantage of the favourable opportunities that lie ahead. At Grant Thornton, we continue to be committed to Canadian manufacturing and very much look forward to helping manufacturers unlock their potential for growth in the coming years.

James Menzies
National Leader - Manufacturing Industry
Grant Thornton LLP



Executive Summary

Conditions are improving for Canadian manufacturers. The loonie is floating below the US dollar and is expected to do so through the first half of 2015; American manufacturing is surging; and the Bank of Canada is forecasting growth of 2.5% in 2015, then 2% in 2016. Meanwhile, the federal government is negotiating the Trans-Pacific Partnership with several countries after negotiating deals with the European Union and South Korea, all of which will provide expanded and new markets for Canadian products.

Yet 60% of respondents to the Manufacturers' Outlook 2015 survey are cautiously optimistic about their prospects, compared to 29% who see market conditions as "very favourable."

The survey, conducted by Bramm Research for **PLANT** in partnership with sponsor Grant Thornton LLP, is based on 416 replies from senior manufacturing executives, and has a margin of error of +/- 4.6%, 19 times out of 20.

Most companies (65%) fall into the small business category (under 100 employees), 25% are medium-sized (100 to under 500) and 9% are large firms (500 employees or more).

Business is growing with average anticipated sales of $83 million in 2015 compared to $75.9 million this year and $72 million in 2013.

Just over half (57%) of the senior executives are expecting orders and their value to increase next year, while 50% expect pricing to remain the same (34% anticipate an increase), and 44% are predicting higher profits.

New this year are more detailed questions related to productivity. Ninety-five per cent of respondents say it's key to business growth and 45% are pursuing a formal productivity improvement strategy while 20% are in the process of developing one. Managing productivity is most challenging on the shop floor for 61%, followed by marketing and sales (42%) and purchasing (29%).

Companies cite their biggest challenges as controlling and reducing costs (60%), increasing sales (55%) and staffing (50%), which is among the top investment priorities for 55%. Most significant growth constraints are general economic concerns (49%), difficulty hiring skilled workers (44%) and production capacity (32%). The preferred mode of financing for growth is internal (70%) followed by banks (37%).

The number of firms with risk management plans in place is creeping up from 50% last year to 52% in 2014.

Top competitive advantages are quality (cited by 67%) and service (61%) followed by an ability to engineer and customize (58%) and flexibility (56%).

Most companies (62%) anticipate hiring over the next three years and 44% will add new lines of business. New product development tops the list of growth strategies for 59%. Over the next three years 79% of companies intend to invest in machinery and equipment, and 44% say they'll invest up to $1 million next year, although the overall average spend is $2.16 million. Average investment in expansions, upgrades or new facilities is $1.2 million.

More than 90% derive their revenues from trade in North America, 63.1% in Canada, and 50% intend to focus on North America as a key growth strategy although 35% say they plan to enter new geographic markets.

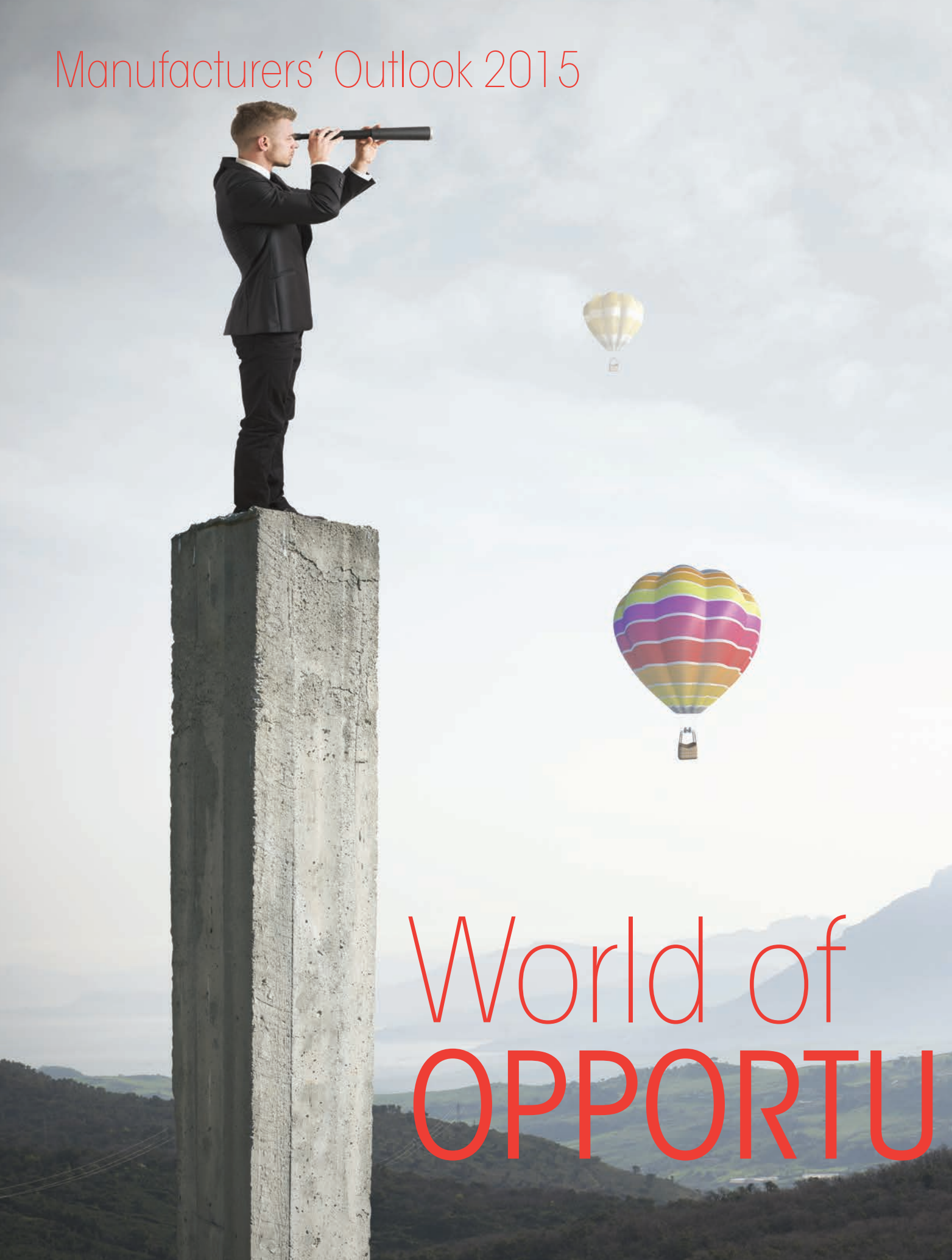
Thirty-one per cent of companies intend to seek new markets within Canada, 37% in the US, 15% in Mexico, 15% in other Central America, South America, and 12% in Brazil. Currently 2% are doing business in China but 10% plan to enter that market.

Finding skilled people continues to be a concern. Respondents identified areas where they're experiencing shortages and leading the list for 45% of them is production, followed by general labour (31%), management (28%), engineering (28%), production support (19%) and R&D (13%).

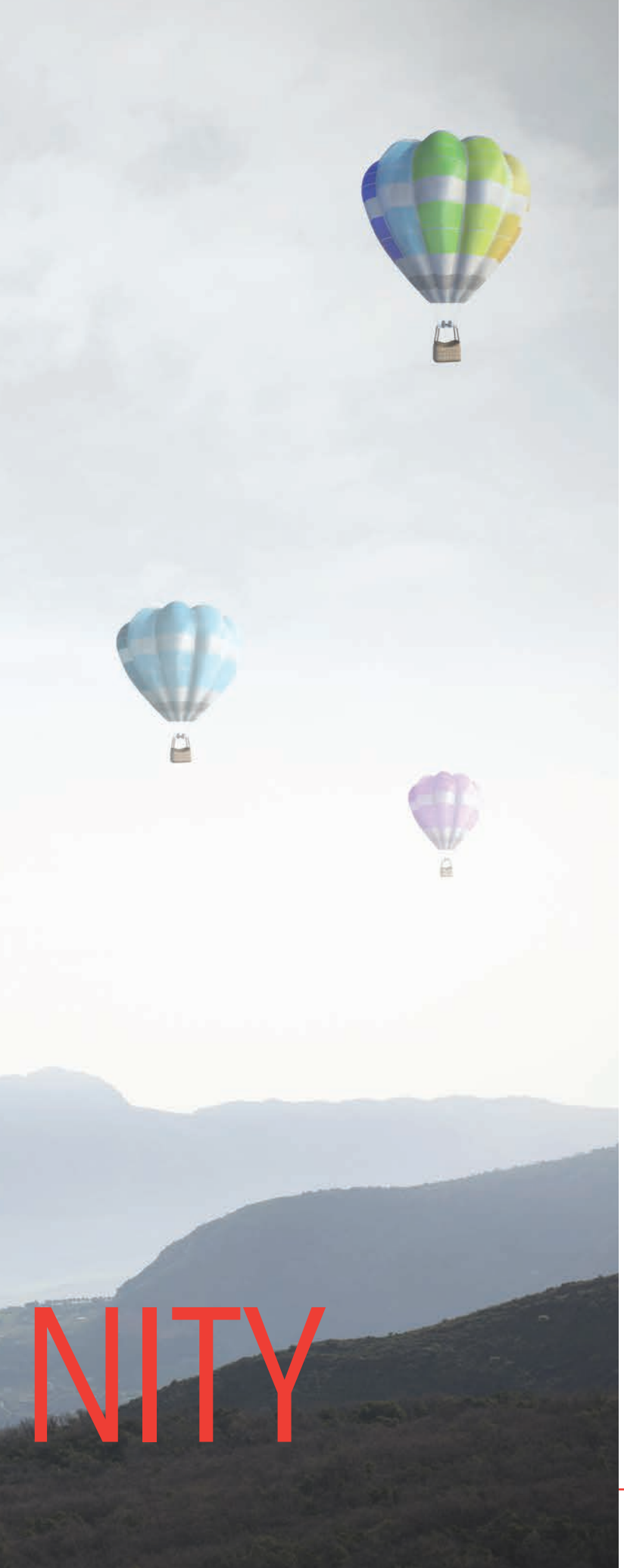
This year's survey shows Canadian companies are addressing competitive issues such as productivity improvement, but are slow to seek opportunities beyond North America, which limits their ability to grow. The Made in Canada brand is respected around the world and economic conditions are generally positive. Manufacturers need to embrace the risk and reap the reward.

