Tax, tariffs, AI and the future of manufacturing

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David Sites:

Welcome and thanks for tuning in to the DC dispatch. I'm David Sites, National Managing Principal of Grant Thornton's Washington National Tax Office. The DC Dispatch is our way of bringing you quick insights into how developments coming out of our nation's capital could impact your business.

Today, we've got a really great topic. Today, we're going to delve into what's top of mind in the manufacturing industry as dynamic and turbulent action continues to pour out of Washington, DC, impacting manufacturers around the world. We've had tax law changes, tariffs, we've seen advances in AI and a shift towards automation. We're going to delve into these recent changes and we're going to talk about whether we're going to see manufacturing surge in the United States as a result of recent policy efforts to bring manufacturing back. I'm really excited to have Kelly Schindler with me today, Kelly's the Head of our Manufacturing Industry here at Grant Thornton and one of my favorite people to talk to about the manufacturing space. Kelly, welcome to the podcast.

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Kelly Schindler:

Thanks David.

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David Sites:

So the One Big, Beautiful Bill Act, I think it was a major win for manufacturers. If you look at this legislation, you got full expensing for equipment and capital investments, full expensing for qualified production property, you got more favorable R&D provisions for people that are investing in in R&D, better interest deductions, which means you can borrow money to make these investments, and that's all plus right for US manufacturers. And there's also like a clear policy intent here, Kelly, right? It seems like all this stuff is meant to encourage people to, in fact, manufacture here in the United States. So I wanna ask you, do you think that all these incentives will be meaningful and shifting more of the global supply chain back to the US or are there other things in play that are going to make it much more complicated?

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Kelly Schindler:

David, when you were describing the environment of manufacturing, you used the word dynamic, it's exactly the word I would have used. As a member of the board of the National Association of Manufacturers, we like to refer to the One Big, Beautiful Bill as the "manufacturers bill" because it is so exciting for manufacturing and it's such a strong positive in that way, and it is more incentivizing honestly of bringing supply chain or the manufacturer of made products into the US much more so than tariffs, right. It's more incentivizing to do that. But I do get the question often about do I think supply chain is going to shift back, you know, whether it's at conferences or articles that I get quoted in. Shifting supply chain is hard. It is not something that can be done overnight. Supply chain has been built over years and years for companies and to relocate it just overnight is not something that any company can really do easily and there's not a lot of viable alternatives in some instances, so they don't have a choice. They have to keep with the supply chain they have. Some of the large manufacturers maybe have a little bit more ability to do such things, maybe have more CapEx to be able to do that, but 98% of manufacturers are small middle market manufacturing companies that don't have that capital or don't have that wherewithal to be able to make something like that happen.

So, the other thing that's coming into play even with the large or the mid market size, manufacturers is well, what's going to be here three and a half years from now, right. You know, so they don't wanna make any knee jerk reactions now, if it's just gonna change again in three and a half years. So there is some hesitancy to make any kind of significant change in their supply chain and bring anything back to the US because they just don't know what it's going to be like in a quick period of time. And it takes a long time for some of that to happen anyway. So by the time they get it done, it may be changing all over again. So what I do believe will occur and I'm seeing occurring is more redundancies, right, where they have the supply chain maybe in an Asian country, but they're also bringing it more state side or looking for entities that have it more state side that they could possibly acquire so that they have it kind of in multiple places that they can pull levers on rather than just one big switch move.

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David Sites:

Well, you brought up so many good points there. One I want to focus in on is I'm hearing the same thing from clients out in the market that I talked to that while provisions in the Big Beautiful Bill are permanent, there is still uncertainty as to well what happens if there's a change in control in the Washington, DC, midterm elections, and what direction does tax policy ultimately take, right? And so it begs the question, do manufacturers see enough certainty so that we'll start to see people making the investments that we expect over the next 12 to 24 months? Is there optimism? Is it just cautious optimism? I mean, certainly on the tariffs side you don't know what's gonna happen over the next 12 days. On the tax side, you have a little bit more certainty. So what's the outlook? What do you think about the next 12 to 24 months in the manufacturing space or even a little beyond?

