

2014 BDO MANUFACTURING RISKFACTOR REPORT

for Michigan



RESURGENCE IN MANUFACTURING BRINGS NEW RISKS

The *BDO Manufacturing RiskFactor Report for Michigan* examines the risk factors in the most recent 10-K filings of publicly traded U.S. manufacturers headquartered in Michigan. The factors were analyzed and ranked by order of frequency cited.

The manufacturing industry in Michigan is picking up momentum, as the larger industry continues to see a renaissance in the U.S. With a strong focus on rebuilding what was once one of the most robust manufacturing states, Michigan is poised to seize large business opportunities within the sector and regain its notable industry status. Yet, growth is not without its challenges. Manufacturing companies based in Michigan, despite their positive business outlook, continue to face many challenges – from competition and labor concerns to environmental laws and product recall risks.

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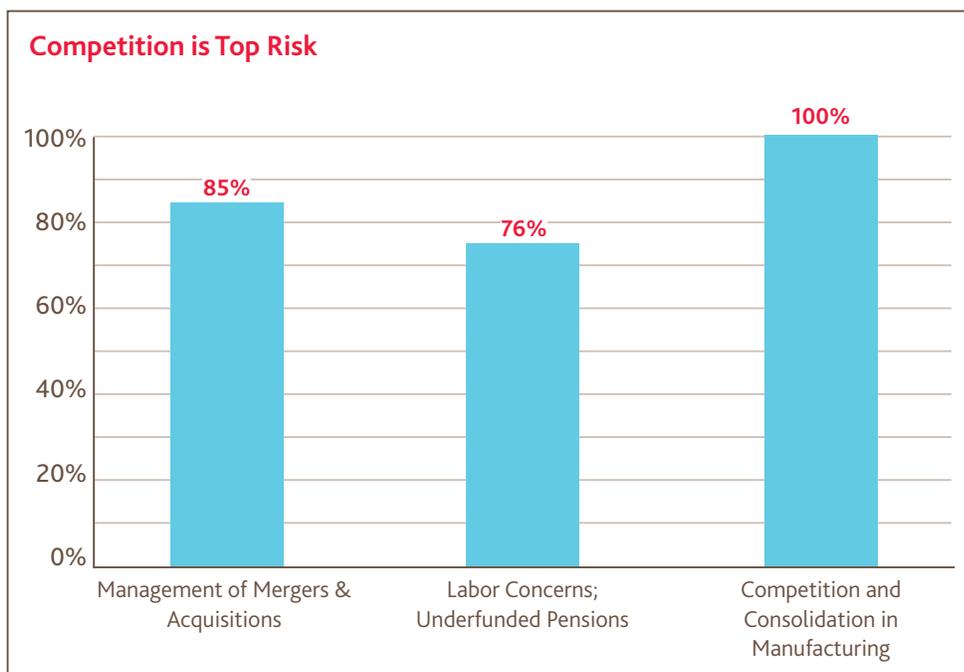
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“Growth in the manufacturing industry on a national level is good news for the economy and workforce overall. However, Michigan, with its strong manufacturing reputation and history, is uniquely positioned to benefit from reshoring trends and investment in the sector,” said **Fred Rozelle, Central assurance regional managing partner and member of the BDO Manufacturing & Distribution practice.** “Despite the positive activity in the industry, manufacturers will continue to face risks. Yet, those risks will shift to reflect business challenges faced in up cycles.”

►GENERAL ECONOMIC CONDITIONS CONTINUE TO BE OF IMPORTANCE

Michigan has been marked by a long economic struggle: First, with the decline of the U.S. automotive industry that surfaced largely in the 1980s; then with the general decline of the U.S. manufacturing industry; and finally, with the Great Recession. The ongoing economic challenges facing not only the industry, but the state, may be contributing to 97 percent of Michigan-based manufacturing companies citing general economic conditions as a risk. Despite this, Michigan continues to be a strong manufacturing hub. According to the National Association of Manufacturers, Michigan had \$53.6 billion in manufactured goods exports in 2013, and in 2011 approximately 31 percent of the state’s employment stemmed from exports.



►REGULATORY RISKS HIGHLIGHT ENVIRONMENTAL LAW CONCERNS

Ninety-four percent of Michigan-based manufacturers note risks related to federal, state and local regulations. There is a paradoxical challenge facing the manufacturing industry. While the U.S. is focused on reclaiming its production and export status, environmental laws and considerations are also shifting into purview and may be laying the foundation for an unfavorable operational environment. This could be why 76 percent of Michigan-based manufacturers cite environmental laws, regulations and liability as a risk. While nearly all manufacturers have some environmental liability exposure, those in the industrial manufacturing sector – for example, those who convert raw materials into finished goods – may face an even greater threat of breaching environmental laws and the need to pay remediation costs or costly legal fees.

►GROWTH BOLSTERS COMPETITION, M&A AND LABOR RISKS

Growth in the industry may be leading to several risks, including competition, mergers and acquisitions (M&A) challenges, and labor concerns. With customer pricing pressures and a competitive market environment, it is no surprise that 100 percent of Michigan-based manufacturers note competition as risk. Coupled with this is the concern around managing M&A (cited by 85 percent). Further exacerbating the complex growth environment is the notable labor gap, with 76 percent of Michigan-based manufacturers noting risks related to labor. Despite the manufacturing renaissance in the U.S. and positive reshoring trends, the long period of stagnation in the industry – marked by job cuts, less focus on building a talent pipeline, and a flurry of retiring baby boomers – has likely led to a challenging labor shortage. Moreover, advanced manufacturing has

created an even stronger competitive need for educated and highly trained employees.