Joe Terrett
Editor
PLANT

Manufacturers' Outlook 2015



World of OPPORTU

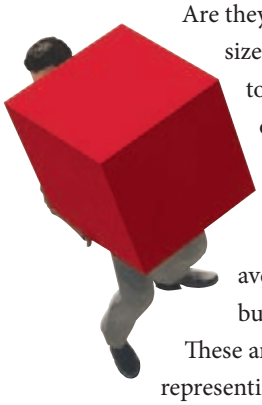


Manufacturers are cautiously optimistic as they focus on North America

By Joe Terrett, Editor

Canadian manufacturers are looking at positive business conditions for 2015, particularly those who choose to expand or venture into new export markets. The global economic outlook is for 4% growth and Canada can look forward to 2.8% next year followed by 2% in 2016 (Bank of Canada). The loonie is hovering in the vicinity of 90 cents US, American manufacturers are enjoying a resurgence that includes reshoring work to North America, free trade deals with the EU and South Korea are wrapping up and there are others on the go, all of which expands opportunities for Canadian products and technologies.

The 416 responses to the **PLANT** Manufacturers' Outlook 2015 survey show that owners and senior executives of companies from across Canada, most of them with less than 100 employees, are pursuing growth by improving processes, investing in their businesses, hiring, developing new products, and entering new markets. Yet they view the next year cautiously, and continue (as have respondents in past surveys) to focus on domestic and US markets while resisting the lure of more outward-looking opportunities.



Are they sticking close to home because of the size of their businesses and a lack of resources to venture farther afield? Are they focused on making up for lost ground during the 2008/09 recession? Is it a leadership issue or perhaps it's because many of them are closing in on retirement and are more averse to the risks involved in expanding their businesses beyond what's reliable and familiar?

These are questions explored by 12 panellists representing manufacturers and industry analysts who gathered at **PLANT's** offices in Toronto for the Manufacturers' Outlook 2015 roundtable where they discussed the study results and other issues affecting manufacturing in Canada.

Bramm Research conducted the survey through September and October for **PLANT**, in partnership with sponsor Grant Thornton LLP, an accounting and advisory firm with offices across Canada. The survey's margin of error is +/- 4.6%, 19 times out of 20.

Most (90%) of the companies are SMEs, 85% are privately owned, and 66% of those firms are family owned. Just 24% identified themselves as subsidiaries of a multinational company. Annual revenues for the entire group will average $75.9 million this year and senior executives are forecasting revenues of $83 million next year.

The responses show 57% of the companies expect orders to increase, 57% are looking at rising sales dollar values, 44% are banking on higher profits and 34% anticipate higher pricing, while 50% see prices staying the same.

The top challenge for 60% of the companies is controlling and reducing costs, 55% cite increasing sales and orders, training

Continued on page 12

Introducing the 2015 Manufacturers' Outlook panel

Ian Almond,
Senior Director, Operations
Siemens Canada Ltd., Peterborough, Ont.
Siemens Milltronics Process Instruments manufactures high technology process instrumentation.

Jonathan Bendiner,
Regional Economist
TD Economics, Toronto
Analyzes and forecasts metro and provincial economies across Canada.

Al Diggins,
President, General Manager
Excellence in Manufacturing Consortium, Owen Sound, Ont.
Not-for-profit organization for manufacturers that facilitates the global competitiveness of its members.

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(L-R) Jonathan Bendiner, Rob Hattin, Al Diggins, Sean Van Doorselaer, Brian Freeborn, Martha Oner, Ian Almond, Jim McCoubrey, Glen Gilbert, Dave McPhail, Jean-Claude Perrault, Jim Menzies.

Brian Freeborn,
Operations Manager
M.C. Healthcare Products, Beamsville, Ont.
Manufactures nursing home, electric and manual beds, institutional furniture, tables, lamps, chairs, dressers.

Glen Gilbert,
Partner, Tax Services
Grant Thornton LLP, Toronto
Accounting and advisory firm, Manufacturers' Outlook sponsor.

Rob Hattin,
President
ProVantage Automation, Ancaster, Ont.
Provides automation controls design and integration services for automated manufacturing.

Jim McCoubrey,
President & CEO
Troy Life & Fire Safety Ltd., Owen Sound, Ont.
Manufactures fire alarm, suppression and detection systems.

David McPhail,
President and CEO
Astrix Networks/Memex Automation, Burlington, Ont.
Provides factory floor data communications and efficiency systems.

Jim Menzies,
National leader, Manufacturing and Distribution
Grant Thornton LLP, Toronto
Accounting and advisory firm, Manufacturers' Outlook sponsor.

Martha Oner,
National Leader, Tax Incentives
Grant Thornton LLP, Burlington, Ont.
Accounting and advisory firm, Manufacturers' Outlook sponsor.

Jean-Claude Perrault,
Vice-president, Sales
Prinoth Ltd., Granby, Que.
Manufacturer of snow groomers, tracked utility vehicles and vegetation management machinery.

Sean Van Doorselaer,
CEO
Lind Equipment Ltd., Markham, Ont.
Manufactures and distributes static grounding, hazardous location and industrial work lighting, portable power and GFCI products.

Business Outlook

Greatest business challenges

- 60% Controlling/ reducing costs
- 55% Increasing sales/orders
- 50% Staffing - training/finding skilled workers
- 49% Pressures on pricing
- 39% Value of the Canadian dollar
- 38% Improving productivity
- 33% Tougher competition in key markets
- 32% Gaining market share in NA
- 29% Developing new products
- 28% Costs of key inputs
- 27% Economic conditions that impact Canada
- 26% Entering new markets
- 20% Regulations: red tape, associated costs
- 20% Quality
- 19% Supply chain, logistics issues
- 17% Gaining market share globally
- 16% Impending retirements
- 15% Investing in R&D, commercialization
- 15% Accessing new/advanced technology
- 13% Border issues
- 13% Environmental issues, regulations
- 10% Accessing credit/financing
- 8% Barriers to foreign markets
- 5% Attracting investment/ product mandates

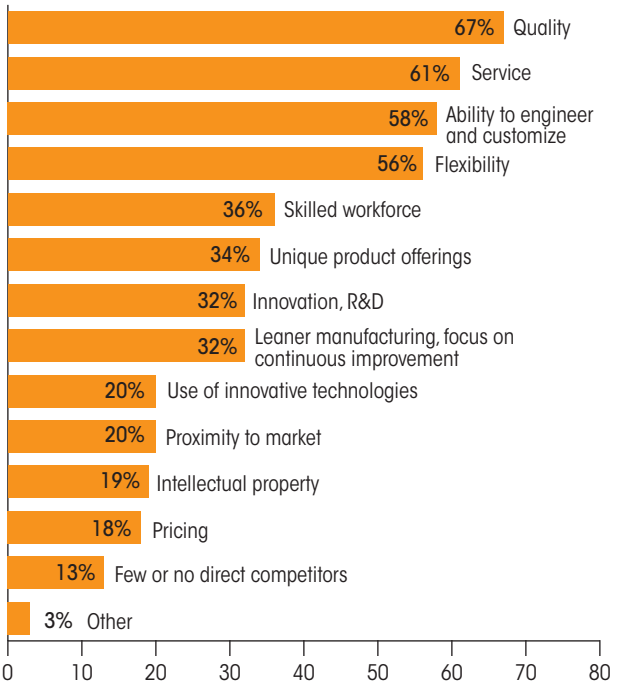
Growth constraints

- 49% General economic concerns
- 44% Difficulty hiring skilled workers
- 32% Production capacity
- 27% New product development
- 25% No clear growth strategy
- 23% Gaps in management skills
- 22% Lack of internal cash generation
- 19% Number of willing and feasible target companies
- 15% Regulatory issues
- 14% Access to external financing
- 11% Limited distribution capabilities

Anticipated changes (next three years)

- 62% Hiring new employees
- 44% Adding lines of business
- 35% Enter new geographic markets
- 33% Expanding plant size
- 28% Acquiring other companies or lines of business
- 13% Merging with another company
- 13% Selling of company
- 12% Downsizing employees
- 10% Downsizing lines of business
- 8% No changes
- 5% Downsizing plant size
- 4% Closing of company

Competitive advantages



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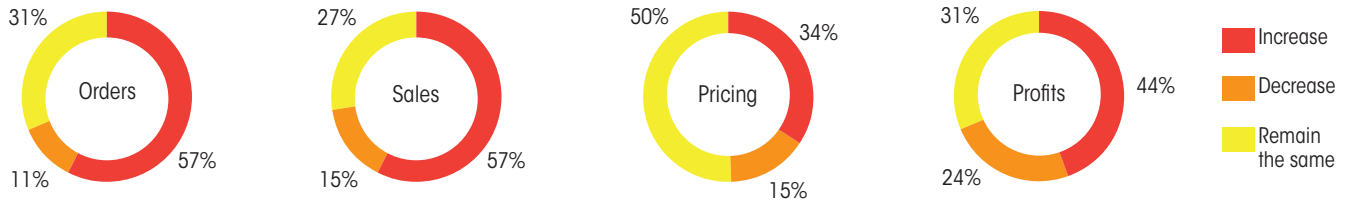
Revenue by country

Canada	63.1%
United States	26.2%
China	2%
Mexico	1.3%
Other	1.1%
Other Central, South America Other Western Europe (each)	0.9%
UK, Other Asia (each)	0.8%
Brazil	0.5%
Germany, Japan, India (each)	0.3%
Australia/New Zealand	0.4%
France, Russia, Korea, Other Central and Eastern Europe (each)	0.2%
Italy, Poland, Switzerland (each)	0.1%
Czech Republic	0.0%

Entering new markets (next three years)

United States	37%
Canada	31%
Mexico, Other Central, South America	15%
Brazil	12%
Other Western Europe, Other (each)	11%
China	10%
UK, India (each)	9%
Australia/New Zealand	8%
France, Germany, Other Asia, Other Central and Eastern Europe (each)	6%
Korea	5%
Poland, Italy, Russia (each)	4%
Japan, Switzerland (each)	3%
Czech Republic	2%

2015 business growth



30% *strongly agree pursuing new geographic markets as an important strategy, but 43% say pursuing North American markets is a priority over global markets.*

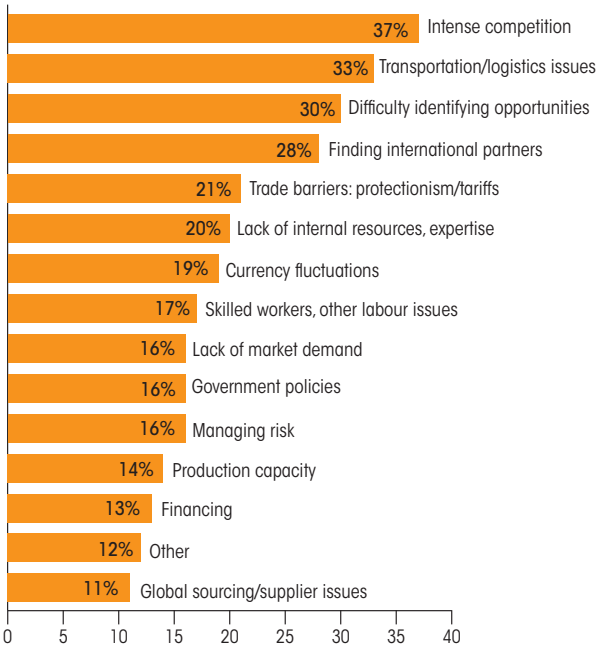
44% *somewhat or strongly agree that trade partnerships and agreements with the EU and various Asian countries will benefit their companies.*

Business Outlook

Financing methods over the next three years

Internally generated cash flow (retained earnings)	70%
Bank financing	37%
Private investors (including owner, family, etc.)	21%
Government programs	16%
Asset based financing	11%
BDC	11%
Don't know	10%
Private equity	9%
EDC	8%
Leasing	8%
Public offering	3%
Subordinated/ mezzanine debt	1%
Other	1%

Constraints to increasing revenue outside of North America



23%

Companies that say production is scalable to adjust quickly when markets fluctuate.

