

WHERE THE MONEY IS: MANUFACTURERS HAVE SOME OPTIONS FOR RAISING CAPITAL

By Bill Virgin

Those high-tech guys. They get all the attention – and, it sometimes seems, all the money.

Come up with a social-networking app, or a one-hit-wonder mobile-phone game, and the world, in the form of angel investors, venture capitalists and the IPO market, can't throw enough money at you fast enough, even if you haven't quite figured out how you're going to make revenue from it, let alone earn a profit.

But if you're in an unglamorous, stodgy sector like manufacturing, with real products, revenues and profits, where are you going to find the dollars to finance a startup or expansion of an existing business?

As recent news items indicate, manufacturers are finding multiple avenues to finance their ventures, some well-established, some new and still evolving.

In the latter category is crowdfunding, in which entrepreneurs use one of the websites dedicated to the purpose of conducting a campaign to raise money from the public (like Kickstarter and Indiegogo).

Venues like Kickstarter are best known for artists seeking funds for videos, CDs and books, or for craft projects.

But product manufacturers have used crowdfunding, too. Seattle-based PicoBrew raised \$661,000 (its goal had been \$150,000) for development of a simplified home-beermaking appliance.

Less successfully, a Bellingham company, FlipOut Screwdrivers, tried a Kickstarter campaign to raise \$50,000 to develop a handheld power tool with a swiveling head. The company fell well short of its goal (on Kickstarter you have to raise all of your target amount within the stated period or you get none of it). The company says it plans to introduce the product anyway.

The drawback to crowdfunding campaigns is that companies can't offer what investors want most – equity and the promise of a return should the venture succeed. Kickstarter campaigns can offer swag like T-shirts or a chance to buy the product at a discounted price.

But now the Washington Legislature has addressed that

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question. In its most recent session it approved a mechanism for crowdfunding for small securities offerings.

Once in effect (the state is supposed to have the program ready to go by April 1, 2015), Washington companies will be allowed to sell shares of stock to Washington investors, up to \$1 million in a 12-month period. There are also limits to how much stock a company can sell to an individual investor.

Companies have to get approval from the state Department of Financial Securities for their offerings; they can do the filing by themselves or through a “portal,” defined as one of the state’s regional economic development agencies or port districts.

Washington has long had a Small Company Offering Registration program, but it’s been lightly and sporadically used. In approving the crowdfunding program, the Legislature noted that other states have created similar mechanisms, and Washington needs to keep up if it wants to be an incubator for startups.

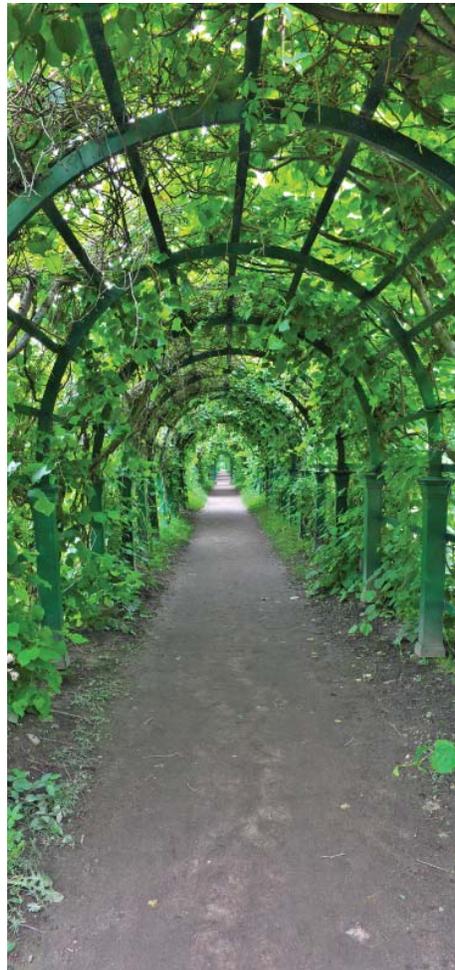
This is fine for fledgling companies, but what about older, larger companies? Where can they find money?

One channel is private equity, which are investment funds that assemble portfolios of companies for their clients. Some private-equity funds specialize in specific sectors, such as manufacturing.

Private equity has long been an important player in Washington manufacturing. The Cores Group bought and reopened a specialty pulp mill in Cosmopolis that Weyerhaeuser no longer wanted. More recently, American Industrial Partners bought Flow International, the Kent-based publicly traded maker of industrial waterjets, as

well as the parent of a Tumwater company that makes waterjet system parts and accessories.

