

The currency crunch

Addressing market volatility
and solutions for manufacturers



Addressing currency volatility

Short-term solutions to immediate issues manufacturers face

In the highly competitive manufacturing industry, organizations are well aware of the need to pursue continuous improvement. Yet, this imperative has become increasingly urgent in light of recent Canadian dollar volatility.

To succeed in this rapidly evolving environment, manufacturers must move more quickly and make bolder moves than ever before.

They must reexamine their business models by taking a careful look at their products, suppliers, procurement practices, diversification strategies and supply chain costs. And they must engage their finance function as a catalyst for driving business performance.

Yet, foundational change takes more time than many manufacturers have. Which raises the question: what can companies do in the short term to address immediate challenges?

To answer this question, professionals from Deloitte's national manufacturing industry network collaborated to develop a series of solutions designed to help Canada's manufacturers respond to ongoing market volatility. **Here are some of the short-term strategies they identified:**

1 Focus on top-line growth

"In the short term, companies must analyze their customer value drivers to identify the action steps most likely to drive revenue growth," says Consulting Partner Richard Carson. "To succeed, Canada's manufacturers must engage in product and services innovation, rethink their pricing strategies and identify the distribution channels – and the customers – with the highest potential."

This cannot be an idle inquiry. To truly differentiate amid current volatility, manufacturers must find new ways to add value to their customers. This should include developing and designing product and service innovations, enhancing customer service standards, ensuring optimal sales force deployment and strengthening their marketing and brand management.

Take the example of a leading Canadian paper product company that was experiencing flat revenue growth, declining margins and decreasing customer loyalty. With a weak understanding of its customers' needs, this company had failed to develop a robust sales and marketing strategy, which was in turn resulting in low sales force morale.

In an effort to improve its flagging performance, this company worked with Deloitte to review its customer value drivers, conduct a market segmentation study, analyze its margins and assess its sales force tools. As a result, it was able to develop segment-specific customer value propositions, introduce a new contracting and pricing process and enter new supply chain contracts that work more to its benefit. In addition to enhancing employee morale, this approach allows the company to better serve its highest potential clients.

Beyond this structural examination, manufacturers should also review the ways in which they can take advantage of today's strong dollar to engage in strategic mergers and acquisitions. In addition to accelerating the penetration of new markets, more and more manufacturers use mergers and acquisitions as a way to generate cost synergies. To take full advantage of market opportunities, however, it is important to lay the groundwork for future transactions. To that end, it makes sense for manufacturers to optimize their financing while their balance sheet remains strong.

"The best time to get financing is when you don't need it," stresses Financial Advisory Partner Michael Badham. "By taking early action, manufacturers can position themselves to improve the productivity of their capital by sourcing the most efficient forms of capital available."

By considering the potential for strategic mergers and acquisitions, acting early to optimize their financing, and questioning traditional approaches to their product mix, market focus and pricing strategies, manufacturers can begin to identify ways to grow revenues – both in the short and long terms.

2 Aggressively reduce costs

Given the rapidity and intensity of Canada's currency fluctuations, manufacturers cannot pursue improvement in an unstructured fashion. Rather, they must commit to changing the way in which they do business by seeking process improvements, supply chain efficiencies and, where necessary, financial restructuring.

In this regard, leading manufacturers pursue competitive cost structures and invest in process improvement on an ongoing basis. Rather than taking a one-off approach, they must have several projects going on in these areas.

For instance, one leading manufacturer ensures ongoing responsiveness to customers by making plant managers directly accountable to customers and then continually realigning its business units to ensure optimal performance. At the same time, this company is pursuing other strategic initiatives to improve margins and reduce costs – including penetrating new global markets and seeking more cost-effective global sourcing relationships.

Sourcing products and outsourcing processes to low cost jurisdictions are two of the most significant ways of reducing costs. "To remain competitive in today's world, manufacturers must develop core competencies in both procurement and outsourcing," notes Consulting Partner Kurt Ritcey. Other ways to reduce costs in the short term include taking advantage of

the strong Canadian dollar to automate, implementing lean manufacturing, re-engineering key processes and improving logistics management. Additionally, manufacturers should examine the financial viability of their suppliers and develop strategies to mitigate the impact of potential supplier bankruptcies.

