



# Manufacturing at continued risk for disruption

2019 began with the US and global manufacturing sectors experiencing continued growth, though recently the manufacturing sector has slowed as the risk for a downturn in global manufacturing increases. The global purchasing manager's index (PMI) in September recorded its fifth month below 50.0, which is the level that symbolizes the divide between expansion and contraction. While US manufacturing indicators have been positive through the first two quarters of 2019, in August the US PMI joined the global trend with its first below-50 reading (49.1) in more than three years. Deloitte projections based on the Oxford Economic Model (OEM) anticipate that modest annual manufacturing GDP growth levels may be tapering for 2019/2020, with projections of 2.7 percent for 2019 and 1.3 percent for 2020, lower than our prior projections of 3.7 percent for 2019 and 2.0 percent for 2020.

As we indicated in our [2019 Outlook](#), the historically tight labor market was a potential constraint on the industry's momentum. This year has seen muted job growth in the manufacturing sector, adding an average of 6,000 jobs per month to date in 2019, compared with an average of 22,000 jobs per month in 2018.<sup>1</sup> Even with the slowdown in hiring, manufacturers still report difficulty filling critical jobs. Another often-discussed constraint to continuing manufacturing's momentum has been the ongoing uncertainty in tariffs and their subsequent impact on trade flows. Costs throughout the manufacturing value chain are seemingly impacted every day. The uncertainty appears likely to continue into 2020, and thus manufacturers' optimism has experienced a noteworthy setback. Compared with the 2018 Manufacturers' Outlook Survey report, which noted 93.9 percent of manufacturers had a somewhat or very positive outlook on business, the latest report shows that just 67.9 percent are optimistic, with the remaining 32.1 percent having a negative outlook.<sup>2</sup> This mixed view of the sector is expected to be the prevailing sentiment for 2020.

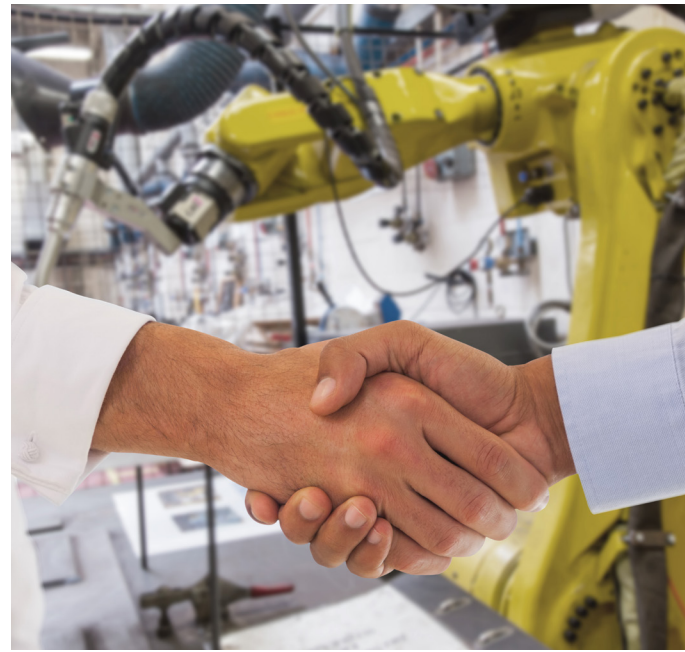
# 1

## Portfolio optimization

### Industrial companies are getting their diversified “houses in order”

Many US industrial companies made inroads in 2019 to streamline operations and double down on the core of their portfolios. For those with historically diversified business models, activities are increasingly focused on streamlining businesses and realigning around key markets or customer segments to further drive results and crystallize companies' value propositions to customers and financial markets. Some are turning to mergers, acquisitions, or divestitures to get their “houses in order.” In terms of divestitures, the industry observed 13 \$500+ million deals between January and August of 2019 and is on pace to potentially surpass the 16 that were recorded in 2018.<sup>3</sup> The activity is the result of multiple pressures these industrial companies are facing, including from shareholders, customers, and the broader public financial markets, that may increasingly favor focus over diversification. With this focus, a desire to intensify capabilities within the core business could further drive deal activity or focused investments, especially as they relate to protecting value chains from ongoing trade uncertainties. The most diversified industrial companies could consider several different variations on this theme, identifying options for rounding out core businesses even as they divest themselves of other entities.