Private-equity investing also goes in cycles, and lately it’s been on a buying binge, according to Christian Schiller, a managing director of the Seattle-based investment banking firm, Cascadia Capital. Arbor Investments of Chicago, having bought Wenatchee’s Keyes Packaging Group last year, recently acquired Trojan Lithographic of Renton (Cascadia worked on the Trojan deal.)



Private equity funds were sellers two years ago, driven by changes in capital-gains tax law. Now they’re looking to restock their portfolios, he says, and they’re aided by still-favorable conditions and interest rates on bank and debt financing. “How long it lasts is how long Fed policy lasts,” he says.

Companies interested in going the debt route rather than selling equity are giving another look to an old favorite, industrial revenue bonds.

ST Fabrication in Federal Way wants to buy and equip a building in Orting. To do so, it has turned to the Economic Development Corp. of Pierce County, an arm of the economic development board, for the issuance of \$3.84 million in bonds. Industrial development revenue bonds, like municipal bonds, produce tax-free income to the buyer, thus allowing the issuer to pay a lower interest rate and reducing the project’s overall cost. The bonds can be issued for manufacturing and processing projects up to \$20 million, and up to \$10 million in bonds can be issued. While a public entity like the county or state authorizes the bonds, the issuing company holds responsibility for repayment.

On the other side of the state, Spokane’s Sonderon Packaging is asking the Washington Economic Development Finance Authority to issue up to \$7 million in industrial revenue bonds to finance new machinery.

These conventional and emerging financing channels will be increasingly important to Washington manufacturers if predictions of economic expansion prove out and companies want to expand to capture a share of that growth. Let the tech sector have its gaudy financings and eye-popping valuations. For manufacturing, slow, steady and undramatic will work just fine – maybe better – for both investor and investee.

Bill Virgin is a veteran business journalist and the founder of the newsletters Washington Manufacturing Alert and Pacific Northwest Rail News. He is also a columnist for The News Tribune, Seattle Business Magazine and the energy newsletter Clearing Up.

“DESIGN APPROACH” TO SAFETY IN THE MANUFACTURING PROCESSES

By Jamie Madonna, AH&T

The way safety is addressed in product design is changing. No longer are safety factors, safety checklists, mere compliance with standards, or yet another warning label considered leading-edge safety methods. Much like the quality movement, safety is increasingly being addressed through design rather than as an add-on effort after the design is complete.

Design safety is a process or an approach to safety that relies heavily on engineering controls. These controls include analyses developed to identify and reduce hazards with design changes before problems emerge. Design safety employs the following prioritized approach to hazard elimination and control:

- Eliminate hazards through the design process;
- Protect or guard against the hazard.
- Warn user(s) about the hazard.
- Train user(s) to avoid the hazard.
- Provide personal protective equipment.

Part of practicing design safety is identifying situations where hazards exist and developing the best response to the hazard according to the hierarchy. Design safety seeks to minimize reliance on behavioral interventions that use a warning or training approach to safeguarding.

Documented, task-based risk assessments are becoming more and more prevalent in U.S. and international standards and regulations. Manufacturing companies are being



required by those standards to document why they have safeguarded their machines in the manner they have chosen. Have they identified all of the hazards/risks of the machine, have they evaluated those hazards/risks, have they safeguarded the users from those hazards/risks? Finally have they safeguarded the users from any hazards/risks that may remain?

Why the emerging interest in the design safety process? There are four key reasons: costs, competition, international influences and legal requirements. Perhaps one of the most compelling reasons to adopt a design approach to safety is costs. Manufacturers cannot afford the expense of ignoring the design safety approach for both product designs and workplace designs.

Similar to losses for product quality, unaccounted safety losses for products and facilities can be very large due to accidents, injuries, lost time, customer dissatisfaction, legal fees and the like. Additionally, the costs of retraining (“retrofitting”) design engineers who lack design safety awareness are imposing.

The requirements for design safety are increasing because safety is becoming a point of competition. Product designs that reduce hazards to users are more attractive than those that do not. As safety losses become better accounted for, these costs will increasingly be factored into purchase decisions.

The countries of the European Union (EU) a decade ago led a global development in design safety. The EU decided that to promote the “free movement of goods,” most goods must have the CE mark, which indicates conformity to a “common level of safety.”

The Asia/Pacific region is no longer immune to product liability exposure. Product liability laws are one of the fastest growing imports of legal principles into the region.

Australia, New Zealand, China, Taiwan and Japan have product liability statutes. The countries in the Asia/Pacific region that do not have statutes do have tort-based legal theories for a product liability exposure. It can be expected that there will be less tolerance in any country if an injury occurs on a product that has been produced with less than the state-of-the-art design. It will be compared to similar products sold elsewhere in the world.