53% Companies that don't have comprehensive tax strategies.

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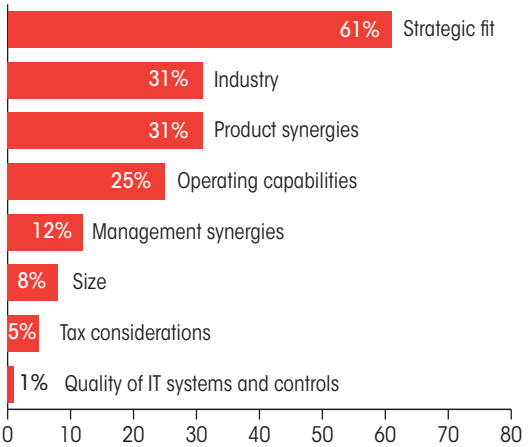
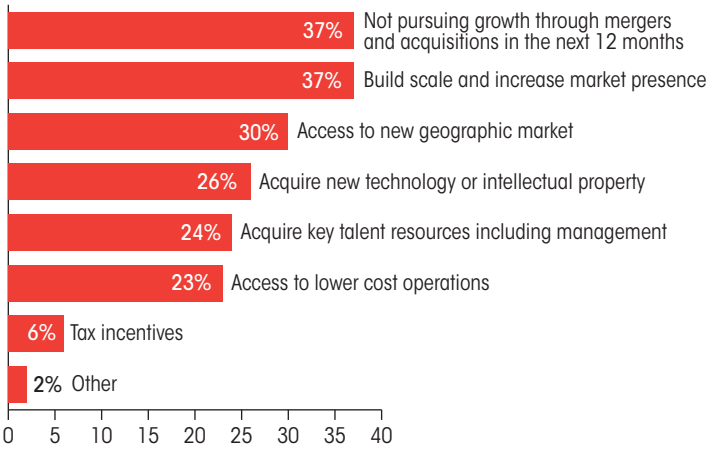
Key factors sizing up a company for acquisition



** 9% not stated*

Drivers for growing through M&A



Green efforts in 2015

Increased energy efficiency in plant and production	54%
Reducing scrap	54%
Recycling more material	53%
Reducing packaging	28%
Sourcing locally	21%
Using more environmentally friendly machinery and equipment	20%
Using more fuel-efficient transportation modes	15%
No formal green/ sustainability efforts	15%
Using more environmentally friendly suppliers	14%
Sourcing sustainable suppliers	13%
Reconfiguring supply chain	7%
Other	5%

14% *... strongly agree environmental issues and sustainability are strategic concerns.*

13% *... are very engaged in reducing their carbon footprints.*

33% *... don't include green/sustainability measures as part of a formal business strategy.*

(50%) and finding skilled workers, 49% pressures on pricing (49%) and value of the dollar (39%).

The top competitive advantages for business leaders were quality (noted by 67%) and service (61%), followed by the ability to engineer and customize (58%), flexibility (56%), and a skilled workforce (36%).

Over the next three years 62% expect to hire new employees, 44% will add new lines of business, 35% are entering new geographic markets, 33% expect to expand their plants and 28% will acquire other companies or lines of business.

Although companies recognize the importance of environmental issues, as in past surveys they're almost evenly split on whether investing in green initiatives represents a cost (47%) or a revenue opportunity (53%). The focus for 54% is on increased energy efficiency in production and reducing scrap, followed by recycling more material for 53%. Farther down the list are reducing packaging (28%) and sourcing locally (21%).

Seventy-three per cent agree not being green is a risk to their brands and reputations, but just 32% include formal green measures in their business strategies, 35% do so informally and 33% do not. Only 13% are actively engaged in reducing their carbon footprint, 38% are somewhat engaged and 49% are not engaged.

Roundtable panellist Jonathan Bendiner, a regional economist with TD Economics in Toronto who analyzes and provides forecasts for metro and provincial economies, highlighted some of the factors affecting and influencing manufacturers – chief among them being a sustained pickup in US demand.

Traditionally, Canadian companies see their fortunes rise as US activity picks up, but this time, he cautions, it won't be a one-for-one proposition. "Some of that reflects a loss of market share in the US."

He sees the loonie falling to around 85 cents US by mid-2015, which will help improve manufacturing's competitiveness.

This is good for exports but he indicated the loonie's lower value poses challenges for industries (such as petroleum and coal, plastics and rubber) that rely more on imports for inputs.

"Given that the dollar was at par for as long as it was, it wouldn't be a stretch to suggest that maybe firms in Canada navigated towards import sources for inputs, and it's not automatic that you can unwind those types of supply chains," he explained.

TD Economics is expecting moderate growth in domestic demand and the percentage of growth in the US will likely be in the high twos or low threes. Put it all together and the outlook for manufacturing is moderate, but certainly positive.

All the same, most senior executives (60%) said they are cautiously optimistic about

Continued on page 14

If firms are making more money they'll be more inclined to invest in machinery and equipment… So we're seeing positive momentum.
— Jonathan Bendiner

Jonathan Bendiner

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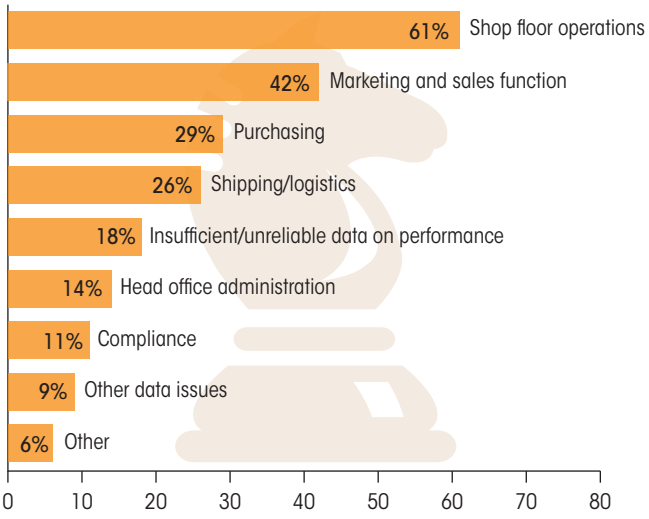
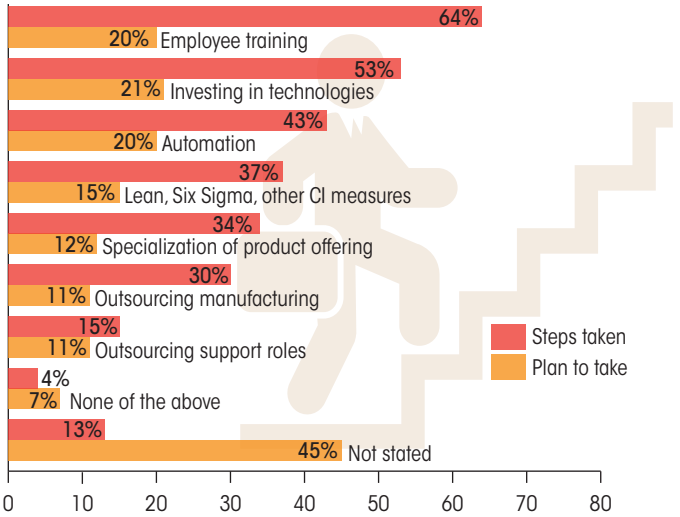
Productivity

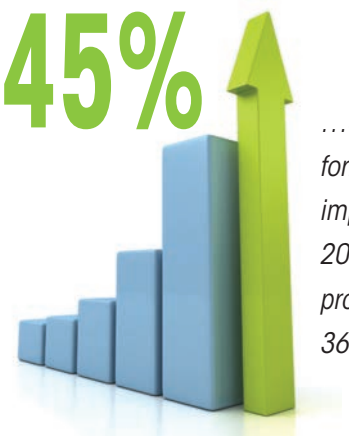
Challenges to improving productivity



How productivity will be improved



45%



…are pursuing a formal productivity improvement strategy; 20% are in the process of doing so; 36% are not.

51%

…are measuring shop floor productivity manually, 31% use automatic data collection, analysis and review; and 17% aren't measuring.

25%

…are connecting shop floor to top floor in the next 12 months; 28% are "somewhat" likely to do so, 45% won't be making the connection.

68%

…can't monitor any part of the plant with a smartphone; 3% cover the entire plant, 6% three-quarters, 6% half and 15% one quarter.

their prospects in 2015, expressing some uncertainty about economic and market conditions, versus 29% who find economic conditions to be very favourable and 10% who say conditions are not favourable.

The Outlook survey shows their top five growth strategies are new product development (identified by 59%), pursuing new customers in North America (50%), expanding sales and distribution channels (42%), developing strategic alliances, partnerships and joint ventures (33%), strengthening supply chain links and relationships (32%), and diversifying industries served as well as markets (31%). Forty-nine per cent identified general economic conditions as the most significant constraint to growth, 44% said difficulty hiring skilled workers and 32% cited production capacity.

As in past surveys, revenue comes mostly from North America.

