

# Perspective

Third Quarter 2009

Practical ideas for manufacturers and distributors

## How SMB Supply Chains Are Changing

Ninety-Eight percent of all manufacturing plants in the U.S. are small to medium-sized businesses (SMBs). In the last several years, SMBs have moved away from vertical integration to a horizontal organization. Consequently, SMBs control a smaller portion of the supply chain and their sources of supply can come from anywhere in the world. These developments have made the supply chain longer and more complex. With this change, and the slowing world economy, it is more important than ever to increase the efficiency of the supply.

Supply chains continue to evolve and change. For example, for outsourcing China is losing ground to other low-cost countries such as India, Malaysia and even Mexico. Having an effective and efficient supply chain to drive down costs, react to market changes quickly, minimize risk and improve responsiveness, will be critical to remaining competitive.

**“SMBs must reassess their competitive positions on a regular basis and position themselves to respond rapidly to changing conditions.”**

### Technology

Technology is a key requirement for collaboration in the supply chain. Most SMBs have some type of an Enterprise Resource Planning (ERP) system, but typically utilize 30 percent or less of its capabilities. As a result of the economic downturn, many SMBs have postponed plans to upgrade or implement a new ERP system because of cost and business uncertainty.

A more common approach regarding supply chain integration is to optimize the use of current systems. Many ERP systems have significant management capabilities that can be used to a much greater extent to collaborate in the supply chain. Supplier Relationship Management (SRM) and Customer Relationship Management (CRM) are both common applications in most modern ERP systems; however, they are rarely used to the full extent of their functionality.

The SMB can also minimize risk of implementing new technology by optimizing their current ERP system with stable and proven technologies, rather than implementing “latest and greatest” technology solutions recently released to the market.

### Supplier collaboration

Many SMBs talk about value-added supplier partnerships, yet continue to treat their suppliers as adversaries. There is little collaboration with suppliers because the relationship typically consists of negotiating and placing the purchase order with the lowest bidder. In the slow global economy, increased integration with suppliers regarding supply and demand planning, strategic sourcing, reducing inventories throughout the supply chain and early warning of shifts in demand, are critical.

Suppliers have also been affected by the current global downturn. Tracking key supplier performance measures for early warning signals of increased risk is an important benefit from supplier relationship management. The loss of a key supplier can cripple an SMB's ability to support the supply chain.

Many SMBs do not realize that supplier relationship management and supplier integration can have a greater impact on profitability and risk mitigation than any other area. Tighter integration and supplier collaboration can often reduce the cost of materials and services by 10 to 20 percent and provide early feedback of potential supplier risks

[SMB, continued on page 3](#)

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## Managing Compensation and Human Capital Investment in an Uncertain Economy

The current economic situation in the United States is being compared to the stagflation of the '70s, the deep recession of the early '80s and lately to the Great Depression of the '30s. The biggest question everyone is asking is, "How long before we will begin to recover?" Of course, this is a subjective question as everyone's definition of recovery may be different. The reality as to when the recovery will occur will vary from industry to industry, company to company and by who is doing the forecasting.

If you assume that the recession will be long lasting or severe, you will need a comprehensive approach to managing employment decisions as well as reduction and deferred compensation strategies to ensure survival and long-term strategic success. Total compensation costs are typically among the largest line item expenses for most companies. To the extent that economic conditions have impacted your company or industry harder than others, your ability to make these employment and cost-reduction decisions may determine whether your company's survival strategies are of a long- or short-term duration. In the long term, you may face a worst-case scenario unless top management is strategic in identifying internal sources

of working capital and managing their total compensation costs.

Striking a balance between financial considerations, your company's human capital philosophy and market considerations can be quite difficult when it comes to identifying cost reduction strategies. Any decisions to reduce payroll costs all have specific short- and long-term ramifications. The turnaround approach, while very effective, efficient and oftentimes necessary in the short term, needs to be balanced with a well-thought-out strategy/human resource perspective and methodology.

A holistic and well-executed plan can help differentiate your company and provide a competitive advantage during challenging times. The board of directors, senior management and ownership must invest the required time and effort to devise a proper and reasoned plan to safeguard the company's financial future and reputation as a fair employer.

For a more in-depth discussion related to this article, please download a comprehensive white paper at [www.rsmmcgladrey.com](http://www.rsmmcgladrey.com).

## Reading the Fine Print: What Borrowers Need to Know About Loan Agreements in the New Recession

The economic free fall that U.S. businesses are experiencing traces its roots back to 2007, when the enormous failure of the markets for subprime mortgages and mortgage-backed securities triggered a collapse in the global credit markets.

