CANADIAN MANUFACTURING OUTLOOK 2015

The time to invest is now

Foreword

The last year has been challenging for economies around the world – including Canada's. The sharp decline in oil prices and the falling Canadian dollar against the US dollar have reshuffled some of our strongest performing industries and caused many Canadian companies to rethink their strategies for 2015 and beyond. Overall, Canada still performed well in 2014, posting an increase in GDP of 2.5 percent over the previous year.[1]

Canadian manufacturers' risk averse attitude proved a boon for the economy up until now, helping Canada achieve its steady economic growth – but it is not enough to move us forward. If we maintain our "slow and steady" approach, we will be caught off guard by the rapid changes transforming the global economy today, changes that we need to embrace if we are to continue to succeed.

Today, being risk averse is the real risk. Instead, Canadian manufacturers need to invest now in their futures and take the risks that make sense.

New Markets

Canadian manufacturers have been reluctant to move into markets outside of North America because of the risks involved, but to continue to meet the needs of customers, they need to collaborate and communicate more with them – and be in the markets they are in.

Innovation

Regulations and environmental targets set for 2025 are driving innovation across the automotive sector, for example, and Canadian manufacturers in this sector need to invest now if they are to keep up.

Talent

Attracting and maintaining the skilled people required to enter new markets, and manage and keep pace with the technology and innovation that many leading manufacturers are already focused on requires investment as well, especially given the global talent shortage organizations around the world and across industries are experiencing even today.

1 Canadian economic accounts, fourth quarter 2014 and December 2014, http://www.statcan.gc.ca/daily-quotidien/150303/dq150303a-eng.htm

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The Canadian government understands that investment in our manufacturing sector is vital to Canada's future economic success. On April 21, the 2015 Federal Budget highlighted some key elements to encourage investment in the Canadian manufacturing sector, such as a 10-year tax incentive to boost productivity-enhancing investment, $100 million over five years supporting product development by auto parts suppliers through the new Automotive Supplier Innovation Program, and $2.5 million per year to increase the analytical capacity of the Defence Procurement Strategy.[2] The extension of the accelerated capital cost allowance in 2013's Federal Budget also continues to benefit Canadian manufacturers for the 2014 and 2015 fiscal years when it comes to deferring taxation and improving the financial return from investments in eligible manufacturing or processing machinery and equipment.[3]

Now is the time for Canadian manufacturers to take advantage of these incentives.

Some of today's largest and most successful global manufacturers are stream-lining their supply chains. If Canadian manufacturers want to continue to compete with companies like these, they need to invest in the skilled people, innovative processes and collaboration tools that will help them drive efficiencies in their own supply chains – and not be left behind.

Robert Jolicoeur
National Industry Leader
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Don Matthew
National Sector Leader
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2 *Budget 2015*, Chapter 3.1 – Supporting the Manufacturing Sector and Investing in Advanced Research, http://www.budget.gc.ca/2015/docs/plan/ch3-1-eng.html

3 *Canada's Economic Action Plan 2013*, Programs and Benefits, Tax Relief for New Manufacturing Machinery and Equipment, http://actionplan.gc.ca/en/initiative/tax-relief-new-manufacturing-machinery-and

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Executive summary

Throughout the last few years of recession, Canadian manufacturers have chosen to play it safe, putting innovation and investment in R&D on the back burner, and storing up cash until the tide turns.

The time for investment has come, but Canadian manufacturers still seem reluctant to take risks.

While 32 percent of global manufacturers indicate increasing R&D and developing new products is their top strategic priority for the next one to two years, the same is true for only 17 percent of Canadian manufacturers. What is more, the top two strategies for driving new growth and innovation among global manufacturers are adopting new manufacturing technologies (48 percent) and increasing R&D spend (44 percent), compared to only 20 percent and 13 percent for Canadian manufacturers, respectively.

Canadian companies risk falling behind their global counterparts if they do not take the risks and invest in the areas that will help them remain relevant and competitive in the future.

Three of the most significant findings from the survey are:

- **Engaging in a global or emerging market strategy can be a huge step toward achieving sales growth – the top priority for Canadian manufacturers.** Success in achieving this has been slow as manufacturers have been hesitant to move into markets outside North America because of the risks involved. To keep up with the impending rapid pace of change, and opportunities in new markets, manufacturers should first evaluate where it is most cost effective for their company to produce, followed by determining where their customer base is and how best to access it.

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- **Canadian manufacturers have an opportunity to gain significant strategic and costing advantages by embracing supply chain visibility and collaboration, making supply chain a key strategic focus and ensuring it has representation at the leadership table.** Investing in supply chain efficiency is seen as lower-risk than investing in areas such as breakthrough innovation, in which the costs and risks can be substantial and the wait time for a return on investment can be long. Canadian manufacturers have historically lagged their global counterparts and they continue to do so.

- **Canadian companies can benefit from looking at talent from a risk perspective, analyzing what talent risks they face and putting the right systems in place to address and mitigate them.** Organizations across industries are facing a global talent shortage. In an era in which properly managing gaps in talent can mean the difference between success and failure, Canadian manufacturers indicate talent is not a serious concern. That does not mean it should be left unaddressed and creating a plan for recruiting and maintaining quality talent now and in the future should be a key focus for them.

Sales growth, supply chain, HR – all three areas can benefit from the valuable data that today's sophisticated IT systems can gather. Using the Cloud on a subscription basis has made access to such systems more cost effective than ever before, taken some of the risk out of the equation and made it a real option for many Canadian manufacturers. Thanks to the Cloud, manufacturers have better opportunities today to gain actionable insights and drive cost efficiencies across everything from supplier relationships to sales strategies.

