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To: Clients, Associates & Friends of Pro@ctive CPA
From: Mark Wyssbrod, Managing Member
Date: November 1, 2011
RE: The Tide May Be Turning

The tide for the small business environment might be turning. But let's not get too over joyed for dangerous rip currents are around! However, the sun is out and the water feels good; just do not forget your life vest.

Small Business Environment

We have observed solid performance of small businesses so far this year. Generally speaking, revenues have grown and gross profit margins have stabilized (low compared to prior years, but stable). This is good news! So why are so many small business owners so stressed or frustrated?

One reason might be cash flow. Cash flow from operations is stable; however, cash flow to owners is lower. The forced process by financial institutions for small businesses to deleverage is mandating cash flow profits to reduce debts. The small business is left with profits, taxable income and minimal cash. The financial institutions don't understand these decrees are draining the very working capital and liquidity their borrowers need in order to begin to grow once again. Although it is easy to point the figure at the financial institutions, the business owners must take final responsibility and must learn from the past few year in order not to over leverage in the future. Let's not allow history to repeat itself again.

Potential Global Manufacturing Shift

The more I have learned about farming over my life the more respect I have for farmers. The planning and patience which is required is not found in the modern urban life of quick and massive amounts of communication. Briefly, the farmer must prepare the land, till the soil, plant the seed, weed and care for the crop, harvest and then take the final outcome to the market. This is a lot of hard work and it takes time. Patience is a virtue!

Businesses are the same with concept to market products and services. A great allocation of time and resources are used to develop the next generation of products and concepts. A large corporation can spend hundreds of millions (if not billions) of dollars on these next generation productions. Generally speaking, these concepts are initially conceived in the United States and other western countries which believe in intellectual property rights (i.e. patents). Then the product is manufactured in a different country with much lower wages. Usually the manufacturing takes place in Asia with the most popular example being China. Even with the cost of transporting and distributing the product from overseas the arrangement is profitable.

However, a few variables in the equation are changing. First, companies are finding out very quickly the country they are producing their goods in are not enforcing intellectual property rights. Companies are waking up to the fact that they have invested hundreds of millions (or billions) developing a product transferring knowledge to a factory to find out within two years the same factory is now their main competitor.

Second, wage rates in the Asian manufacturing countries have risen during the past several years. Compared to stagnant to lower wages in the Western counties has resulted in minimal wage difference. This may be due to an increase in overseas standard of living, a decline of the currency value of western countries or a combination of both.

Third, investors have not become fully aware of loss of intellectual property situation and are not calculating it into valuations. However, as profit margins begin to come under pressure investors will demand net profit growth. Activist shareholders may grow more influential in the future. A quick way to boost profits might be to stop giving away your knowledge free to your future competitor in lieu of short-term savings in labor costs.

Fourth, the cost of energy and transportation will continue to rise. To transfer massive amounts of goods across the seas or across continents requires fossil fuels. There are no solar powered freight trains or wind pushed ocean liners. The power of these resources is oil. Most economists and experts expect oil to increase in the future.

These issues and concerns are on a collision course and will result in a major shift of where high-end manufacturing takes place globally. The United States currently has excess capacity as well as excess work force. The United States also protects intellectual property rights. At the Georgia Society of CPA Real Estate Conference in June 2011 several commercial real estate brokers and agents mentioned seeing the signs of selective manufacturing returning to the United States. Additionally, the whispers of and the scouting trips by companies has increased. Of course, the same individuals all signed confidentiality agreements and could not mention names, dates or anything specific.

When I receive these data points I am led to believe the return of high-end and sensitive manufacturing will return to the United State within three to four years. This return will fuel jobs and housing along with other sectors of our economy. Small businesses will feed off of this new energy. The return may also increase global competition by increasing intellectual property rights and contractual agreements in counties which currently do not do so.

It is too early to get too excited. From aforementioned farming example, the land is prepared (via United States excess manufacturing capacity and employment) and the field is tilled (the whispers and scouting trips). Now our economy needs for these companies to plant their seeds!

I have been told that my views on this are “great for daydreams” and a “great what if” for the future. I am not trying to stir false hope. The questions remain for small business: how do they survive until then? How do they strengthen their financial position?

If you need help transforming and strengthening your financial position contact us and we will talk through your business model and strategy with you.