As a result of this worldwide distress, one of the largest participants in the subprime mortgage market – the investment bank Lehman Brothers – filed for bankruptcy protection under Chapter 11 in September 2008. Almost immediately, business lenders retreated, constricting the availability of credit even more.

In addition to making less credit available, lenders today are putting greater pressure on business borrowers by paying closer attention to the debt covenants in loan agreements. Designed to ensure that underwriting standards and risk pricing are proper and that borrowers don't fall into a position where they are unable to repay what they owe, debt covenants are binding promises by borrowers to maintain certain financial ratios and limit certain business activities.

In good times, both lenders and borrowers paid relatively little attention to debt covenants. In fact, many so called "covenant-light" agreements were consummated containing few, if any, covenant restrictions. Today, in a tougher economic environment, both sides are focusing keenly on these legal commitments. Lenders are attempting to both monitor

and amend existing covenants, resulting in very restrictive constraints on borrowers' behavior.

Before the current credit crisis began, there was healthy competition in the credit markets, which provided many options for both lenders and borrowers. Today, that simply is not the case. As a result, lenders and borrowers are unwilling or unable to make significant changes to their lending agreements. Instead, lenders and borrowers are engaging in short-term renegotiations, forbearance agreements and demands for additional equity, which may or may not be met. These negotiations are difficult for both sides and contribute to an ongoing paralysis in the credit markets.

To cope with the credit crisis, business borrowers need to study their loan agreements. Specifically, companies need to understand:

- The types of debt covenants they have
- How those covenants can impact their borrowing base
- The degree to which their corporate structure affects their ability to borrow
- The status of any collateral or liens associated with their borrowings

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### RSM McGladrey 2009 Manufacturing and Wholesale Distribution Survey - Interim Report

RSM McGladrey's 2009 Manufacturing and Wholesale Distribution (MWD) National Survey was conducted between March 11 and April 13, 2009. Following are some initial insights into the survey's major findings. The survey analysis includes the results of 923 executives and managers of U.S.-based MWD enterprises. Results indicate trends and strategies employed by the participating companies to maintain status or profitability during one of the worst recessions in 80 years.

#### Initial Findings

The final data analysis is still under review with a final report due out in early summer. The initial results indicate several trends and opportunities that alert companies may wish to consider as the U.S. and global economies begin their recovery and reinvention:

**Business conditions** have deteriorated, as expected. Thirty-nine percent of 2009 MWD survey respondents report their businesses are declining, a significant increase of 27 percent over last year's 12 percent. On the positive side, nearly half of respondents are optimistic regarding **company growth prospects** for 2009. The vast majority expect their companies to **rebound from the recession** in either the second half of this year or first half of 2010.

Even in the midst of a global recession, one-third of companies anticipate increases in 2009 international sales, while a quarter project domestic sales increases. The largest projected international sales increases are for the electronics and food segments. The highest projected decreases are in transportation equipment and industrial equipment.

#### What to watch for

- Concerns about government intervention were expressed throughout the comments sections of the survey responses. Companies that capitalize early on government programs will have a clear competitive advantage, especially where it applies to innovation and green initiatives.
- Opportunities for growth in international sales pose a clear advantage, not only for large multinationals but for small and mid-sized companies. Immediate neighbors Canada and Mexico are still the leading source of international opportunity for U.S. companies, followed by Western Europe and then China.

### SMB, continued from page 1

#### Customer collaboration

SMBs typically have less control over customer collaboration than supplier collaboration. In addition, the demand from customers has become increasingly less predictable and more volatile. Even though many SMBs invest significantly in Customer Relationship Management, Contact Management and Forecasting and Sales & Operations Planning software, most are not using the technology strategically with their customers. Instead, the software is often used to gather historical information on the customer, products or contact management, rather than for proactive collaboration and partnering activities. Emphasis by all partners in the supply chain needs to focus on capturing timely and accurate demand information from the ultimate customer. This allows the product to be "pulled" through all levels in the supply chain rather than "pushing" the product based upon a forecast.

#### Final thoughts

Due to the current economic downturn, many SMBs have lost many of their resources to focus on supply chain management. However, since the economy is going to continue to make the competition between suppliers more intense than ever before, it is critical that SMBs address the supply chain. Increased collaboration is needed to reduce costs and risk while increasing flexibility to react to market changes. SMBs must reassess their competitive positions on a regular basis and position themselves to respond rapidly to changing conditions. This mindset must start with top management to redirect their emphasis from the status quo to improving the supply chain.

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## Inside this issue:

- How SMB Supply Chains Are Changing
- Managing Compensation and Human Capital Investment in an Uncertain Economy
- Reading the Fine Print: What Borrowers Need to Know About Loan Agreements in the New Recession
- RSM McGladrey 2009 Manufacturing and Wholesale Distribution Survey – Interim Report



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