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01 Growth and innovation

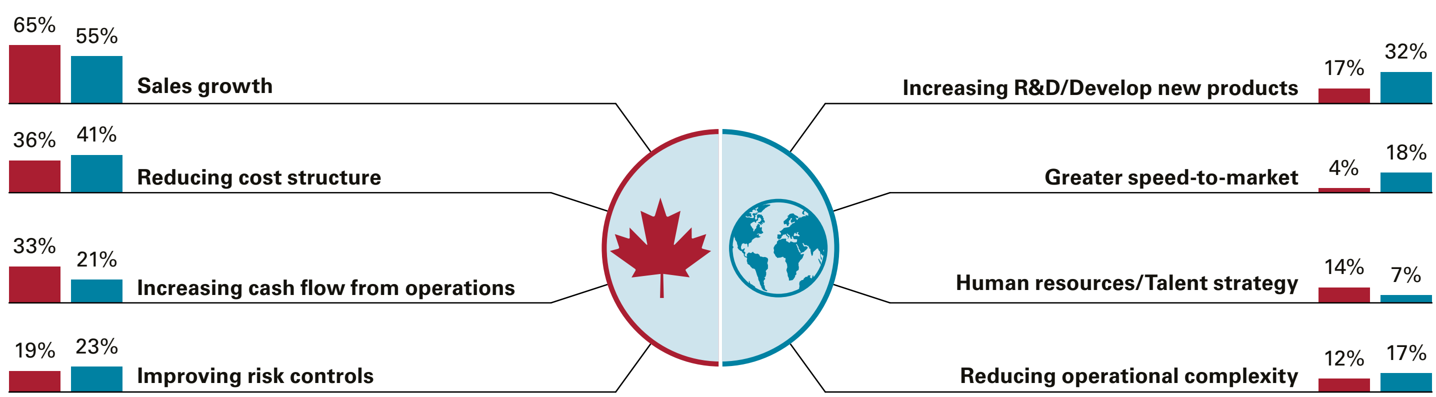
Slow and steady isn't winning the race

Canadian manufacturers' gradual approach to investing in growth and innovation is not keeping pace with global competitors. Changing their strategic focus to areas such as new markets to drive sales growth and boosting R&D investments can help ensure they aren't left behind.

The sharp drop in the price of oil and the Canadian dollar against the US dollar caused shifts in some of our most prominent industries in the last 12 to 18 months. With such volatility in the market, it is no wonder Canadian manufacturers continue to focus on the essentials. For the third straight year, revenue growth ranked as their top strategic priority (65 percent).[4] Reducing the cost structure (36 percent) ranked second and increasing cash flow from operations (33 percent), third.

When asked how they plan to drive new growth and innovation, Canadian manufacturers indicate their top two strategies are entering new geographic markets, and channel expansion (36 percent each), followed by entering new product segments, and new partnerships to drive innovation (32 percent each).

Strategic priorities over the next 2 years



4 *Canadian Manufacturing Outlook 2014*, p. 7, http://www.kpmg.com/Ca/en/IssuesAndInsights/ArticlesPublications/Pages/Canadian-Manufacturing-Outlook-2014.aspx. *Canadian Manufacturing Outlook 2013*, p. 5, http://www.kpmg.com/Ca/en/IssuesAndInsights/ArticlesPublications/Pages/Canadian-Manufacturing-Outlook-2013.aspx.

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Looking to new markets to drive sales growth

The Canadian market alone isn't going to feed the growth that Canadian companies need. To stay competitive in a global marketplace Canadian manufacturers need to ask themselves two main things:

Where is the future consumer and how can we access that market?

Growth is coming from exports and foreign markets, including Indonesia, Vietnam, and ASEAN nations. With only 5 percent of Canadian export-viable companies trading globally,[5] opportunities for growth are being missed. Canadian manufacturers should consider moving production closer to their consumer base in those emerging markets. Look at joint ventures to facilitate entry into new markets and to distribute goods. Joint venture partners know their markets, understand the government and regulatory environments, and have established supply chains. With joint venture partners, Canadian manufacturers can ask themselves what type of company they want to be. Take the time to look forward five to ten years and determine how you can mitigate the competitive risks that may emerge.

Where is it cost effective to produce?

Evaluate where the quality of manufacturing is best in terms of infrastructure, labour, and the costs of both. Canadian manufacturers should explore whether it makes more cost sense to enter other markets for production. Not all Canadian manufacturers are large enough or have the global footprint required to make on-shoring cost effective. Fear of the unknown is limiting manufacturers from exploring new markets, but information is everything.

5 Export Strategy Report: May 2015, https://www.bot.com/Portals/0/unsecure/Advocacy/TAPGTA_Export_Strategy_Report_2015.pdf