►SUPPLY CHAIN RISKS ARE PARAMOUNT

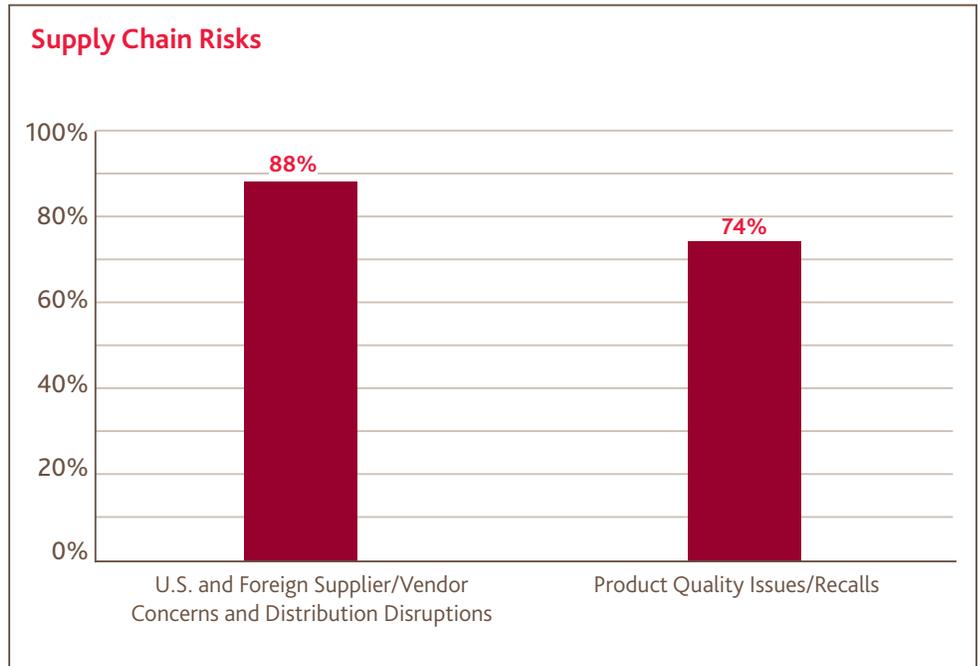
Eighty-eight percent of Michigan-based manufacturers cite risks related to U.S. and foreign suppliers/vendors. Many manufacturing companies have extensive supply chain exposure. These systems are complex and span multiple states and countries. For that reason, natural disasters, geopolitical unrest and backlogs are all stress factors that manufacturers face as a result of their supply chain, which can lead to both long- and short-term revenue challenges. In addition to the cultural and environmental issues impacting supply chains, other supply chain liabilities are closely linked to the quality of the good or product provided by the outside vendor. This is an especially acute risk when dealing with non-U.S.-based

“The regulatory regime governing environmental hazards are in a state of flux as the government continues to debate the scope of the Environmental Protection Agency’s authority,” said **Matt Becker, Central tax regional managing partner at BDO USA, LLP.** “But manufacturers also have to worry about shifting tax regulations as a result of federal budgetary pressures. Critical tax incentives, such as the R&D Tax credit, spur the innovation necessary to keep U.S. manufacturing competitive internationally. Any moves to curtail these incentives could potentially compromise growth and our place in the global economy.”

suppliers and vendors. Barring legal recourse for a contaminated or faulty product, the manufacturer will often face financial, legal and reputational harm. Additionally, it is challenging to ensure that international vendors and suppliers are implementing and enforcing the same quality standards mandatory in the U.S. Therefore, product quality and recall risks are identified by 74 percent of Michigan-based manufacturers.

► CONCERNS OVER INTELLECTUAL PROPERTY RISKS ARE TOP OF MIND

Seventy-four percent of Michigan-based manufacturers cite concern over corporate copyright and intellectual property infringement. Manufacturers’ licenses, trademarks and intellectual property for products, goods and processes not only provide a strong competitive advantage but are often fundamental revenue streams. There are a number of ways a violation can occur, including a data breach and employee fraud. However, one of the largest exposures is through international business operations and partnerships. Many foreign countries, especially popular outsourcing hubs, do not have the same level of regulatory oversight governing intellectual property infringement violations. Additionally, should a patent expire, allowing other companies to freely replicate a product or process, the manufacturer will be put at a disadvantage and could be exposed to pricing pressures.



2014 Rank	Top 20 Risks for Michigan-based Manufacturers	2014
1.	Competition and Consolidation in Manufacturing	100%
2.	General Economic Conditions	97%
3.	Federal, State and/or Local Regulations	94%
4.	U.S. and Foreign Supplier/Vendor Concerns and Distribution Disruptions	88%
4t.*	Currency/Foreign Exchange Fluctuation	88%
6.	Less Demand for Products	85%
6t.	Threats to International Operations	85%
6t.	Management of Mergers & Acquisitions	85%
6t.	Legal Proceedings	85%
10.	Restrictive International Trade Policies	79%
11.	Environmental Laws, Regulations and Liability	76%
11t.	Commodity/Raw Material Prices	76%
11t.	Access to Capital	76%
11t.	Labor Concerns; Underfunded Pensions	76%
11t.	Failure to Properly Execute Business Strategy	76%
16.	Intellectual Property Violations/Challenges	74%
16t.	Product Quality Issues/Recalls	74%
16t.	Health of The Major Industries They Serve	74%
19.	Ability to Innovate to Meet Changing Customer Needs	68%
20.	Loss of Key Management/New Management	65%

*t indicates a tie in the risk factor ranking



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