As 2019 ends, and in spite of the steady level of divestiture activity, overall M&A activity appears to have softened recently: volume decreased by almost 30 percent in the first two quarters of 2019 compared with the same period a year earlier. On the brighter side, overall deal value has increased by almost 35 percent comparing year-to-date 2019 with the prior year. The data reflect that manufacturing deal activity has been driven by scale transactions, which are primarily focused on product, customer, and geographic expansions. This implies that those industrial companies wading into the M&A market seem to be making very deliberate decisions that could drive significant changes. We expect 2020 to continue this trend of lower overall deal volume, but for those deals that do occur, they will likely be of higher value.



# 2

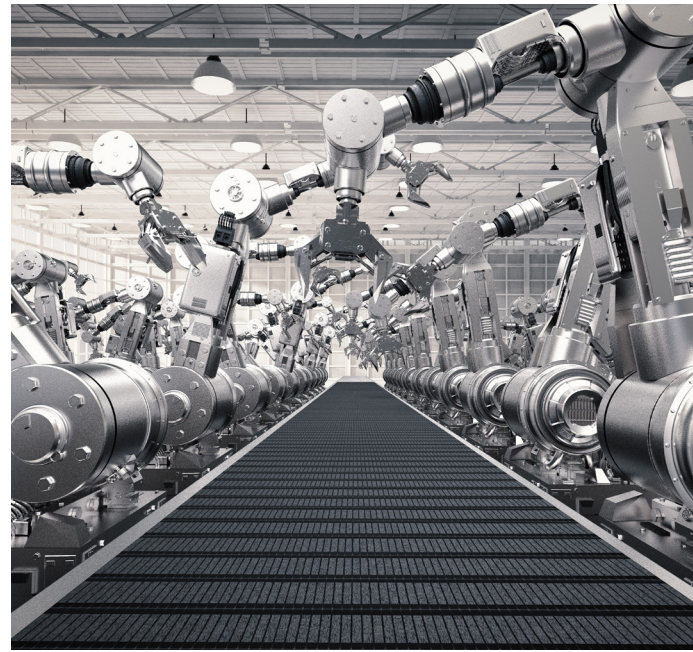
## Digital

### Current business climate driving manufacturing companies to build digital muscle

The velocity with which the fourth industrial revolution is progressing is now challenging manufacturers to roll up their sleeves even more to keep the momentum going as they achieve various milestones along their digital journey. Early successes have increased many companies' appetites for further digital exploration and investment. However, the current labor and trade uncertainties within the global manufacturing industry could stall digital progress. Therefore, in recent months, many companies have shifted their efforts toward digital projects that build agility and scalability to help them to manage risk.

Digital "muscle building" can be one of the leverage points to increase flexibility in global supply chains. Applying artificial intelligence, cloud computing, advanced analytics, robotics, and additive manufacturing to the value chain can increase visibility and transparency, allowing manufacturers to make faster changes to operations to respond to market-based threats or opportunities. As manufacturers continue to seek out the bright spots in the global landscape—including emerging markets—their ability to flex production, delivery, and customer support will continue to be important.

Shifts in sourcing (and thus production) are already playing out on the global stage. US imports from China were down 12.7 percent in the first eight months of 2019 versus the same period in 2018. Meanwhile, US imports from Mexico were up 5.9 percent, and US imports from Vietnam were up 37.4 percent.<sup>4</sup> In a matter of months, manufacturers have shifted both sourcing and production to different geographies, seeking tariff-friendly combinations. For manufacturers, this must be executed precisely given lead times (and even customer approvals) for both original equipment and their highly profitable aftermarket components. These focal points are likely to continue for 2020, as they support manufacturers' efforts to build digital into the core of their supply networks and improve risk management in uncertain conditions.