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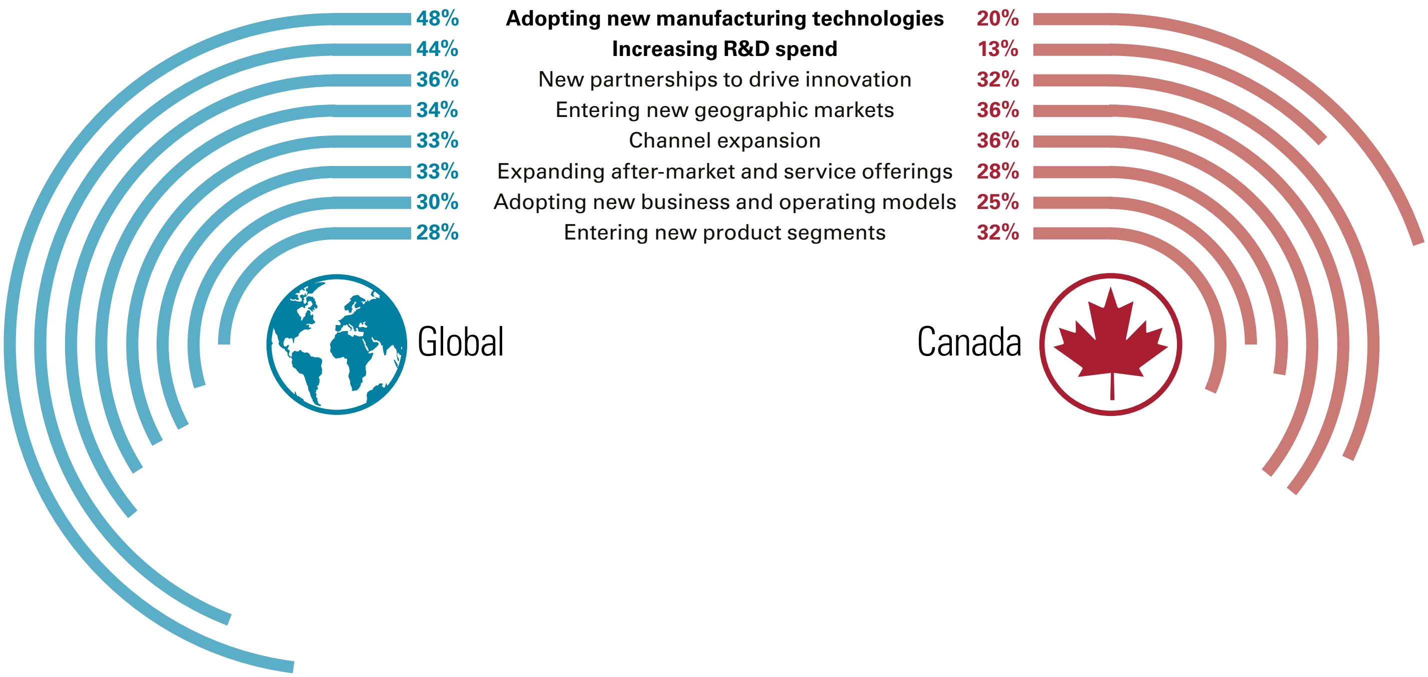
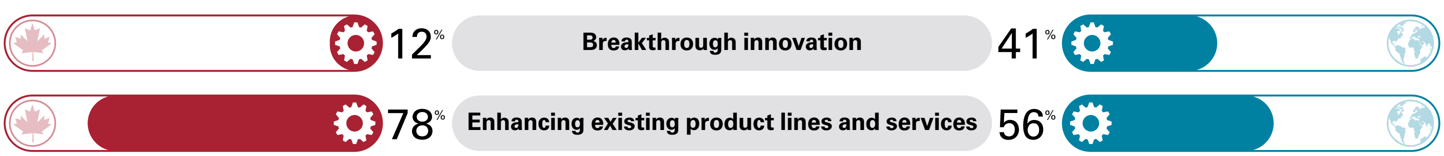
Organization's focus to drive growth & innovation



Taking on additional risk and spending more in R&D (13 percent) should be a key driver for growth and innovation, but most Canadian manufacturers do not share this view. Instead, they look to enhancing existing product lines and services (78 percent) over the short-term of one to three years (55 percent), rather than breakthrough innovation (12 percent) that tends to happen over the long-term of three to five years (15 percent) or more. In fact, only a quarter (26 percent) of manufacturers agree their R&D department is focused on longer-term (5 to 10 years) innovation strategies.

Primary strategy for pursuing innovation



It is clear that Canada has a short-term focus, preferring to develop products incrementally rather than putting all their eggs in one proverbial innovation basket and focus on pure research. Breakthrough innovation can take longer, is more risky and costs more – and Canadian companies are not willing to take the risks. Instead, 80 percent prefer to adopt more collaborative business models with suppliers and customers and 63 percent say partnerships, rather than in-house efforts, will characterize the future of innovation.

Because of our risk-averse culture, Canadian manufacturers can be thought of as "doers" rather than "innovators", which is borne out by what they describe as their primary motivations for innovation: lowering cost (28 percent), accessing new technology (27 percent) and reducing risk (16 percent).

