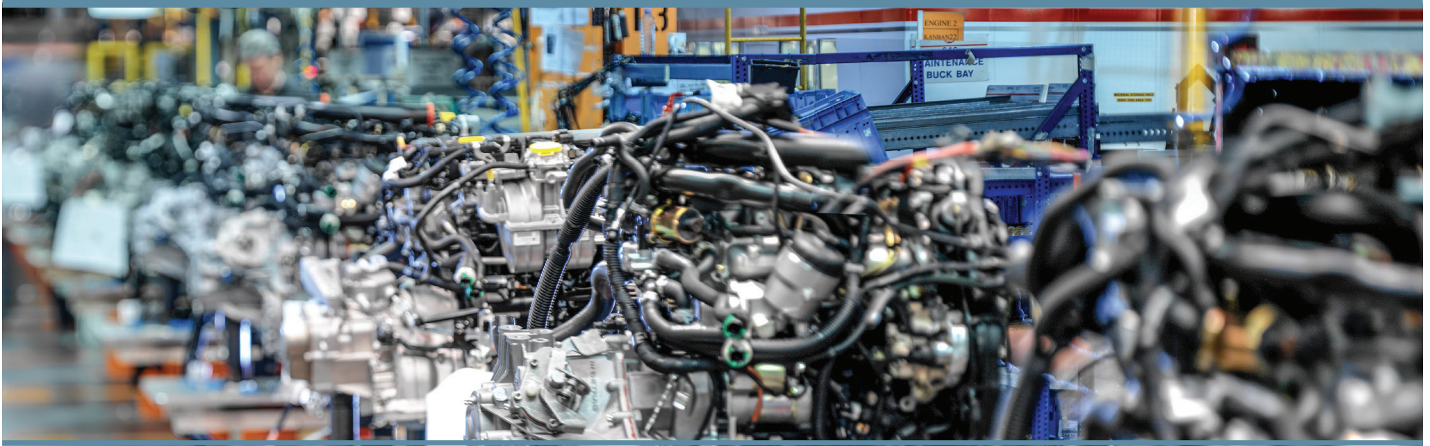

Executive Insights

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What's on the Minds of U.S. Industrial Manufacturers?

U.S. industrials have been facing a number of challenges over the past year and a half, resulting in slow end-market growth. They are also grappling with evolving value chain dynamics, a continuing stream of new technologies, and uncertainty about some of the regulatory and policy moves of the new administration.

Yet with every challenge comes an opportunity. By crafting the right strategic responses, today's U.S. manufacturing leaders can transform the way their companies operate and position their businesses to compete more effectively in the future.

Where should U.S. companies be focusing their efforts? L.E.K. Consulting spoke with a broad range of senior industrial manufacturing executives to get their take. These conversations, combined with our client work, suggest that four areas are of particular concern to the leaders of U.S. industrials.

Sales model transformation

U.S. manufacturers have traditionally gone to market with a product-centric sales approach that focused on selling their products and services based on features and benefits. But a number of trends are decreasing the effectiveness of this approach, pushing companies to adopt more customer- and outcome-centric business models.

Customers, in an effort to make their supply chains more efficient, are using fewer suppliers and at the same time demanding more value-added services and solutions from those that remain. The rise of the Industrial Internet of Things (IIoT), or Internet 4.0, has facilitated this process, allowing original equipment manufacturers (OEMs) to manage and repair equipment and deliver other services remotely. Advances in data analytics are also helping OEMs turn information gathered during the normal course of business into highly specific customer insights that they can then use to improve solutions and customer success.

There are significant benefits in being able to offer customers holistic solutions that meet their evolving needs. Above all, such solutions increase the "stickiness" of customer relationships: The more value the customers receive from a supplier, the more likely they are to continue and even deepen the relationship. In addition, higher-value solutions often command greater margins.

Leading organizations are revamping their sales approach to capitalize on these trends toward more customer- and outcome-centric strategies (see Figure 1). While organizing sales and marketing to align with the market is typically the first step in the evolution to a customer-focused organization, it is rarely sufficient. Rather, companies must take things a step further by integrating customer service, aftermarket sales and product development. They may need to develop new commercial skills, resources and management capabilities, as well as to redefine their governance structure and even their culture. Further developing an outcome-centric model may require whole new business models, delivery models, financing strategy and risk-mitigation capabilities.

What's on the Minds of U.S. Industrial Manufacturers? was written by **Eric Navales**, Managing Director, and **Rory Murphy**, Senior Manager, in L.E.K. Consulting's Industrials practice. Eric and Rory are based in Boston.