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Kelly Schindler:

Well, someone argue on the tariff side, you wouldn't know 12 hours. But going back to your question, 12 to 24 month outlook: It's very exciting, honestly. The first Trump administration, where the tax cuts JOBS Act came out, manufacturers experienced some of their highest record earnings, record revenues. They expanded their plants, they developed their people so that it was a very exciting time. It was really good for manufacturing and when Trump was elected, and that was part of his campaign, right, I'm bringing that back, so, once he was elected, manufacturers were counting on this bill to get passed and come July 4th it did. Right? So it is exciting. There's a lot of excitement coming out. You see a lot of press on that. And so we are expecting some expansion, some upskilling of workforce, again R&D activity coming back and coming into play, but M&A activity is one thing that you know my M&A folks are telling me they're getting super busy and I've been super busy with because that activity is definitely there or it's being explored. And so this bill is definitely triggering some exploration to happen. Now it just happened last month, so some of them are still figuring out to what extent, you know, they're gonna get those cash tax savings.

The one thing that I'm also hearing and seeing is companies are challenging their departments on how customers will be impacted by this bill, so that maybe they can maybe market to them and that way or understand what the buying patterns are now gonna be. So not just what they can use their own cash tax savings on, but what is the customer impact gonna be as well. It's a very interesting perspective and interesting to watch that flow through.

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David Sites:

Yeah, that is a great point and it's the customer side for sure. It's also the supplier side. Have your supplier costs changed and does that change your relationship with your supplier? That conversation happens on the tariff side and now it happens a little bit on the tax side in the wake of OB3. So obviously a lot of the provisions in the Big Beautiful Bill cause cash tax savings immediately cause they accelerate depreciation — they accelerate huge amounts of deductions to spur this investment. So talk to me about what you're hearing on, "Hey, what do we do with this new-found cash?"

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Kelly Schindler:

This has been my most fun conversation when I meet with companies and it puts a smile on the face. When I would bring up tariffs before, not so much of a smile. But this one I'm not getting the eye roll like I did before. And you know, how are you going to spend your cash? And it's fun to talk about it. There are some major headline news out there, Apple announced a $600 billion plant expansion, a carrier has announced a large expansion, Rolls Royce, AstraZeneca. There's quite a few out there, but 98% of manufacturing right, small, medium sized companies, that CapEx spend isn't necessarily always as desirable by their boards or by their executive team. But there is a huge curiosity on how to improve the technological debt. And so seeing what other companies are doing, they know they need to get into automation or AI or other means of technological innovation. They know that that needs to be done. There's been some hesitancy before, but I do believe the cash tax savings from this bill have basically given that permission, like OK, you now can go do this. We have that extra money or cash on hand. Let's get into it. We had a webcast a couple weeks ago on building your business case for AI and we had a polling question in there and we find again and again that companies, they want to get into it, they just don't know where to start. Right. And so that question is big. It's out there. Every conference I'm going to every board I'm meeting with seems to be the fundamental question that I just don't know where to start. So they need to get into and explore that. It's been fun having those conversations and talking to them and where is it you want to go on that journey

But some of them, to answer that question again because they don't maybe want to have that CapEx spend, but the board has more appetite for M&A type spend. Some of them are doing acquisitions to acquire that technology, or acquire that innovation, it's something that they're interested in it. It's more aligned with their North Star or future of them, and so they're doing that M&A to acquire that technology that takes them to that next level and honestly saves them from the whole implementation headache, right, that technology can sometimes have. So it's been exciting to see some of that come through. And again, keeping my M&A folks busy.