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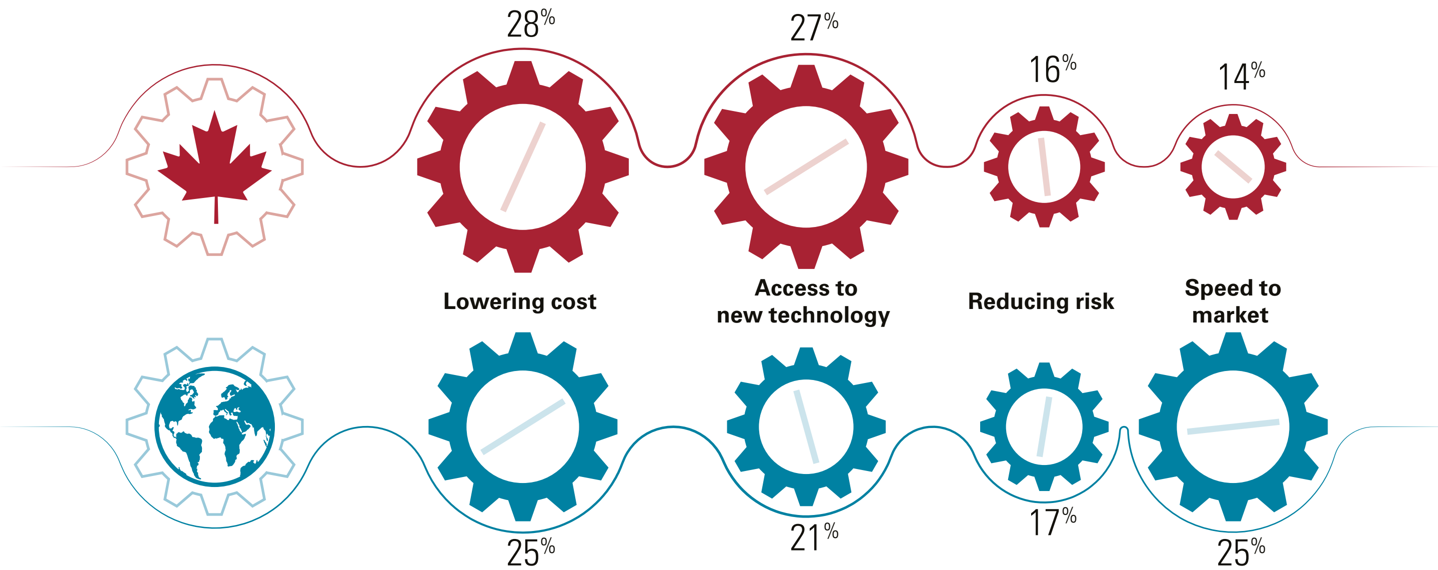
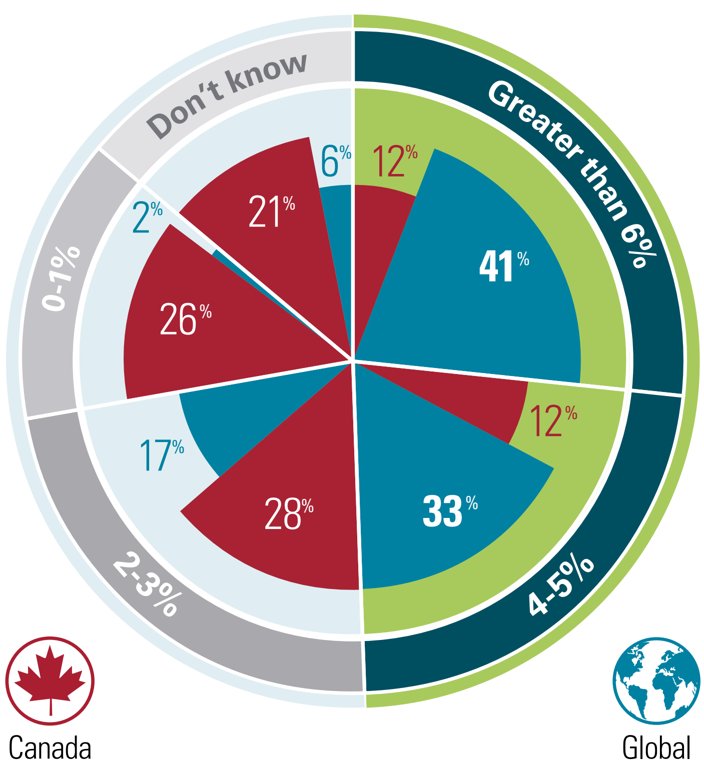
Primary motivation for collaborating on innovation



Add to this the fact that most spent between 0 and 3 percent of revenue on R&D and innovation over the last two years (56 percent), and they plan to do the same over the next two years (54 percent), and it is clear that R&D and innovation is not an area of critical focus for Canadian manufacturers.

This is low compared to global manufacturers, 59 percent of which spent more than 4 percent of revenue on R&D and innovation over the last two years, and 74 percent of which plan to do the same over the next two years.

Investment on R&D and Innovation



This suggests Canadian manufacturers may be unprepared for the changes on the horizon for environmental targets around greenhouse gas (GHG) emissions set for 2025. The potential for incredible manufacturing innovation is possible. Innovation in the automotive sector, for example, is affecting everything from the kinds of metals used in parts manufacturing – moving toward an increased use of materials such as aluminum to help make vehicles lighter and more fuel efficient – to the technology involved in ensuring engines produce fewer GHG emissions.

With the investment incentives recently announced in the 2015 Federal Budget[6] and the focus on innovation by many leading global manufacturers and their suppliers, if Canadian manufacturers want to stay in the game, they will need to access some of their unused capital or explore financing options – and invest.

6 *Budget 2015*, op cit

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02 Integrated and cost effective supply chains

Information replaces inventory

When effective supply chain communication and collaboration happens, information replaces inventory and manufacturers can run leaner, be more efficient, and gain advantages over competitors that have months or even years' worth of inventory in reserve.

When we spoke to Canadian manufacturers about their supply chains, their risk-averse nature was evident, as was the lack of top management focus on this important part of business operations in today's global economy. Anywhere from 20 to 25 percent consistently indicate they do not know how to respond to questions covering everything from their top strategic supply chain priorities (22 percent) and challenges (26 percent) to their visibility into supply capacity information (25 percent) or the obstacles preventing them from adopting new technology for critical supply chain communication (25 percent). This clearly indicates that for a significant portion of Canadian manufacturers, supply chain is not a key priority.

Top strategic priorities for supply chain

Given, however, that Canadian many manufacturers are looking at entering new geographic markets and channel expansion as key ways to drive growth they could benefit from having greater strategic focus on their supply chain.

Many times, companies view the supply chain as a cost centre, because traditionally they only see the physical part of it, such as transportation, distribution, etc. Much of the success and strategic capabilities in the supply chain, however, now lie in the parts that really connect it to the rest of the business, such as vendor-management, procurement, and customer-analytical demand planning.