# 3

## Supply chain ecosystem

### Manufacturers are turning to partnerships for digital momentum

As manufacturers think about building agility into their supply chains, there is increasing realization that these efforts cannot occur in isolation. The need to cultivate a strong ecosystem is a trend that has emerged, and our research shows that it is an increasingly effective strategy for manufacturers, especially as it relates to digital momentum. The way this trend will likely play out in the coming year is twofold.

First, many manufacturers are actively mobilizing partnerships within their ecosystem that can drive targeted business goals, ranging from bolstering a traditional area (e.g., improving customer experience) to adding new capabilities (e.g., creating new business models). Recent Deloitte research showed that a group of digital front-runner manufacturers were executing in these areas at a much higher rate than their peers. For example, these front-runners pursue partnerships to create new business models at 5x the rate of others and to create new value for customers at 2x the rate of others.<sup>5</sup> Additionally, we have seen this play out in the factory. Leaders in smart factory initiatives are partnering across their ecosystems at a significantly greater pace than their peers—including with suppliers, channels, and customers—to drive higher productivity and output.<sup>6</sup>

Second, forward-leaning manufacturers are expected to continue to seek expansion of their ecosystems to source the capabilities required to satisfy their strategic vision. Many of these capabilities include digital technologies applied to existing manufacturing processes or ones that create customer stickiness. As per our analysis, approximately one in four deals in the manufacturing space over the past two years can be linked to companies with digital value propositions, and the appetite for these capabilities is likely to continue in the coming months. Given the relative premium value on digital capabilities in the market, however, it may be more likely that 2020 will bring partnerships and joint ventures rather than outright acquisitions.



# 4

## Social responsibility


### Manufacturers are transitioning to renewable energy sources

Corporate social responsibility is increasingly important for manufacturers. [Deloitte's 2019 global Industry 4.0 readiness study](#) identifies more than one-fourth of manufacturers as “Social Supers”—manufacturers who express a genuine commitment to improving the world. They believe societal initiatives are fundamental to their business model and contribute toward profitability. Social Supers are ready to develop or change their products and services to make a more positive impact on the environment. And, being good appears to pay off: 40 percent of Social Supers report that these initiatives have helped them to generate new revenue streams.

One way these “Social Supers” demonstrate their commitment is by taking operational steps (like carbon reduction) to improve the environmental impact of their business. As the [Deloitte survey about the transition to 100 percent renewables](#) indicates, 64 percent of manufacturers surveyed plan to source a significant percentage of their electricity from renewable resources over the next five years. Apart from reduced carbon footprint and societal impact, more than one-third of manufacturers agreed that this transition will help them to diversify their energy dependency and reduce costs.<sup>7</sup>

The commitment toward green and clean energy continues in 2020 as numerous manufacturers experiment with multiple renewable energy resources for current and future energy procurement, including solar, wind, hydro, and geothermal.





# 2020: How will manufacturing weather the storm?

The coming year promises to be an ever-changing environment for manufacturers as they try to regain their footing amidst continued volatility in costs and policy decisions. While the potential for uncertainty may continue for the foreseeable future, manufacturing leaders should increase resilience in their operations and double down on the core of their portfolios. Levers to support this include building “digital muscle” across areas like the supply chain, mobilizing partnerships within their ecosystem to drive targeted business goals, and leaning into corporate social responsibility. Manufacturing leaders can begin by examining current supply networks and considering how they could build additional agility throughout, including adding digital technologies that increase visibility and transparency to drive the ability to flex production and resources as necessary.

# Endnotes

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# Let's talk



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