Continued on page 17

Jim McCoubrey

We have a quasi agent that has relationships through a number of different countries that he understands. He has close relationships with dealers… so we depend on [them] to direct us.

— Jim McCoubrey

Research Investment

Money for the taking

Funding innovation with a tax planning strategy

By Matt Powell, Assistant Editor

Martha Oner wants more Canadian manufacturers to use the Canada Revenue Agency's (CRA's) Scientific Research and Experimental Development (SR&ED) incentive program as a tax planning strategy and as a tool to fund innovation.

Indeed, the Manufacturers' Outlook 2015 survey reveals just 47% of respondents have comprehensive tax planning strategies in place. The other 53% has Oner concerned.

"That means only one in two companies are working to maintain their competitiveness and productivity on their bottom lines," says Oner, national leader, R&D and government incentives for Grant Thornton LLP.

Investment in innovation and research and development (R&D) has been an Achilles heel for a Canadian manufacturing sector stuck in rebuild mode as it balances losses caused by the global financial crisis.

Forty-four per cent of companies plan to take advantage of SR&ED for investment in R&D next year. Thirty-five per cent said they have not or don't plan to take advantage of the tax credit.

As a percentage of revenue, 32% of respondents intend to spend 1% to 3% on R&D and 16% will invest 4% to 6%. Six per cent will spend more than 10% and 22% don't know what their annual expenditures will be.

"Companies should leverage the SR&ED program to enhance their bottom lines," says Oner, who helps manufacturers, processors and technology companies compile and submit SR&ED and digital media claims.

SR&ED, which she describes as Canada's primary mechanism for funding industrial level R&D, is meant to encourage R&D that leads to new, improved or technologically advanced products, processes, devices and materials. The CRA reports more than $4 billion in investment tax credits go to more than 18,000 claimants annually, of which about 75% are small businesses.

SR&ED expenditures are deducted as business expenses, and may also qualify for investment tax credits in the form of a reduction in income taxes payable, cash refunds, or both. Qualifying expenditures may include

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The components of a tax planning strategy respondents consider to be important.

wages, materials, contract expenses and overhead expenses directly attributed to SR&ED activity.

Oner says part of the problem may be that SR&ED is filed annually at fiscal year-end, which can make it an afterthought for many companies. The application process is compliance-based – an onerous task for small companies busy running day-to-day operations because of the high-level documentation the CRA requires.

Economic drivers

But she says there are solutions to the perceived challenges. Companies need to think of SR&ED as a tool in product lifecycle development planning.

"SR&ED should be a part of your initial risk assessment and business plan when initiating an innovation project. The most successful companies have a planned, well thought-out approach with respect to innovation," she says.

The SR&ED program is geared to Canada's two main economic drivers: innovation and privately held businesses.

Canadian-controlled private corporations receive refunds of up to 41.5% on eligible expenditures, double that of their large, public or foreign-owned industry peers.

Another part of the problem is a disconnect between awareness and perceived benefit. The CRA typically allocates only 1% of its budget to SR&ED marketing. "If you're not working with an advisor or networking with industry peers, it's unlikely you're going to be aware of what's available and how to access it," says Oner.

Manufacturers also need to be better at collaborating on innovation and R&D, which has been successful in the technology sector. "We need to start creating or lobbying for these industry centres of excellence for manufacturing, such as regional innovation centres, which would help drive access to these types of government programs," says Oner.

There are a number of manufacturing-specific programs and services available that encourage investment in innovation and R&D, including these: **Canadian Manufacturers' & Exporters SMART Prosperity Now program.** It fosters long-term growth for SMEs. Funded by the Federal Economic Development Agency for Southern Ontario (FedDev), the program attracts manufacturers looking to grow by transitioning to sustainable business models through productivity enhancement and the development of innovative technology. **www.cme-smart.ca**

The Funding Portal. Also administered by CME, it's an online tool that aggregates information from more than 7,000 sources of funding totalling more than $27 billion in incentives for Canadian manufacturers. **www.thefundingportal.com**

AIME Global Initiative. This program by the Yves Landry Foundation, in partnership with the federal government, provides up to $50,000 per company in the form of a grant for fostering training that leads to advancements in innovation within Ontario's manufacturing sector. **www.yveslandryfoundation.com**

MentorWorks. It assists companies across Canada to access funding for business expansion, training, exporting and capital purchases. **www.mentorworks.ca**

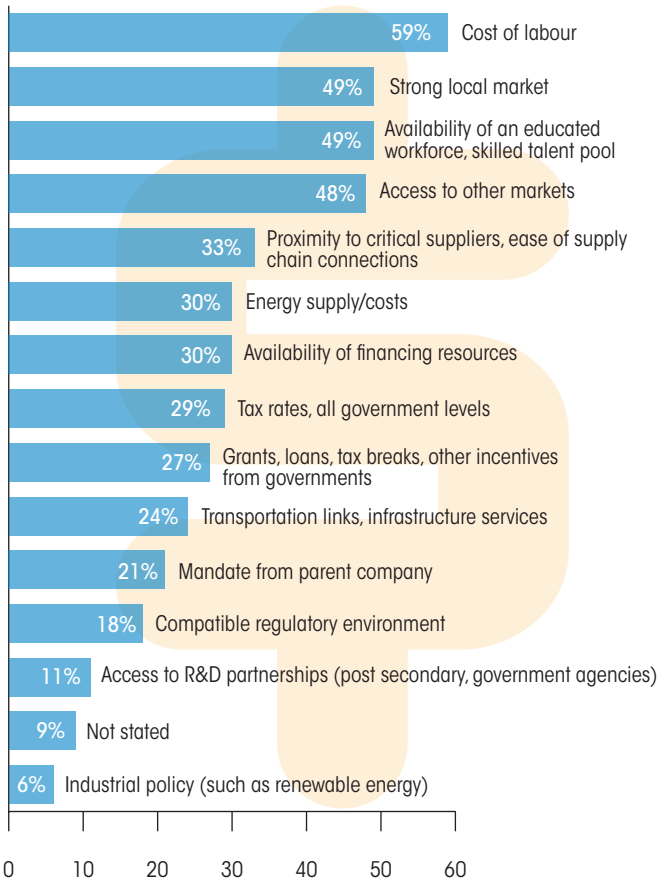
Also, the CRA launched the Self-Assessment Learning Tool (SALT) and the First-Time Claimant Advisory Service (FTCAS) in January as part of the Red Tape Reduction Commission (RTRC) to improve SR&ED services.

Oner warns against becoming consumed by the tax planning process. She says compliance doesn't require complex tracking initiatives or data, it simply needs to show time-based activity tracking, and the experience of going through a formalized planning process is an added benefit.

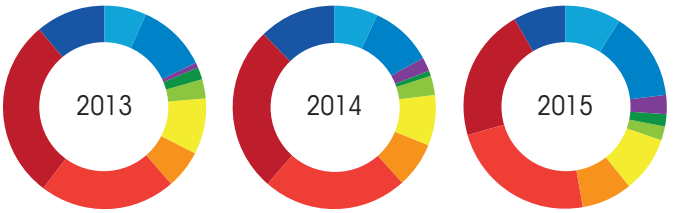
For privately-held businesses, SR&ED is a must. A successful claim goes directly to the bottom line. You just have to be ready to do the work.

Investment

Business investment criteria
(Appears in top 5 choices)

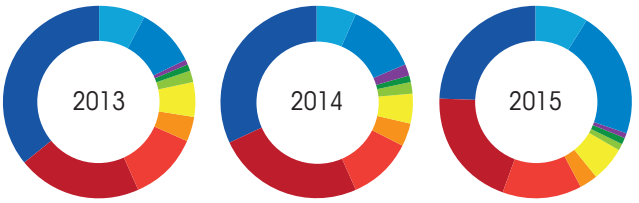


Machinery, equipment, technology



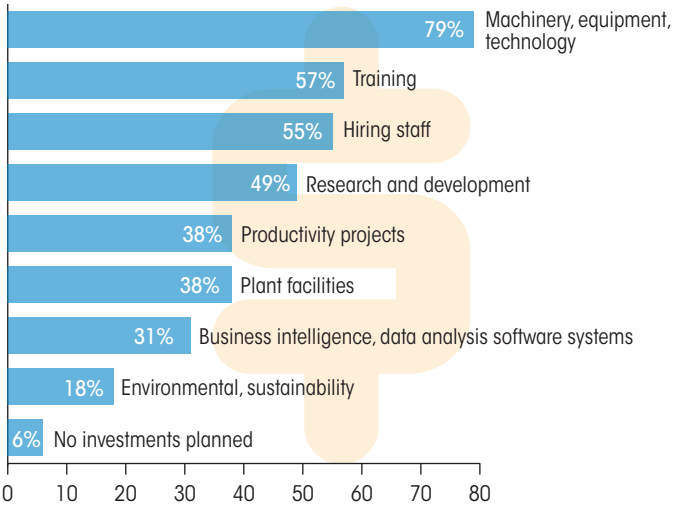
	2013	2014	2015 (forecast)
None	11%	12%	8%
Up to $99,999	29%	26%	21%
$100,000 to $499,999	22%	23%	23%
$500,000 to $999,999	6%	7%	8%
$1,000,000 to $4,999,999	9%	8%	9%
$5,000,000 to $9,999,999	3%	3%	2%
$10,000,000 to $19,999,999	2%	1%	2%
$20,000,000 or more	1%	2%	3%
Don't know/not sure	11%	10%	14%
Not stated	7%	7%	9%
Average	**$1.55M**	**$1.5M**	**$2.16M**

Expansion, upgrades, new facilities



	2013	2014	2015 (forecast)
None	36%	32%	24%
Up to $99,999	21%	25%	20%
$100,000 to $499,999	12%	11%	13%
$500,000 to $999,999	4%	4%	3%
$1,000,000 to $4,999,999	6%	5%	6%
$5,000,000 to $9,999,999	2%	2%	1%
$10,000,000 to $19,999,999	1%	1%	1%
$20,000,000 or more	1%	2%	1%
Don't know/not sure	10%	12%	21%
Not stated	8%	7%	9%
Average	**$1.11M**	**$1.07M**	**$1.20M**

Next three years



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Breaking it down further, 63.1% comes from Canada, 26.2% from the US, 2.4% from the EU, 2% from China and less than that from all other markets. Looking ahead three years, North America is still the preferred region for market expansion (37% to the US and 31% to new markets in Canada), followed by Mexico (15%), other Central and South American countries (15%), Brazil (12%), other western European countries (11%), China (10%) and the UK (9%).