Product liability and the related costs of litigation are also encouraging manufacturers to increase design safety efforts and to keep pace with advancements in design safety.

Past law required a manufacturer to design products in accordance with the state-of-the-art in existence at the time of manufacture. The state-of-the-art defense is still an admissible defense in a number of jurisdictions. Today however, many jurisdictions will look at the safeguards a machinery manufacturer has put on the machine and ask:

- “Have they followed appropriate standards?”
- “Could they have made the machine safer?”
- “Would making the machine safer be technologically or economically feasible?”
- “Has the hazard analysis/risk assessment of the machine been done thoroughly and does the documentation bear that out?”

The “design approach” to the safeguards used by a machinery manufacturer would lead to positive answers to those questions.

AH&T works in partnership with its manufacturing clients, using task-based risk assessment, standards compliance, incident management and specialized software to aid in developing both products and the manufacturing process. Through a detailed process, we assist clients and customize programs to make the process of building locally and selling globally simple.

GETTING TO THE ROOT OF THE PROBLEM - ONE "WHY" AT A TIME

By Jessica Kinney, CPA, CFE, Manager

Getting to the root of any problem can be painful. Speaking of roots... and pain...for some of us it may be as painful as getting a root canal.

What are some of the problems you never seem to get to the bottom of? Could they be, "Why don't I get the reports I need timely? Why does my shop continually make the same errors? Why are certain expenses on my financial statement so high?" All of these issues take time to get to the root of the problem, and in order to make effective and efficient changes, identifying the root cause of a problem is critical. Our natural reaction to finding a problem is to immediately want to fix it without fully analyzing the situation.

I recently saw an article that said a 4-year-old child asks 437 questions a day. If you have kids, this may be all too familiar. Asking questions is how, as a child, we learned. Children are great at this because they are starting from ground zero, meaning they don't act as if they already know the answer to their question (well, of course, if they are teenagers, that is a different story.) They



genuinely want to know why, why, why to everything. As managers, we tend to ask questions trying to get the answer we want to hear instead of really wanting to hear the actual answer.

One method to drill down and find the root cause is to ask the question "why." The difficult part is not stopping at asking the question once, but continuing to ask the question, with the purpose of fully understanding the situation and finding the source of problems.

A local manufacturing company making custom products for its customers was seeing higher than normal customer returns. The CFO, in reviewing the financial statements, continued to see these trends and finally asked the production manager why customer returns were so high. A quick response by the production manager stated the obvious - well, we continue to screw up and not make the orders to meet the customer specifications. In receiving that answer, the CFO fires off an email to employees in the company stating that they need to stop making errors because it is costing the company money. OK, problem solved, right?

NOT! The next month rolls around, and the CFO continues to see the same problem. Again they go to the production manager and ask why customer returns are so high; the response was similar to the previous month "because customers are being shipped products that don't meet their specifications." This time the CFO tries to drill down a little deeper and the conversation continues:

- **CFO** – Why are customers being shipped bad products?
- **Manager** – Because manufacturing is building the products to a specification different from what the customer and sales team agreed to.
- **CFO** – Why does manufacturing build the product to a different specification?
- **Manager** – Because the sales team tries to expedite the orders by calling

the manufacturing employees on the floor to directly begin working on the project. Errors happen when the specifications aren't being communicated or written down in the shop.

- **CFO** – Why does the sales team call manufacturing to start a project without completing the start work form?
- **Manager** – Because the start work form requires the sales director's approval before work can begin and this slows the manufacturing process down a lot, or in many instances, stops it altogether because the sales director is never in the office, so orders sit and wait.
- **CFO** – Why does the start work form require an approval from the director of sales?
- **Manager** – The sales director likes to know what jobs are going on for discussions with the CEO.

Ah, now we are getting somewhere! This method of asking why, why, why and drilling down to get to the root cause of errors also identifies the root cause of a significant problem. The good thing is the solution is also very easy. In this case, the Company was able to modify their processes by not requiring the sales director to sign off on the start work forms and, accordingly, the manufacturing team was able to produce a report after the fact to meet the sales team's needs. And the best part, the company was able to control its customer returns.

Asking the "whys" can be a beneficial part of solving everyday business problems as well as part of large process change projects and in understanding human behavior. It is one of the simplest tools we can use to understand the business and make efficient and effective change. "If you don't ask the right questions, you don't get the right answers. A question asked in the right way often points to its own answer. Asking questions is the ABC of diagnosis. Only the inquiring mind solves problems." – Edward Hodnett

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