Finally, organizations facing cost pressures they can't manage should consider ways to proactively restructure their company. "Companies that respond to crisis proactively have more options available to them," asserts Financial Advisory Partner Ryan Brain. "For example, over the short term, manufacturers can divest under-performing businesses, strengthen their balance sheets by improving management of working capital, bring in third-party specialists to help with bank negotiations and analyze their market opportunities. In this way, they may be able to avoid more formal restructuring proceedings."

3 Explore global business opportunities

Manufacturers today face unprecedented competition from low-cost economies such as China and India. In addition to sourcing more materials internationally, Canadian manufacturers must begin to develop strategies for selling into these fast-growing countries to counter the competitive threat they pose.

"To take advantage of globalization in the short term, organizations need a clear understanding of their global structure," explains Luc Martin, National Leader of Deloitte's Manufacturing practice. "This means knowing how much raw goods are sourced in different currencies and how much each product costs to manufacture, taking into account transportation, warehousing, customs and regulatory costs."

Armed with this information, organizations can begin to make more informed sourcing and manufacturing decisions and avoid costly mistakes. They can also begin to develop the internal expertise required to both reduce their cost structures and take advantage of emerging market opportunities when they arise.

4 Enhance talent management

Industries assailed by volatility often have difficulty attracting and retaining skilled talent. This is particularly true for manufacturers, who have faced talent shortages for many years. Given the current market environment, then, manufacturers must both identify their key employees and take steps to retain that talent.

"To overcome volatility in the short term, manufacturers should review their incentive programs to make sure they're aligned to key business priorities," explains Consulting Manager Paula Harrington. "Next, they should take steps to communicate these focus areas to ensure employees understand what actions they're expected to take to help the company achieve its business objectives. Finally, they must align leadership around those priorities and demonstrate organizational commitment to their change initiatives."

Success in this area ultimately requires a committed leadership and a mobilized workforce working together to execute on both short- and long-term business goals.

5 Involve the finance function

As manufacturers contend with fundamental change, it is imperative to engage the finance function, led by the CFO, to spearhead key strategic initiatives. At a micro level, the CFO is in a powerful position to suggest short-term cost reduction strategies.

"For instance, one way CFOs can help companies manage currency volatility is by using hedge contracts to protect themselves against short-term currency fluctuations," says Financial Advisory Partner Doug McDonald. "But that is not enough. Over the longer term, the CFO can also help in the creation of a natural operational hedge that aligns their U.S. dollar-based costs with U.S. dollar revenues."

At a macro level, however, manufacturers should rely on the finance function to gain greater insight into strategies for cost reduction, top-line growth, the pursuit of global opportunities and talent management. Only by working in tandem with finance can manufacturers hope to understand the interconnections between their business operations, cost structures and profitability.

Finance also needs to manage tax planning proactively. While operations managers optimize the company's global cost structure, tax authorities can look at financial results on a country basis. As manufacturers restructure, it becomes increasingly important to engage in this type of country-by-country tax planning to avoid unexpected tax consequences and reduce effective tax rates. "For example, over the short term, manufacturers should look at their transfer prices from a foreign exchange perspective to reduce taxes for the global business," asserts Tax Partner Rob O'Connor. "Tax authorities in many countries allow for changes to inter-company transfer prices. However, timing is key."

6 Remain flexible in the face of change

A final strategy manufacturers must consider as they respond to market volatility is the need to remain flexible in the face of change. "Manufacturers must have an in-depth understanding of their supply chains, customer relationships and enterprise resources if they hope to balance their priorities," says Consulting Partner Chris French. "We operate in a dynamic economy where volatility has become the norm. Rather than addressing issues at static points in time, manufacturers must develop the institutional flexibility to respond appropriately over both the short and long terms."

Contact us

We can help you through the currency crunch.

The strength of the Canadian dollar means manufacturers need flexible strategies to deal with a rapidly changing global marketplace. **For more information on how manufacturers can succeed, visit www.deloitte.ca or contact a Deloitte professional:**

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