The caution expressed in the survey surprised Al Diggins, president and general manager of the Excellence in Manufacturing Consortium (EMC). The not-for-profit organization based in Owen Sound, Ont. facilitates the global competitiveness of its members, which puts Diggins in regular contact with manufacturers who he describes as generally "quite optimistic."

Similarly Rob Hattin, now past chairman of Canadian Manufacturers & Exporters (CME) and president of ProVantage Automation, a provider of automation controls design and integration services based in Ancaster, Ont., said CME members and customers he has spoken to are bullish. But he brought up another point he related to why companies are much less bullish about out-of-continent adventures.

"We have a deficit of leadership in Canadian industry. We are not embracing innovation like we need to. People are optimistic based upon the resurgence of traditional things they've done. To my mind we are not courageous enough to go forward, to really want to take the world by the horns."

Hattin noted the impact of what's happening with China is misunderstood; he pointed to the US dominance of the north/south market while Mexico has attracted a lot of the new North American automotive investment compared to Ontario's (shrinking) share; and warned that "unless we wake up to that and take action, it will be rough roads ahead… There's going to be a day of reckoning. Your competitors are coming and Canada is going to be a very small bump in their business plan."

The respondents' preference for North America surprised Jim Menzies, national leader of manufacturing for Grant Thornton LLP, an accounting, tax and advisory firm and sponsor of the Manufacturers' Outlook survey.

"I work with companies that are going into Eastern Europe, China and India. Admittedly there are all sorts of risks that come with entering those markets…However, to fall back on the US because economic growth is surging there is just returning to old habits: easier to do, but at the cost of potentially missing some greater opportunities."

Menzies noted China's annual growth is 5% to 6%, "... and many believe it's in a slump. So there is some real growth happening in many other places. Manufacturers need to be aware of that and understand… maybe they should be playing in that game."

There's going to be a day of reckoning. Your competitors are coming and Canada is going to be a very small bump in their business plan.
— Rob Hattin

Rob Hattin

Canada is missing out on $40 billion in export sales, says Bank of Canada governor Stephen Poloz.

PHOTO: THINKSTOCK

Some will find moving into unfamiliar markets intimidating.

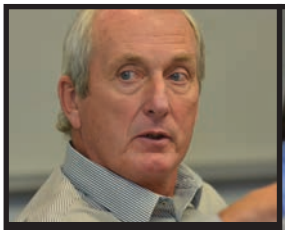
Menzies advised manufacturers not to be afraid to fail. "Go in understanding that you aren't going to get it right the first time. Have that contingency plan, be prepared to fail, learn, get better and eventually succeed."

He acknowledged that many companies are challenged by their size. Indeed, a third of the survey companies have fewer than 25 employees. And size will affect what kind of resources a smallish company can direct towards global ventures.

That's a consideration Sean Van Doorselaer, CEO of Lind Equipment Ltd., brought to the table. The company, based in Markham, Ont., manufactures and distributes static grounding, hazardous location and industrial work lighting, portable power and GFCI products. It invests generously in R&D and is always on the hunt for new customers. Part of its strategy is to attend trade shows, but he observes that for a company like Lind (with 16 employees), sending a couple of people out prospecting [at international events] amounts to a bit more than 10% of the workforce, and that's a lot of workforce to take out of the day-to-day operations.

Lind's entry into new markets hinges on product development. "When you're a smaller business, you can't take the same thing you're

"It's almost a regular occurrence – where a manufacturer's wheels have come off, and the lights come on a year later when everything's going south on the balance sheet, and they start investing in training."
— Al Diggins



Al Diggins

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Sean Van Doorselaer

> *We've got a lot of people who've done a great job of building businesses up to a point and now, to think globally, we've got to get young people interested in taking this path.*
> *— Sean Van Doorselaer*

selling down the street overseas because you're going to get killed by – among other things – the logistics. The key for us has been to come up with something new, unique and innovative that people are willing to pay whatever the premium might be to sell it overseas."

Prinoth Ltd., a manufacturer of snow groomers, tracked utility vehicles and vegetation management machinery based in Granby, Que., has been working on markets outside North America for many years, said Jean-Claude Perrault, vice-president of sales for the company that is part of Prinoth AG, based in Italy. The 144,000 square-foot plant, 70% of which is dedicated to two production lines and a custom shop, employs 250 people who manufacture 14 different snow grooming and utility vehicle models.

Global markets

"Whether it's Chile, Australia, France or Russia, when you go into each of these countries you realize they have their own way of doing business and you really need to understand that or you're just going to hit a wall. What are the drivers and how can you adapt your product or your distribution model? Do you need to find a partner? Do you need to go direct? It takes a lot of presence onsite and a lot of time."

Troy Life & Fire Safety Ltd., a manufacturer of fire alarm, suppression and detection systems with 670 employees, based in Owen Sound, Ont., has ventured into global markets mostly working with general contractors such as SNC-Lavalin. "We have a quasi agent that has relationships through a number of different countries that he understands. He has close relationships with dealers… so we depend on [them] to direct us on how the business is being done, how [the product] needs to be packaged and how it needs to be programmed," said Jim McCoubrey, the company's president and CEO.

Not that the importance of the US market for exports should be downplayed. Pent-up demand will fuel Canadian exports next year, but Bank of Canada governor Stephen Poloz, testifying before the House of Commons finance committee, warned that Canada is missing out on about $40 billion in export sales as uncompetitive producers continue to lose market share. There are several factors to blame, including the loss of about 9,000 exporting firms since the recession, but high on the list is poor productivity.

The Conference Board of Canada describes productivity in Canada and the provinces as mediocre compared to peer nations. Canada's level of productivity was gauged in 2012 at US$42 compared to $52 in the US, placing it thirteenth among 16 peer nations.

The productivity section of the survey, expanded this year, shows 89% of manufacturers see it as generally important and 95% say it's important to business growth,

Continued on page 21

A tool for growth

Take a longer view to identify opportunities

By Matt Powell, Assistant Editor

The number of companies adopting formal processes to identify and mitigate risk has been inching up since the 2009 Manufacturers' Outlook survey.

Jim Menzies, a partner and national manufacturing industry leader at Grant Thornton LLP, thinks that's a good thing, but he's still concerned that too few Canadian manufacturers are using risk management as a tool for managing long-term growth.

"Many manufacturers continue to operate with a short-term outlook," he says. "This was understandable in 2008 through 2010, as many experienced significant short-term issues given the economic times. However, a number of manufacturers still haven't taken a step back to develop a longer-term approach to managing the various risks they face."

PLANT's Manufacturers' Outlook 2015 survey reveals 52% of respondents are pursuing formal processes to identify and mitigate risk, a 2% jump from last year's survey and well ahead of the 35% in 2009. Of those reporting a formal risk strategy, 70% believe they mitigate them merely by identifying them, followed by long-term planning (48%), monitoring internal financial indicators such as cash flow, and insisting on official paperwork for orders (both 43%).

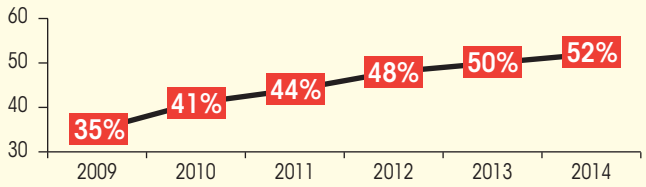
Menzies thinks that many manufacturers have an opportunity to enhance the overall level of sophistication with which they manage their businesses. And he doesn't mean that as a criticism.

"By focusing on incorporating a longer-term approach and enhancing their sophistication level, manufacturing companies can become even better than they are today."

From a growth and risk management perspective, he says if you're looking at your business in six month increments, you're not looking far enough out to take advantage of potential opportunities or to identify significant risks.

Manufacturers need to comprehensively assess their circumstances and future prospects to understand what can go wrong, he adds. There are two main factors to risk identification: which ones can have a significant impact

Companies using a formal risk management process



and on business and those most likely to occur. "You've got to develop processes and controls that are going to manage those significant and likely risks to a tolerable level," says Menzies, who offers some examples of common risks and longer term opportunities:

- **Currency fluctuations.** You can't control fluctuation in the value of the loonie, but you have options to manage the impact.
- **Labour.** Sixty-two per cent of survey respondents expect to hire new employees. Understand the availability of skilled workers and design a plan to avoid any shortages or gaps.
- **Succession planning.** You can't just turn 60 and assume your kids are going to take over the business. It requires longer-term thinking.

Ask yourself how the company will continue to exist. What is your succession or exit strategy? For example, if you plan on passing the business on to family members, you need to integrate them much earlier than when the succession will occur. If you're going to sell your company, make sure you have compiled the necessary information for potential buyers down the road.

- **Relations with bankers and advisers.** They need to know you and understand your company's financial position and business strategy. Don't wait until the day you need them to start the relationship. Communicate frequently with them now.
- **Tax planning.** Many manufacturers don't take advantage of Canadian or international tax rules to ensure that they're structured to minimize their tax liability.

There are a number of tax structures that help maximize the cash you're

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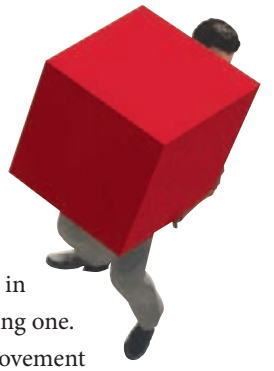
Methods of mitigating risk

able to realize from your business. Many manufacturers don't put them in place early enough, if at all, to take full advantage.

It's also important to have short-term measures in place to measure progress to longer-term goals.

"Identify those indicators that are going to tell you whether or not you're on the right track to achieving what you're strategically trying to achieve," he says. "There's a lot of little wins along the way to that goal, so you want to make sure you're headed in the right direction. Seeing the progress will also provide you with momentum to continue."

Every day, good companies focus on taking advantage of opportunities and managing their risks. The key, Menzies says, is to use tools that allow you to look past tomorrow.



45% have a formal improvement strategy in place and 20% are in the process of creating one. The four most challenging areas for improvement continue to be shop floor operations for 61% of respondents, marketing and sales for 42%, purchasing for 29% and shipping logistics for 26%.

Seventy-four per cent measure productivity by financial data and 66% by product output but only 24% are very satisfied with these measurements, 62% are somewhat satisfied and 81% are not likely to use third parties.

Most (84%) favour employee training to improve productivity, 74% have invested or plan to invest in technologies, 63% have or intend to apply automation solutions, and 52% have or intend to apply lean, Six Sigma and other continuous improvement measures.