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David Sites:

Yeah, absolutely. Such a good point, right? And this this notion of when we bring manufacturing back to the United States, there's always this question of, what does that manufacturing kind of look like, right? And your points kind of illustrate that, is that highly automated, mechanized robotic manufacturing in a lot of cases, do companies now have the means and the wherewithal with the tax incentives to make additional investments in this space? It's such a good point. You know, I don't think we're gonna just see the same job manufacturing, but as you mentioned, we do have a desire to diversify, right? So, speaking of do we need to make stuff in the United States, let's turn to the chaotic world of tariffs and trade. OK, so it looks like tariffs are here to stay, right? There's been a lot of turbulence, but for the short term, it seems like some level of tariffs are here to stay and statistics tell me that it's a level of tariff that on average is the highest since I don't know around World War Two, close to 100 years. We know that tariffs are gonna be in place. I wanna talk a little bit about what you see companies doing kind of in that supply chain space and also strategies to offset the costs that are associated with these tariffs, and also, how much can they pass on to customers?

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Kelly Schindler:

Absolutely common conversation, right? For the last six months or so with companies that I've been having very empathetically and asking them what their impacts have been as resulting from the tariffs. And there are some sectors where their margins are just super tight, right, and they don't have a choice but to pass that through to customers. And unfortunately those that don't get that permission from the customer may not survive. And we are expecting that that will be the case for some companies, unfortunately. On the flip side, we do have some that surprisingly have no or hardly any impact because they're mostly domestic and get their supplies domestically and sell domestically. So there's those that are just kind of in a bubble and do everything domestically and really no impact. Some of the companies I've met with do have really strong and open relationships with their customers and customers are understanding and so there's a bit of a sharing of the tariff cost between the two entities. But surprisingly, there's a large majority that are just absorbing the cost and hoping that they don't have to do it for very long.

And it's sad to see that happening, but it is. It is happening and that's a lot of companies that are doing that and you're seeing it in margins that are coming through. All entities regardless, and this has been going on even before tariffs, but all have been focused on reducing costs, finding efficiencies. And I would say those efforts have doubled down as a result of tariffs. Again, my M&A folks are busy with divestitures. There are now some lines of business that are no longer profitable or not what they need them to be. So they're selling them off and looking to not have those anymore. So we have seen that. But on the flip side, again we're seeing acquisitions of companies that maybe have a better supply chain, you know, are being able to do things more cost effectively. Maybe it's able to vertically integrate the company better. So acquisitions are happening in that regard too, to kind of offset those tariff impacts.

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David Sites:

So it is still chaotic though, right? When you talk to clients, what strategies do you give them to kind of deal with the uncertainty and the chaos around this issue, not knowing what announcement might come out next week?

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Kelly Schindler:

Well, first off, when I talked tariffs with clients I get a big eye roll. They are quite annoyed by it and like I mentioned earlier, it's not as incentivizing as the One Big, Beautiful Bill for them. So they are looking to find ways to cut costs and unfortunately there are quite a few that have cut their FP&A role and they did that as a means of cutting costs before the tariffs happened, you know, in previous years. And so now that role doesn't exist anymore and that's hurting them because that's the role that would have taken these tariff costs and figured out how it may be impacting them and where the impacts are. So to supplement for that, just some AI tools that I've been telling them that are fairly affordable and can be implemented pretty quickly to fill in that FP&A role and identify where those impacts would be and stay on top of the repeated changes of tariff rates, right? Stay on top of that and be able to fill it in so that CFOs can be seen that more quickly.

Along that line, a lot of manufacturers have thousands of SKUs. That's a normal thing, right? They just build up and there's just so many, so many thousands of SKUs, and each SKU is a bill of material or a BOM or a recipe if you want to think of it that way, of multiple components that make up that item, and those components are coming from various different countries, you know from all over the place. And so over those thousands of SKUs and then multiplied, you know by the number of components, how do you determine, this component comes from this country, whose tariff is now this, and it's more costly, until you maybe see it too late and it flows through and your margins. So again, another instance of where AI can be used to be monitoring those SKUs and all those components and setting a flag up in the air and like, Hey buyer, this component of this SKU now costs more than the threshold you set for it. Maybe you should look to this other alternative vendor or supplier or maybe we don't sell that product for a while.