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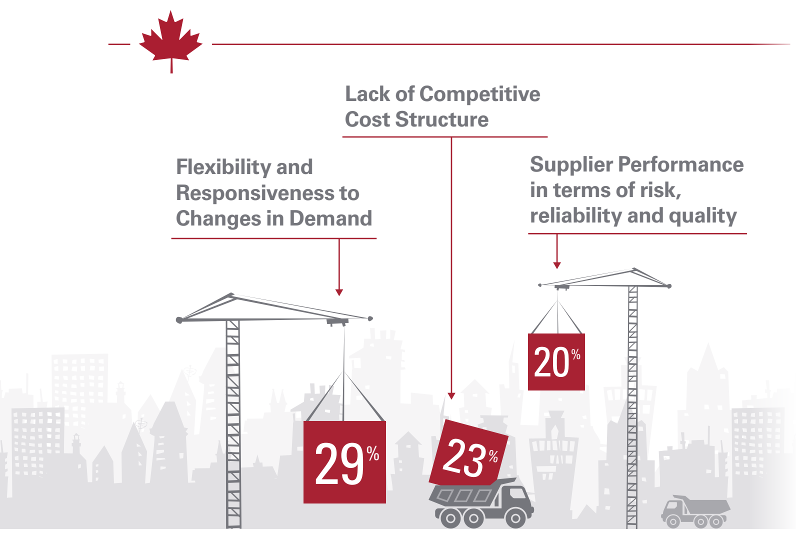
Having a clear focus on the supply chain also impacts competitiveness. If a company has never addressed its supply chain effectiveness, it can take advantage of low-hanging fruit to dramatically reduce costs, helping to drive customers away from competitors and straight to their front doors.

The majority of Canadian manufacturers understand the intrinsic benefits of creating a more efficient supply chain, since lowering costs and working capital levels (52 percent) and restructuring to support growth (20 percent) are their two top supply chain priorities. Fine tuning the supply chain, however, and drawing more strategic value out of it is not as apparent, since segmenting and tailoring supply chain assets and processes based on specific product needs, customers' needs, and demand profiles is their lowest priority (9 percent).

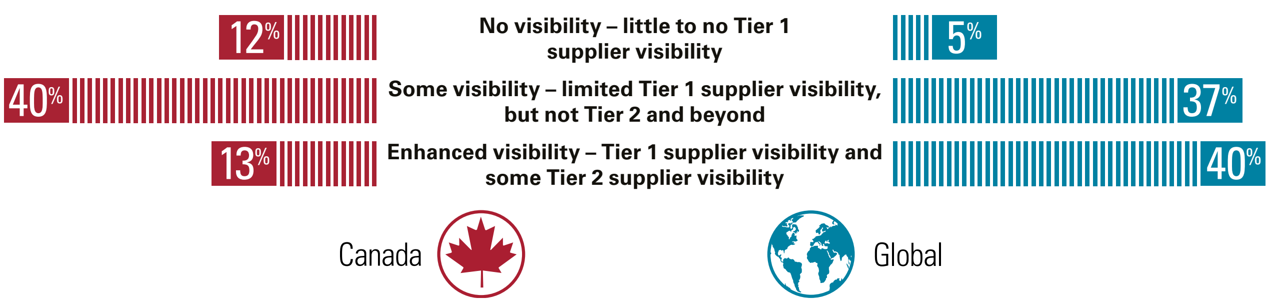
Top supply chain challenges



When asked what their biggest supply chain challenges are, most manufacturers cite flexibility and responsiveness (29 percent), along with lack of competitive cost structure (23 percent), and supplier performance in terms of risk, reliability and quality (20 percent). Inadequate IT systems for supply chain visibility, planning and execution (9 percent) and lack of information and material visibility across the extended supply chain (2 percent) are less of a concern, suggesting Canadian manufacturers are happy with the supply chain data their IT systems are providing.

At the same time, however, more than half (52 percent) have either no visibility or limited visibility across their suppliers and logistics partners, and a quarter don't know how much visibility of supply and capacity information they have.

Supplier Visibility



IT systems are required to support communication and cooperation within the supply chains, but they are not the triggers. Manufacturers already have necessary information to start the process of sharing. Size of the company is not an issue either. In fact, many leading small to medium sized enterprises across Canada are moving toward using innovative strategies and approaches, such as Collaborative Planning, Forecasting and Replenishment (CPFR), and other tools to increase collaboration within the supply chain to great success.

The triggers to more integrated planning are the decisions by top management to share information on all sides of the supply chains, along with properly defined and disciplined processes.

Only one fifth of Canadian manufacturers indicate they have a global VP (or senior leader) for global supply chain whose mandate is to ensure integrated procurement and supply chain efficiency globally – and the companies that do not could benefit from more representation at the C-suite level.

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When supply chain, as a stand-alone function that is not part of marketing or sales, has a role in the ongoing strategic direction of the business, it can have a significant impact on the company's top and bottom lines and help it achieve its key growth goals. Moving supply chain from being a "necessary evil" to a "strategy enabler" is a winning approach for companies who wish to succeed in today's highly competitive global market.

The reluctance to collaborate and cooperate with the supply chain may once again be due to Canada's risk-averse culture. When companies share information among supply chain partners, they risk the information becoming public or suppliers using the data to drive prices up. This risk needs to be weighed against the potential payback, however, which can be substantial.

In the absence of complete visibility, businesses all along the supply chain use forecasts to help ensure they always have enough inventory available. With the valuable information that increased visibility, communication and lean manufacturing techniques bring, however, the supply chain can become more agile and can quickly react to demand changes or the introduction of new products without suffering from high obsolescence costs.

For some companies, therefore, being risk averse when it comes to their supply chains actually increases their business risks. When the benefits can be so huge, taking the risk and opening up the supply chain to collaborative processes is often more than worth the payoff.

How best-in-class companies improve their supply chain performance

Companies that develop "best in class" supply chains focus on improving their everyday performance and use all available means to stay ahead of the market including:

Collaborate with all parties across the value chain and establish strong alliances. Use new technology to improve transparency of orders, inventory and shipments across extended supply chains.