Most companies are not making use of the latest technology to monitor and measure shop floor manufacturing equipment and operations shift by shift. Fifty-one per cent are still using manual methods to collect, analyze and review data compared to 31% who use automated means. Seventeen per cent aren't doing any monitoring or measuring.

How likely are companies to connect the shop floor with the top floor's enterprise management systems in the next 12 months? There's a close split: 52% are very or somewhat likely to do so and 45% not so much.

Using a smart phone to remotely monitor the plant is rare among respondents: 68% have no ability to do so. Just 3% can cover the entire plant, 6% monitor three quarters, 6% cover half and 15% cover less than a quarter.

Sixty-two per cent prefer to purchase their own software and only pay for maintenance. Way down the list is free, open source software (18%) and 14% would rather pay for the software monthly to lessen out of pocket expenses.

Calling attention to the high percentage of companies that aren't likely to link the shop floor with their enterprise management systems, Menzies stated, "You can't improve what you don't measure…If you don't have good information you don't make good decisions."

David McPhail, noting that increased productivity and leaner manufacturing were not high on the list of challenges, agreed. "People still don't get the fact that increased productivity equals increased profitability."

McPhail is president and CEO of Astrix Networks/Memex

Increased productivity equals increased profitability. PHOTO: THINKSTOCK

Automation in Burlington, Ont. His company makes hardware and software for factory floor data communications and efficiency systems. "That's a rope that we have to push a lot with manufacturers because we're changing the way that companies operate. Going from a disconnected manufacturing model to the connected model represents a paradigm shift. They now have the information at their fingertips to manage their business effectively by the second."

Making that shift is actually about "culture change." He says the best implementations start from the C-suite and involve all stakeholders, who look at the data differently, as an inclusive team.

But productivity gains also need a champion on the shop floor, said Brian Freeborn, operations manager for M.C. Healthcare Products in Beamsville, Ont., a manufacturer of nursing home, electric and manual beds, and institutional furniture.

"That's something owners need to recognize. They need to find someone who has the bug, that wants to improve [productivity] and keep it going."

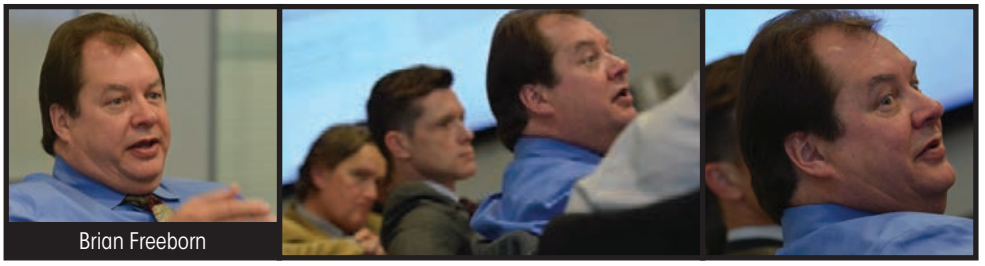
Freeborn sees a champion as a person who is self-motivated, creative, has a strong overview of the business, looks everywhere, including beyond the plant's four walls and who sources improvements through the entire value stream.

This was particularly important for M.C. Healthcare, now a division of Span Medical Products Canada Inc. Freeborn saw many companies in the medical devices business moving production to Mexico. To be competitive, M.C. Healthcare had to find ways to improve processes and make life easier for the people on the floor.

Reduced labour costs

When he was hired, the owners wanted him to reduce labour costs by 5%. By the end of year two, there was a 30% labour cost reduction and it was achieved without losing a person because business grew 82%.

"In the past when we were coming up through our industries, there was a lot of opportunity to move around. You don't see that in the small or a medium-sized business."
— Brian Freeborn



Brian Freeborn

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Ian Almond,

> *They'd get skilled at dealing with issues as they popped up, working around them or to serve them rather than challenging them as necessarily the best way to do business.*
> *— Ian Almond*

Among the changes, the union had to shift its preference for categorized job descriptions and no bumping, to a structure that allows cross-training and flexibility across the shop floor. "Now we can move people anywhere we want, we can train people in any job we want and having that flexibility drives our costs down," said Freeborn.

At Siemens Milltronics Process Instruments, a manufacturer of high-tech process instrumentation in Peterborough, Ont., (part of Siemens Canada Ltd.), improving productivity was about changing the mindset of employees who were comfortable with firefighting, said Ian Almond, senior director of operations. "They'd get skilled at dealing with issues as they popped up, working around them or to serve them rather than challenging them as necessarily the best way to do business."

Key people are now being challenged to look outside the organization to see how other sectors are working. That includes checking out other parts of Siemens (which makes industrial products all over the world).

"If we can get them out, get them that experience and bring them back in, it gives us the leadership model we need. They'll come in repopulated with bright ideas. They'll have understood challenges in different parts of the world," said Almond.

Prinoth has been working on various lean programs that focus on assembly, material flow and the simplification of inventory management, all of which delivered some impressive productivity gains, but Perrault said the biggest gains came from cutting the amount of material they were handling.

"The part count in this business is incredible. [Most] of the product cost is in the design stage. If you design with easier assembly in mind, easier manufacturing, fewer components, simpler design, you get huge productivity gains."

Lind Equipment has learned a similar lesson through "hard" experience, says Doorselaer. The company competes by focusing on customization and having the ability to do it in Canada.

"We created a bit of a monster though, because you end up building a million different bills of material, all using different parts, all manufactured to specification. It really starts to drag down your productivity because you're hiring people to keep up with that. We found by working with our suppliers and streamlining the number of SKUs, we've started to increase our productivity – on a much smaller scale, obviously – but the same sort of basic learning."

Customization is good, but Hattin, returning to the need to be more engaged globally, believes there's something to thinking bigger, as in greater scale.

SR&ED should be a part of your initial risk assessment and business plan when initiating an innovation project.
— Martha Oner

Martha Oner

"When you customize, you restrain yourself in terms of scale," he said. "It's one thing to stay a certain size, but if you're actually talking about amping things up, you have to get to scale. If you don't get to scale, ultimately we'll be customizers of things in Canada. If that's the business strategy, fine. I think it comes to looking at global markets and how you address that. If we focus on north-south, we will be left with that because the Americans will take everything else. They understand scale. That's what they do."

Of course, small companies don't have the resources of the Ford Motor companies of the world but Hattin sees another way: larger companies having a hand in helping smaller companies get bigger. That would help fill out manufacturing's middle ground, which was gutted during the recession. "Like Dragons' Den, they say, 'I'll take a share, I'll give you some governance, some structure because we like what you do and we want to go along for the ride. And by the way, we're going to use your stuff or maybe later on we'll sell it.' "

McPhail noted there's a perception buying new equipment solves the productivity problem. Compare a new machine today with one that was bought five years ago, he said improvement may be 2% to 3%. "When we started working with the average company, they'd get 5% to 10% out of the box, as a result of knowing and managing what they didn't currently know or manage. There's a much larger productivity increase associated with taking the data and effecting change than there is from simply buying the next spindle with 3,000 more rpm."

The survey results suggest companies are being careful about investment.

The average spend for 2015 is $2.16 million, but most companies (23%) are investing between $100,000 to $499,000, followed by 21% that will spend less the $100,000, 8% will not invest and 23% don't know what they'll invest or didn't say. Most (24%) are not investing in expansion, upgrades or new facilities, 9% wouldn't say and 21% don't know. Priorities are machinery and equipment (for 79%), training (57%), hiring staff (55%) and R&D (49%).

The top five criteria for investment are cost of labour (for 59%), availability of an educated workforce/skilled talent pool and a strong local market (each 49%), access to other markets (48%), proximity to local suppliers and ease of supply chain connections (33%), energy costs and availability of financial resources (each 30%), and tax rates, all government levels (29%).

Ask any manufacturer about how they finance growth and they'll likely grouse about the response they get from banks. Going around the table, McCoubrey ran into bank antipathy when he was involved in an employee buy-out; and Doorselear had a similar experience when he and his partner

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were looking for financing to buy Lind Equipment.

The survey found most companies (70%) intend to finance growth through internally generated cash flow followed by bank financing (37%), private investors (21%) and government programs (16%).

Their top choice suggests to Hattin that they want to spend a pittance of what they should be spending: "I've got five bucks in my pocket, I'll spend two-fifty. I can self finance that." But he contends it's not about the money. Money is cheap, and available. "It's about what a company is willing to give up to get the needed financing and whether or not your aspirations are bigger than your desire for control and retention of equity. That's a personal decision."

The top investment priority for manufacturers is machinery and equipment. PHOTO: THINKSTOCK

Financing growth

That was a decision McPhail had to make. His small high-tech company intends to be a leader and it takes lots of money to roll out the technology, "but we also have to seed the market with it – we have to get customer use cases, success stories – before we can actually even sell it en masse."

He looked for a private equity partner, but couldn't find one he could work with. "So we took the public route and it's been an adjustment, and it has been successful so far."

McPhail said to stay in the lead, it's all about a "land grab," which is expensive. "If you want to dominate the marketplace, profitability in our case is secondary. Presently we're all about grabbing additional customers and growing at 100% or more a year for the next two or three years."

M.C. Healthcare has several projects on the go, including the revamping of its IT systems from every computer server to the website, plus software upgrades. Freeborn said there is also a lot of investment in product development, both in Canada and the US. "I see the opportunity on the shop floor. …I'm looking at the processes from the point of view of, 'Where do we have to go,' and we have some major investments ahead of us. Processes have to be more efficient. Because we're using steel, I need to get stuff that allows you to be really creative in how we develop our product to make it simpler to build."

Bendiner said TD is forecasting machinery and equipment investment spending will

"There's a much larger productivity increase associated with taking the data and effecting change than there is from simply buying the next spindle with 3,000 more rpm. — David McPhail"

Dave McPhail

accelerate, which is partly tied to rising operating profits. "If firms are making more money they'll be more inclined to invest in machinery and equipment… So we're seeing positive momentum."

The federal government's accelerated capital cost allowance program (ACCA) is helping some manufacturers invest in machinery and equipment.

Glen Gilbert, a Grant Thornton partner who specializes in tax services, noted the incentive is a fast write-off of the cost of qualifying equipment acquired before 2016. It's three years, 25% the first year, 50% and then 25%.

"The incentive is in the timing of the write-off, otherwise the claim for capital cost allowance would be at 30% on a declining balance, with 15% in the first year and at that rate, it would take nine years to write off 95% of the cost."