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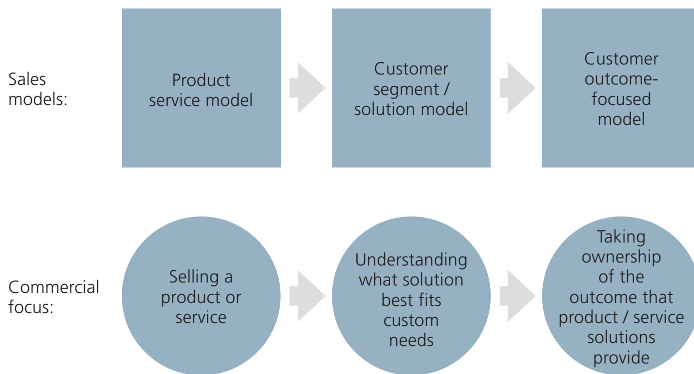
Figure 1
The evolution of a sales model



Source: L.E.K. analysis

Every company addresses these trends differently, often leveraging one over another. For example, Xerox created its Managed Print Services (MPS) offering as part of a strategy to reposition itself as a services company. When customers enroll in the program, Xerox takes over the maintenance and upgrades for all their printers and multifunction devices, as well as supplying paper and toner. Customers are charged based on the number of pages printed. This has allowed Xerox to minimize the impact of hardware commoditization and better align incentives with those of its customers.

Similarly, Philips introduced Light-as-a-Service as an outcome-centric, pay-as-you-go engagement model for customers seeking a managed services solution. Philips pays the upfront cost of installation and is compensated through a performance contract based on energy savings.

Disruptive technologies

New and emerging technologies — such as additive manufacturing, robotics and automation, and the IIoT — are upending industrial markets and reshaping demand for products. U.S. manufacturers must not only assess the impact of these disruptive technologies but also look for ways they can leverage them to achieve competitive advantage.

While most executives acknowledge that emerging technologies are both a threat and an opportunity, the actions they are taking to address the situation vary. Some companies are simply focusing on using technology to drive greater unit efficiency or operational productivity, but in some industry sectors new technology is already having a far more disruptive impact.

A case in point is the automotive industry. The rise of ride-sharing and future expectations regarding autonomous vehicles are changing demand for new vehicle sales and the manner in which U.S. automotive manufacturers compete. Each automotive company is taking different steps to strategically plan for an industry environment that is certain to be very different just a few years from now. For example, General Motors has partnered with Lyft, the second-largest U.S. ride-sharing company, with the intent of gaining access to a leading technology platform. This partnership will also help GM plan for a future that may rely less on owner-operated vehicles and more on ride-sharing fleets.

Technologies can disrupt a business or an industry in a variety of ways — for example, impacting unit efficiency, increasing or decreasing barriers to entry, altering the value chain, or changing overall market demand (see Figure 2). The strategic responses to disruption will depend on what aspect of a company's business is affected. For example, if industry barriers to entry begin to diminish due to a technology platform that leads to disintermediation, an appropriate response is to strengthen customer relationships and differentiate product offerings.

While it is impossible to predict exactly where the blow will land, companies can position themselves for the right strategic choices by conducting an in-depth analysis of the potential for disruption in their particular markets. Scenario planning and ongoing environmental scanning are critical to this process.