Align the supply chain strategy and related initiatives with the overall business strategy. Ensure strong cross-functional participation in planning and strategy development, and execution.

Meet continued pressure to drive down costs and working capital levels.

Instill a performance culture and consider deploying *Lean Manufacturing* in cases of low variety, high volume production, and *Agile Manufacturing* in cases of high variety, low volume production.

Create operational flexibility to adapt to a constantly changing market. Anticipate and adapt to increasing product diversity and innovation.

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03 Strategic priorities

Bringing talent to the top

A focus on talent is important for manufacturers executing on innovation strategies because, to achieve success, many of the same people are needed from the blueprint stage straight through to launch.

Focusing on increasing sales and streamlining operations to reduce costs is a strategy that has worked well for Canadian manufacturers over the last four years. Areas that could benefit from greater focus and attention, however, continue to rank low among the manufacturing C-suite. Developing a talent strategy, for example, is a top priority for only 14 percent of Canadian manufacturers and only 7 percent of global manufacturers. Achieving a greater speed to market also ranked low as only 4 percent of Canadian manufacturers indicated it is a key priority. This is in sharp comparison to global manufacturers, 18 percent of which indicated speed to market was a key priority.

These two areas represent opportunities for Canadian manufacturers to gain competitive advantage now and contribute to the revenue growth they prioritize so highly. Talent shortage is a concern for companies across all industries, including those in our survey, who rated talent shortages as their fourth biggest challenge (19 percent).

Challenges for manufacturers over the next 2 years

Many of today's high-performing companies are implementing smart, efficient strategies to retain talent and reduce the negative impact on their businesses if they lose key talent including the costs associated with finding, hiring and training the right people.

Increasing focus on talent retention for the longer term is particularly critical if manufacturers are trying to execute on innovation strategies. While such strategies might be conceived of in one year, they may require many of the same people to help ensure they come to fruition in subsequent years.

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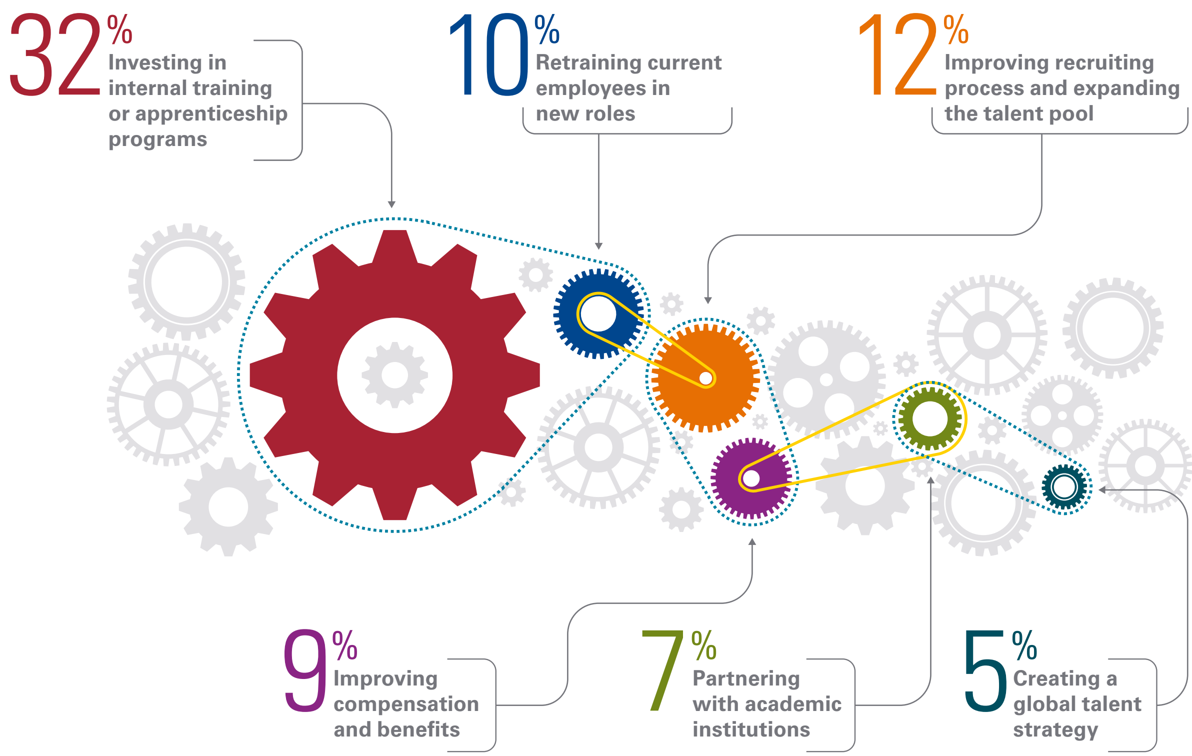
Top method Canadian manufacturers are using to address the global talent shortage



Investing in internal training or apprenticeship programs was ranked the most important method for addressing the global talent shortage by 32 percent of manufacturers. Improving the recruiting process and expanding the talent pool was ranked number one less than half as many times (12 percent), and creating a global talent strategy was rated the top method by a mere 5 percent of Canadian manufacturers.

This suggests Canadian manufacturers have some catching up to do. While each of these top six methods of managing the global talent shortage should be investigated and considered, manufacturers first need to develop their plan and set their strategic talent goals in order to determine which method they should focus on to help achieve them. Even if some Canadian manufacturers are not global in scale just yet, they need to start broadening their perspectives on their talent strategies – because talent knows no borders when it comes to finding the right fit.

When it comes to having a clearly articulated strategy that outlines priorities for the next three to five years, the majority of Canadian manufacturers believe they are in good shape (80 percent). To see these strategies come to fruition, manufacturers should be making strategic decisions which factor in talent among other priorities, will drive operational cost decisions, helping these companies achieve their goals for reducing cost structures. It will also make these manufacturers more nimble and responsive, and help give them the competitive edge they need to accomplish their number one priority – increasing sales.