Gilbert offered an example involving a $100,000 piece of equipment. In the first year it would be a $25,000 write-off, which is $10,000 more than the deduction at the normal 30% rate, resulting in an additional tax deferral of approximately $2,500. In year two, the additional write-off (over the normal rate) would be $24,500 for a further $6,125 tax deferral. "It's about the timing of how quickly you can write off the cost of the investment," he said. "The sooner the better, obviously."

Innovation requires investment, and 61% of respondents plan to spend on R&D in 2015. Thirty-two per cent will spend 1% to 3% of revenue, followed by 16% who will allot 4% to 6%, and 13% who will spend from 7% to more than 10%. Forty-seven per cent consider SR&ED an important part of their tax planning strategy, and 44% intend to take advantage of the tax credit, while 35% have not done so, nor do they plan to make use of it. Collaboration has played a role for some. Forty-two per cent have worked with suppliers, 40% with other companies, 19% with government agencies and 15% with academic institutions.

Siemens has a number of new product development activities on the go. There are markets it wants to get into with greater strength. One activity is to reach into an area of technology in which Almond said Milltronics is a reasonable leader, and improve it.

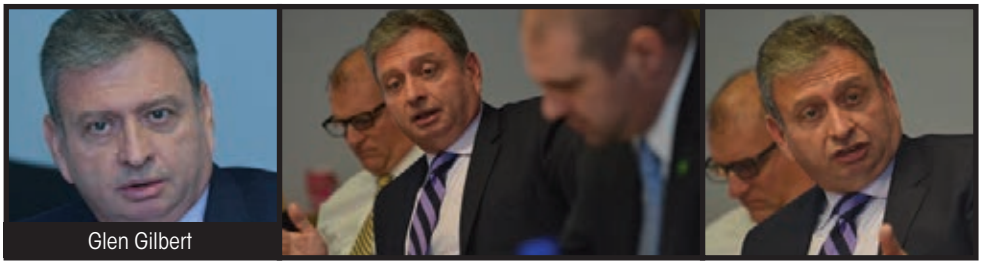
Another involves real time-to-market and a product that is a part of a foundation portfolio. The focus is on two areas: modernization and producing the product at a cost and time that the customer wants. "If we're going to achieve what customers want, then we build better relationships with them."

A lot of Prinoth's R&D is focused on simplifying processes and helping customers be more efficient.

Snowgroomers, for example, cover more acres per hour with less fuel. "We have systems today that are measuring the snow depth to reduce snowmaking costs, and fleet

Continued on page 29

"The incentive is in the timing of the [ACCA] write-off, otherwise the claim for capital cost allowance would be at 30% on a declining balance, with 15% in the first year and at that rate, it would take nine years to write off 95% of the cost."
— Glen Gilbert


Glen Gilbert

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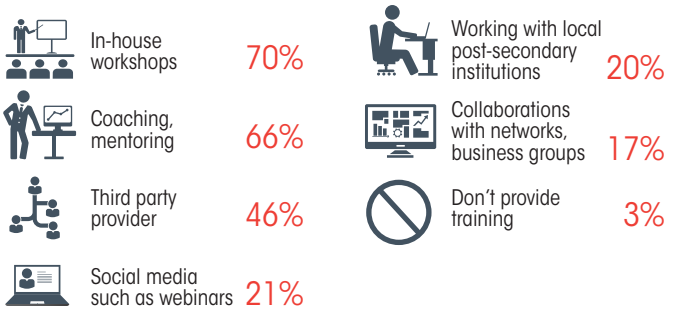
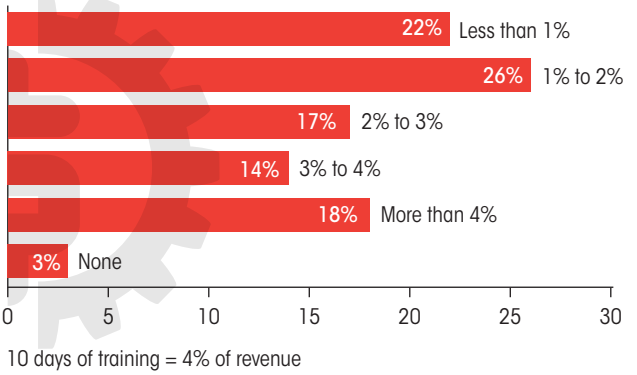
Skills

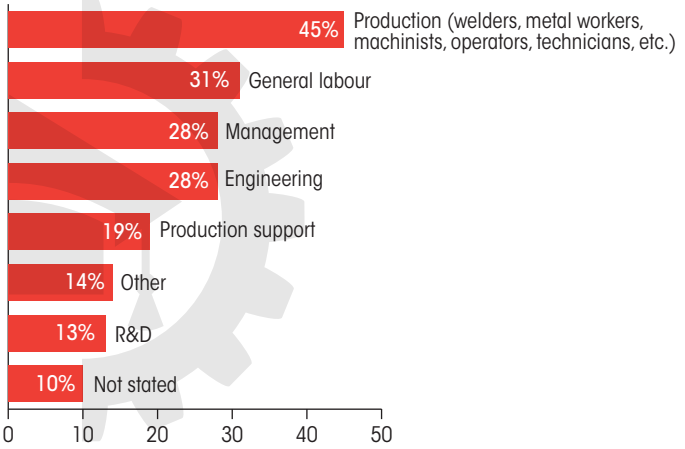
Methods of skills training



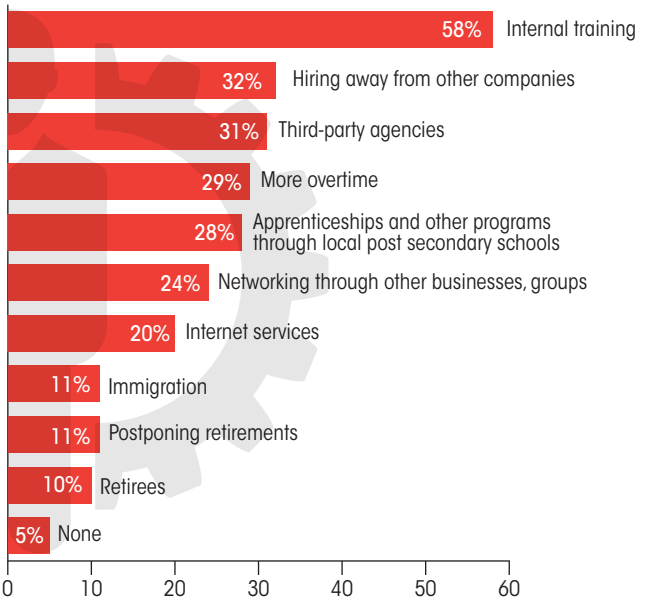
Investment in skills training 2015



Shortages in specific skills areas



How skilled jobs are being filled



• • • say productivity has been negatively affected to some degree by vacancies resulting from a skills shortage/gap.

Innovation

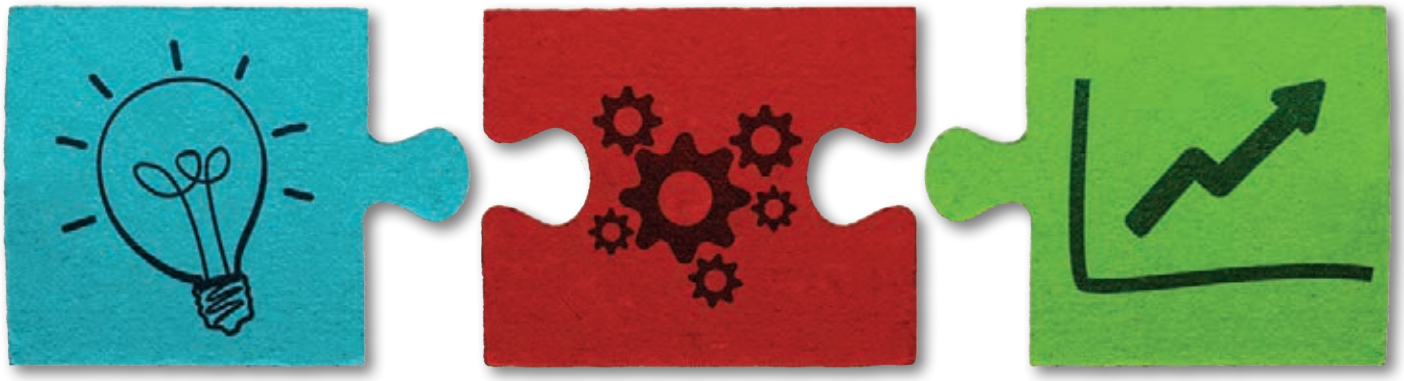
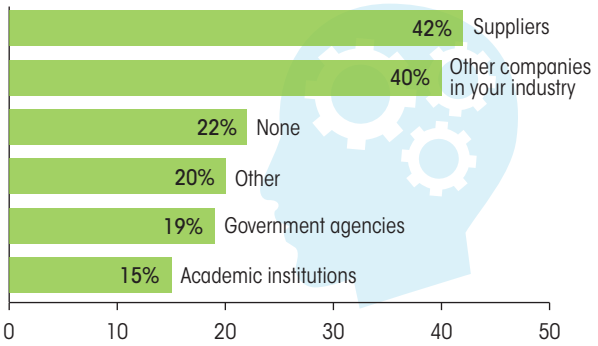
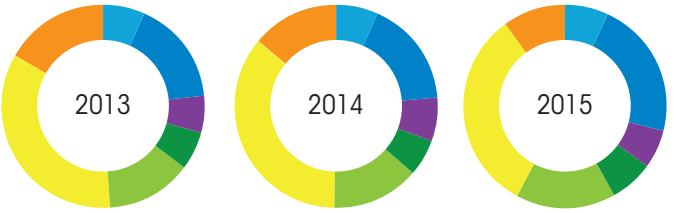


PHOTO: THINKSTOCK

Innovation collaborators



Revenue for R&D, commercialization



	2013	2014	2015 (forecast)
Nothing	17%	14%	10%
1%-3%	35%	36%	32%
4%-6%	14%	14%	16%
7%-10%	6%	6%	7%
More than 10%	6%	7%	6%
Don't know	17%	17%	22%
Not stated	7%	7%	7%

27% ... *of companies claim to have a strong culture of innovation.*

44% ... *of companies are applying for SR&ED; 35% are not taking advantage of the tax credit.*

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management systems that reduce idle time," said Perrault.