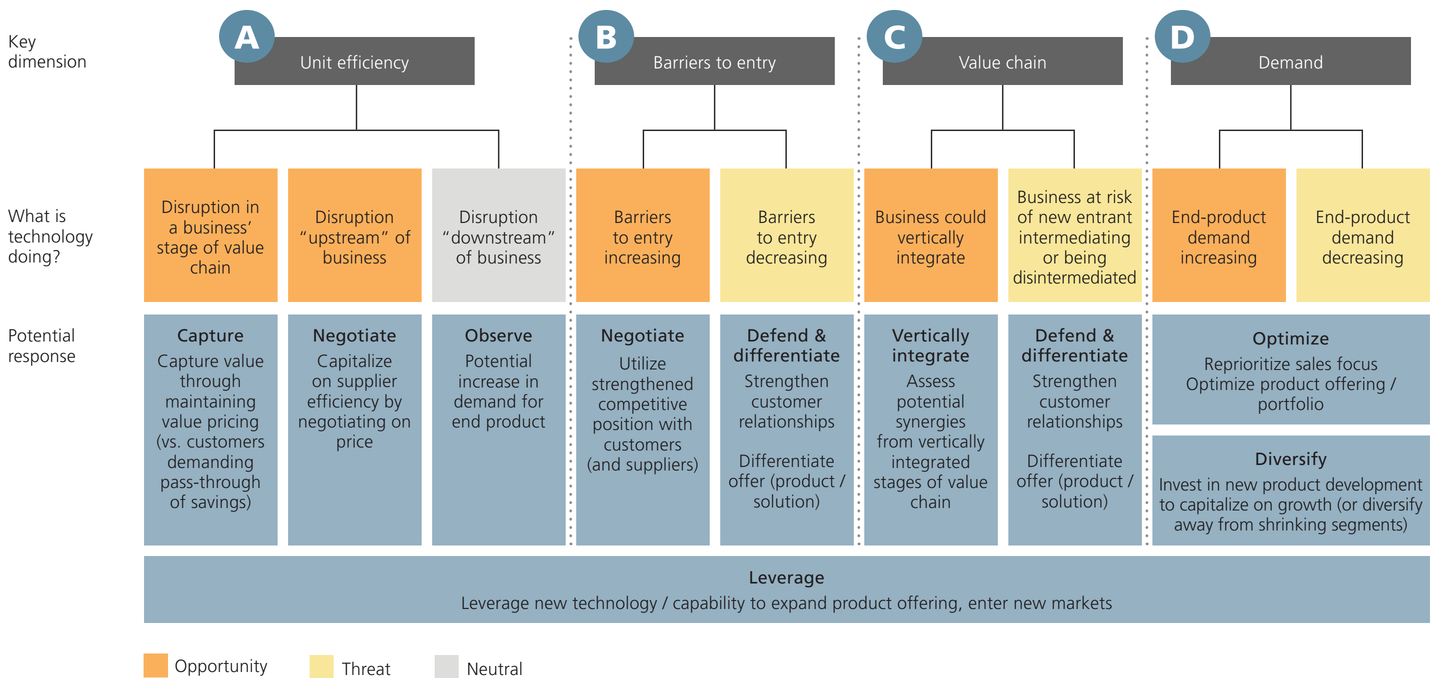
Dramatic shifts in the value chain

Industrial value chains are experiencing disruption on multiple fronts. As a result, many U.S. manufacturers are reconsidering where and how they participate in the value chain, and how they can enhance their position by focusing on higher-value downstream activities. This approach can mitigate potential margin erosion in the base manufacturing business or ensure downstream volume for high-cost upstream assets.

For instance, Millenia Products Group, a steel distributor, decided to vertically integrate into stamping, fabrication and assembly. This strategy improved supply chain efficiency in a number of ways. First, Millenia was able to avoid material price volatility by reducing the amount its distribution business sold when prices were low. Second, by leveraging its services across the value chain within a single facility, the company successfully reduced intermediary freight costs. Finally, Millenia improved its resource management through a closed-loop recycling management program.

As industrial manufacturers move downstream, they are increasingly establishing direct relationships with end users, circumventing traditional sales channels. This allows them to learn more about the needs of the end customer, opening up potential opportunities to expand into new areas such as aftermarket sales.

Figure 2
Potential responses to the impact of disruptive technology



Source: L.E.K. analysis

Increased economic and regulatory uncertainty

The pro-business stance of the current administration is expected to positively impact demand in certain end markets, especially those with ties to infrastructure and defense. Nevertheless, overall sentiment among U.S. industrials is a mixture of optimism and uncertainty. Initial exuberance over the potential for tax breaks and a rollback in regulations has been tempered somewhat by mixed signals regarding how much of this will actually happen in the near term.

Furthermore, changes in U.S. trade policy, including the proposed introduction of a 20% border tax, are causing U.S. manufacturers not only to assess the potential impact on their sales, but also to reconsider their entire global strategy. Large tariffs or other policies that discourage imports could lead to greater demand for domestically produced manufactured goods. At the same time, these policies could disrupt existing supply chains, limiting the quantity of components that are sourced abroad and leading to higher demand for domestically sourced products — as well as higher costs.

U.S. manufacturers must assess and prioritize where they look for growth in the coming years. They must also re-evaluate their global manufacturing footprint to determine how much — and what aspects — of their production they perform offshore and whether some of this production should be "reshored" to avoid negative press and the increased costs associated with a potential border tax.

The sheer number of unresolved issues means U.S. manufacturers need to be prepared for multiple scenarios. Keeping a finger on the pulse in Washington, and conducting ongoing scenario analyses, will allow them to respond quickly when and if the policy environment changes.

All eyes on the future

All told, U.S. industrials face significant challenges that have the potential to compromise future growth. Yet many of these challenges are also opportunities for gaining competitive advantage. Certainly, the changes required to leverage these opportunities will be significant. It will mean building new capabilities, revamping sales strategies, adopting new technologies, doubling down on innovation, improving competitive intelligence and trend analysis, developing more agile and responsive organizational structures, and finding ways to expand into new markets and geographies. But those companies that both embrace and implement these changes are the ones that will still be here tomorrow.

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