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Allocation of total technology spend on HR systems (1-20%)

Anywhere from 30 to 39 percent of manufactures do not allocate any funds to sales force management, HR, ERP, engineering/manufacturing/supply chain, or customer facing systems. Traditionally, the cost for implementing IT systems dedicated to any one of these areas has proved prohibitive for many Canadian manufacturers.

The advent of Cloud Computing, however, has brought the cost for such systems down to a more manageable level. In addition to not having to invest capital costs in expensive software and hardware, and the human resources to manage them, companies using the Cloud purchase access to the systems on a subscription basis, which they can manage as a monthly or annual operational expense.

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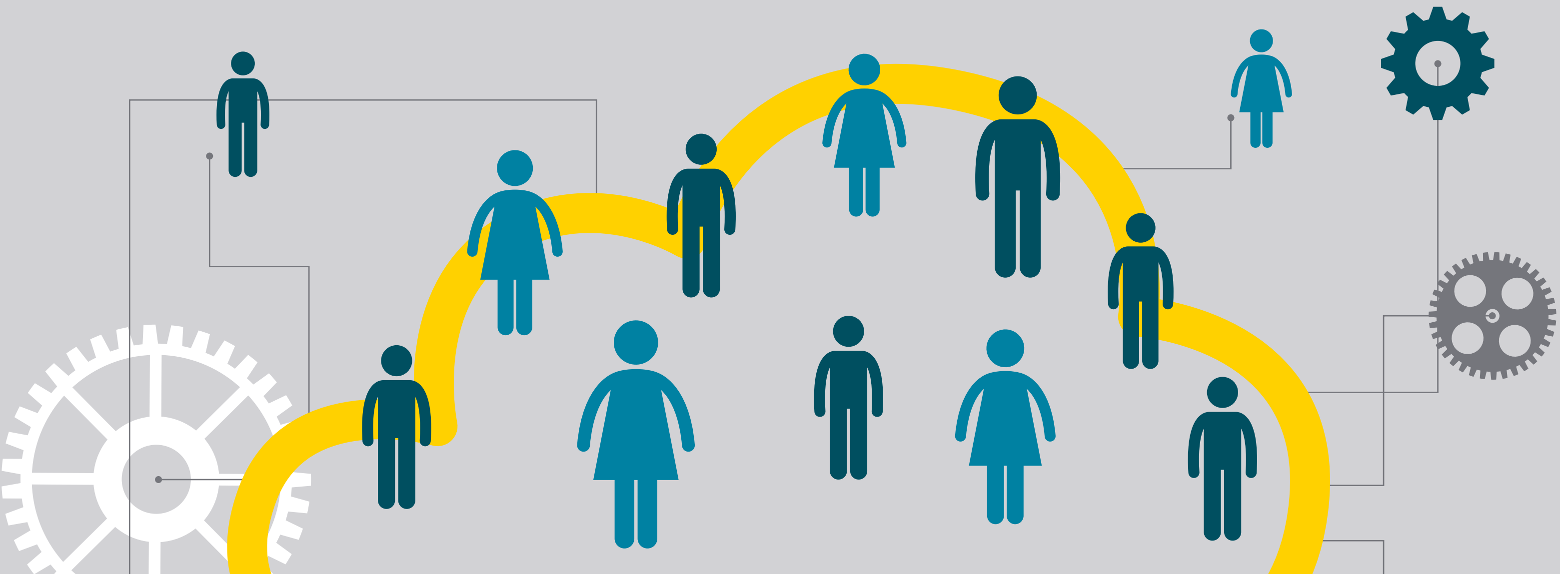

Looking at talent from a risk perspective

When asked how much of their technology spend is allocated to HR systems, the largest number – 51 percent – indicate they spend between 1 and 20 percent. This is a positive sign, indicating Canadian manufacturers have the analytics that can help them track, understand and develop their talent, and make effective talent decisions.

The right systems can monitor where their people are in the recruiting process and, once hired, provide insights on their development throughout their careers, as well as identify areas of talent risk. In the past, such systems were expensive to buy and maintain, but with the advent of the Cloud, they are becoming more affordable. Once in the Cloud, the systems can also integrate with learning management and other HR systems, to help provide even more valuable, integrated talent data.

Before even considering the purchase of either traditional or Cloud-based technology, however, companies need to first create a strategic talent plan. The best place to start is to look at talent from a risk perspective, including risks associated with costs, capacity and capability, which helps focus the company on where it should direct its efforts around HR programs.

Is the company not attracting enough people? Is it having issues keeping people current in their skills? Is it not able to progress its people at the same pace as its manufacturing processes? Taking the time to identify and understand what the risk points are will help manufacturers develop appropriate strategies, including which systems will help them mitigate their risks and achieve their talent goals.

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Key takeaways for CANADIAN MANUFACTURERS

Sales growth and cost reduction continue to be the strategic mainstays of Canadian manufacturing. So is the tried-and-true preference to avoid risk in an effort to maintain consistently strong performance.

There are some areas, however, in which Canadian manufacturers can test more risky waters when it makes sense.

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Seeking growth in new geographic markets

While due diligence is required to determine where in the world it makes the most financial sense for your company to export or produce its goods, along with where your biggest markets are and how you can get closer to them, the benefits of expanding globally can be substantial. For most Canadian manufacturers, where sales growth is the top priority, having a strategy for moving into new markets should be a focus now, if it is not already.

Increasing supply chain efficiency through visibility and collaboration

There may be some risk involved in having complete visibility and collaboration along the entire supply chain, but it can also offer the potential to run a leaner, more efficient and cost effective operation, which meets one of the sector's two top strategic priorities – cost reduction. Running Lean Manufacturing is a must in today's global market and bringing supply chain to the executive table is as well.