Lind Equipment invests heavily in R&D and technology. The company is innovating two different product lines: LED lighting and a niche area for static grounding and bonding for the oil and gas industry. The strategy is to leapfrog some of its bigger competitors and steal market share. Van Doorselaer said Lind got the jump on some competitors who were stuck on florescent lights. "We've probably got a couple of years head start. We see them moving into the LED side now, but they're producing 'me-too' products, and they're not as good as what we were able to do."

Canadian manufacturers are having trouble filling various skilled positions, chief among them for 45% of the respondents are production staff such as welders, metal workers, machinists, operators and technicians, followed by general labour (31%), then management and engineering (both at 28%). Most companies (58%) are coping with shortages by delivering internal training, 32% are hiring away from other companies and 31% are using third-party agencies.

Training for 70% of businesses involves inhouse workshops and 66% are coaching and mentoring. Investment in training based on 10 days equalling 4% of revenues will be between 1% and 2% for 26% of companies but 18% intend to spend more than 4%.

Diggins was pleased to see companies are paying more attention to training. "It's almost a regular occurrence – where a manufacturer's wheels have come off, and the lights come on a year later when everything's going south on the balance sheet, and they start investing in training."

Freeborn observed there are fewer opportunities now for employees to grow and progress. "In the past when we were coming up through our industries, there was a lot of opportunity to move around. You don't see that in the small or a medium-sized business. You can get people so far on the plant floor then they have to go elsewhere. So you're constantly training a new guy."

Hattin believes in some cases management gets the labour it deserves.

"I heard this the other day and this kind of mindset astounds me... 'I don't want to train my people because as soon as I train them they're going to leave.' Oh, okay, so let's just hire idiots. If you're not going to invest in your people, they're going to leave."

Manufacturers who are looking for talent should check out a largely untapped demographic. Hattin said a CME project identified women as a great opportunity for Canadian industry with its emphasis on technology. "Women represent a demographic or a segment of our creative youth that we need to build upon, because other places are doing it," he said, looking around a boardroom table with a lone female panellist.

Jim Menzies

You can't improve what you don't measure… If you don't have good information you don't make good decisions.
— Jim Menzies

There's another demographic poised to have a significant impact on manufacturing in quite a different way.

Jeff Pocock, national leader of Grant Thornton LLP's private equity practice in Canada, warns in an article that appeared in **PLANT** (October 2014) that 20% of Canadian businesses are owned by those 55 and over, and in the coming five years, nearly $2 trillion in business assets are poised to change hands.

US and global private equity firms are entering Canada looking for opportunities.

Boomer buy-out

"My fear is if [Canadian owners] start to sell to non-Canadian investors, management might leave Canada, head offices might move somewhere else, or plant rationalization might occur. I think there could be a paradigm shift if we don't keep [SMEs] Canadian owned," he said.

A manufacturing company worth $10 million looking at a management-led buyout by a general manager may need a few million dollars, but small equity financing is hard to find.

Van Doorselaer can relate. Seven years ago when he and his business partner Brian Astl (Lind Equipment's president) were looking to acquire a small, family-owned business to transform into something bigger and hopefully global, they had no luck finding backing in Canada. The two thirty-something business school grads found a network of private investors that were working with small businesses in the US, and that's how they got the backing to buy Lind Equipment from an owner who was ready to retire.

As boomers move on to other things, manufacturing will need to tap into this kind of entrepreneurial energy.

"We've got a lot of people who've done a great job of building businesses up to a point and now, to think globally, we've got to get young people interested in taking this path," said Van Doorselaer. "One way is to get creative about how we finance some of these transitions."

He said there's a role for banks to play. And maybe there's a role for the boomers who are getting ready to cash out by getting involved and helping to bring along the next generation of owners.

Looking ahead, conditions are promising for manufacturers of all sizes to make bolder advances in North America and in developing markets. The federal government has opened the doors to Europe and South Korea, and it's working on the Trans-Pacific Partnership, a trade pact that offers a potential market of 800 million people. GDP is valued at $28.6 trillion, which represents close to 40% of the global economy. However, less than half (44%) of senior executives believe these deals benefit them, and only 11% of those strongly agree. It comes down to leaders, whatever their age or generation cohort, making the choice to embrace the challenge.

If you design with easier assembly in mind, easier manufacturing, fewer components, simpler design, you get huge productivity gains.
— Jean-Claude Perrault

Jean-Claude Perrault

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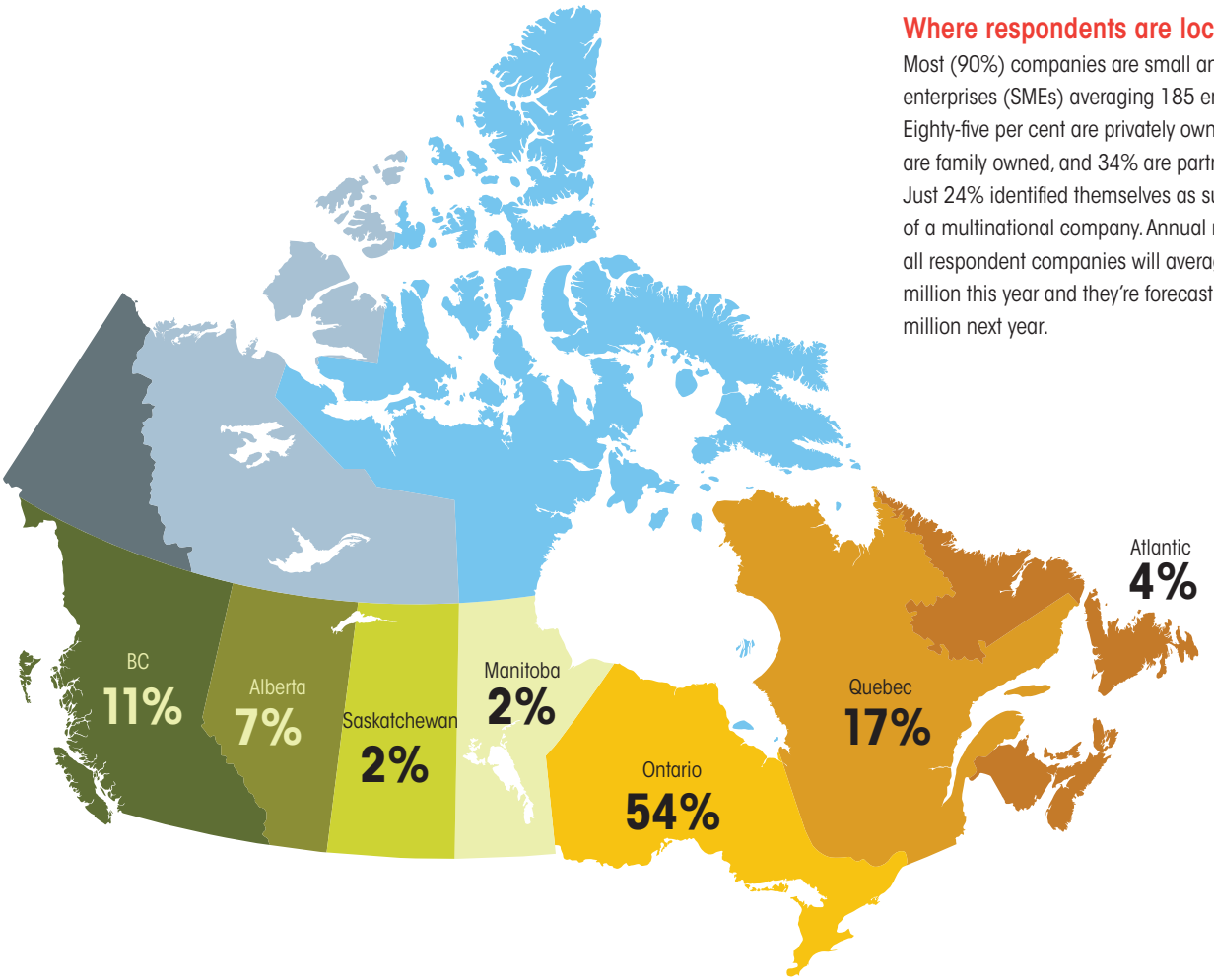
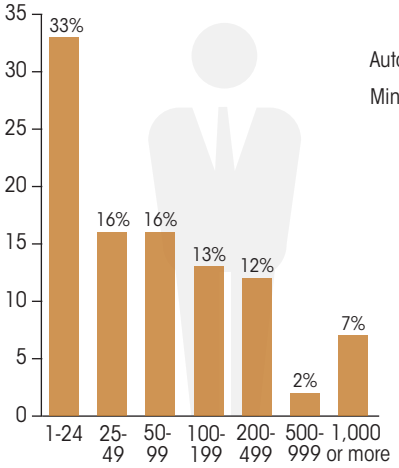
Demographics

Where respondents are located

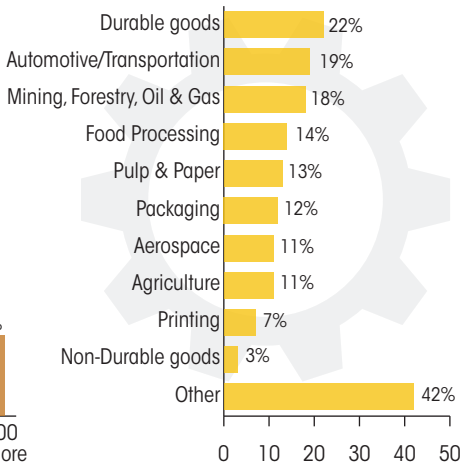
Most (90%) companies are small and medium enterprises (SMEs) averaging 185 employees. Eighty-five per cent are privately owned, 66% are family owned, and 34% are partnerships. Just 24% identified themselves as subsidiaries of a multinational company. Annual revenues for all respondent companies will average $79.9 million this year and they're forecasting $83 million next year.



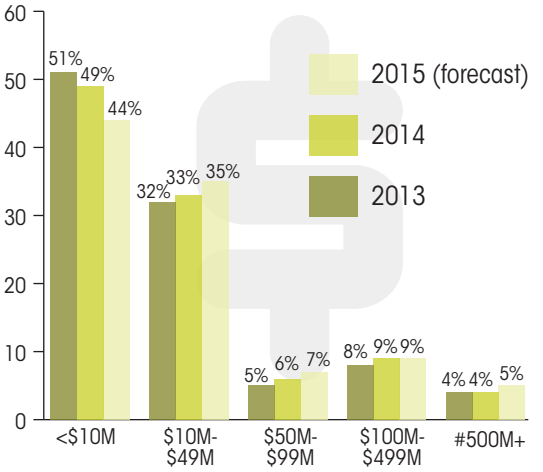
Number of employees



Industry sectors served



Company revenue



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