Establishing a strategic talent plan

What are Canadian manufacturers doing about the global talent shortage? Currently, they are content with the HR systems they have in place to manage their people, but they could benefit even more from having a strategic talent plan in place. Such a plan would help them assess their talent risks regarding costs, capacity and capability, and help ensure they are focusing their efforts in the strategic areas that will benefit them the most, now and for years to come.

Harnessing the Cloud

Using the Cloud to access innovative IT systems data around sales, supply chain and HR, can help Canadian manufacturers better assess their sales initiatives, talent risks, and free up cash in the supply chain that would normally have been sitting on the shelf as inventory. It can make them more nimble and responsive, provide competitive advantage and give Canadian manufacturers the step up they need to achieve the growth they want.

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ABOUT THE SURVEY PARTICIPANTS

CANADIAN MANUFACTURING **OUTLOOK 2015**

ANNUAL REVENUE

$100 million

$1-$10 billion

Almost ⅔ **of Canadian** respondents indicate that their revenue is less than $100 million. **Globally** ⅔ of respondents indicate that their revenue is between $1-$10 billion.

Canada (%)

- Less than $100m
- $100m–$250m
- $251m–$500m
- $501m–$1bn
- Greater than $1bn

Global (%)

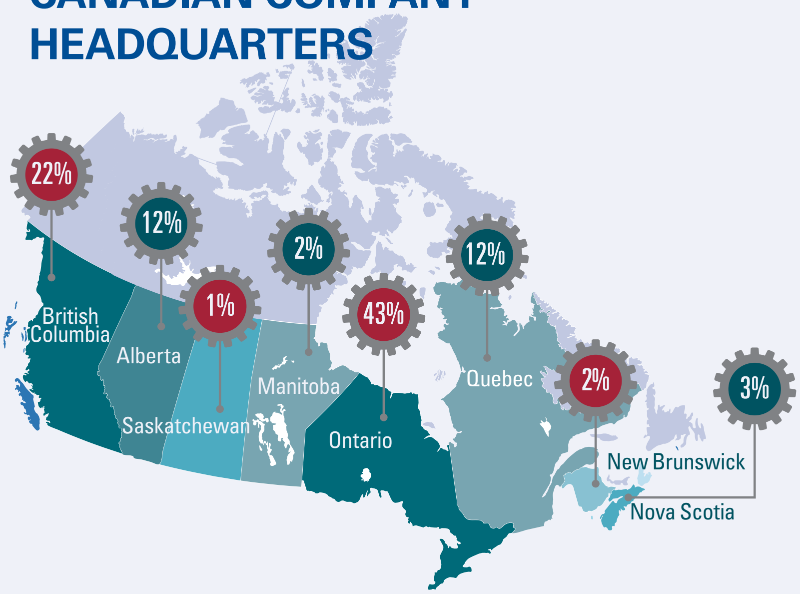
- $500m–$999m
- $1bn–$4.99bn
- $5bn–$9.99bn
- $10bn–$24.99bn
- More than $25bn

JOB TITLE

Canada

- 41% CFO etc
- 32% CEO etc
- 12% Senior VP/ Director etc
- 15% Other

CANADIAN COMPANY HEADQUARTERS



PRIMARY INDUSTRY

- 20% Industrial products, technology & electronics
- 19% Consumer products, food & beverage
- 7% Transportation
- 7% Construction
- 6% Financial Services
- 6% Automotive
- 6% Aerospace & Defence
- 4% Energy
- 4% Mining & Metals
- 3% Forestry
- 3% Chemicals
- 2% Biotechnology & pharmaceuticals
- 9% Others

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Industry Insights

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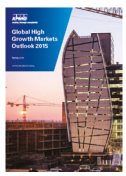
Some of our recent publications include:

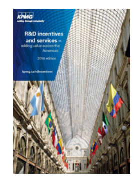


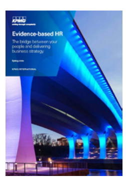
Global High Growth Markets Outlook 2015

Insights from more than 300 senior executives across the world's most mature markets on the opportunities and challenges in high growth markets.

R&D incentives and services – adding value across the Americas

This guide examines the tax policies behind R&D programs in 11 countries including Canada and the United States.





Evidence-Based HR: The bridge between your people and delivering business strategy

This report reveals that now is the time for C-level and HR leaders to embrace evidence-based HR or risk losing ground.

Competitive Alternatives

KPMG's guide to comparing international business locations in North America, Europe and Asia Pacific.

2015 Global Manufacturing Outlook: Preparing for battle

KPMG's annual report explores the steps that manufacturers around the world are taking to prepare their organizations for the innovation and technology-driven transformation that is to come.

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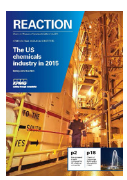
KPMG's Global Automotive Executive Survey 2015

KPMG's annual assessment of the current state and future prospects of the worldwide automotive industry

KPMG's Global Aerospace & Defense Outlook 2015

This report explores the challenges and opportunities present in today's A&D market and offers practical and forward-looking insights for players around the world.



Reaction Magazine

A magazine published three times per year by the KPMG Global Chemicals Institute. Each edition focuses on key issues impacting the chemical and performance technology industry.

KPMG Transport Tracker

In the four editions of this report, KPMG International takes a look at market fundamentals and M&A activity in the global transport and logistics market. It also features regular updates on the shipping and sea freight, aviation, and parcel and express logistic sectors, along with case studies.

Transport Perspectives

Each issue focuses on two highly topical issues currently impacting the transport sector. Article insights are available on aviation leasing, passenger transport, and postal services markets, plus many more.

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