And along the lines of not selling that product for a while, we've been encouraging, and some companies have been doing, SKU rationalization. Over years they've just grown, like I said, thousands of SKUs and they need to come back and focus on those SKUs that really are truly given them those good margins and their profitability. So coming back to focus on those.

The term scenario planning is a term that we hear over and over again and scenario planning can be you know looking at your customers and the customer strategy and where can I do it through pricing. Looking at your cost and your supply chain strategy and where can those costs be done and scenario planning through that again scenario planning is something that is not a new thing. Historically for humans to do, it can take hours or weeks or months to do, where now an AI model can be developed and be doing that in hours or less. So it does give them quicker information and be able to make decisions more timely rather than again seeing it come through on your margin base.

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David Sites:

Yeah, it's fascinating, right, that AI is coming to the fore at a time where there's all these challenges on the trade side and opportunities on the tax side. And you're right, these are great ways to implement strategies that I think otherwise, you know, could have been out of reach for some companies based on the way their data is structured.

One of the things that we've talked about around the Big, Beautiful Bill is how the pieces kind of fit together and with things like tariffs and the ability for a company to look out five to seven years to not just make smart tax decisions, but to really understand their forecasted numbers, their margin pressures and things like that. When you think about scenario planning, do you find people maybe missing the boat by doing it a little bit in isolation because of the challenge like you mentioned with doing broad FP&A?

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Kelly Schindler:

Yes, I think tariffs have caused them to miss out. I find there have been companies that have focused just on the here and now because they feel like they can't look outside, right and they've lost sight of their North Star or the end game. And that worries me. And so when I do meet with boards and boards are like, What can we be doing with our executive leaderships, I'm always telling them, make sure your leaders of your company aren't losing sight of future of future them, and to have that in the forefront and to encourage that.

Whether it's uncertainty of tariffs, it's uncertainty through the use of AI or whatever it may be, things change fast nowadays. That's not gonna stop, whatever it is. And so certainty is not happening. Uncertainty is. They scenario plan through it and they keep their eye on that North Star and use the noise or put the noise as part of the strategy. They need to be able to strategize against that quickly and move on and continue forth with what is going to be future them and successful them.

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David Sites:

Yeah, it's like resilience is the call word of our podcast. You need resilient financial planning strategy. You need resilient supply chain and manufacturing. I think that's right. So I want to talk about automation. Do you think that things like the One Big Beautiful Bill and that impact of tariffs will really accelerate that investment and we'll see more of that in the United States?

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Kelly Schindler:

Automation is super exciting. I've seen some of the larger companies and what they do. A year ago we would not have thought these things to be where they are now. It's very exciting. I love going to conferences and seeing this stuff and seeing people on stage show on screen what they've done with their company and I hugely encourage companies to get to these conferences. I do think the One Big, Beautiful Bill, like I said, the cash tax savings is going to incentivize them to want to make up for the technological debt and get their innovation forward moving. Even if you don't, your neighbors are doing it, right? And so get to these conferences. They're inexpensive ways of being with lots of companies that are in the same boat you are, trying to figure out where their starting points are, seeing the big companies up on stage that are, light years ahead and what they've done. But then talking to your neighbors at those conferences and like, where are you? What are you thinking and the knowledge share that happens at these conferences is huge, which, when I visit with companies, they all want to talk about it. They all want to be the future them and figure out how to get there. I think OB3 has definitely opened that door and said go, right, and start your journey there. It's very, very exciting. It's cool to see where all it's going.

On the workforce, normally the legacy generations are fearful of the workforce replacement by the innovation and what we're seeing is it's not a replacement, it is not. It could be, right, used as a headcount reduction, but that's not what it's being used for. Companies are using it as a workforce supplement, and it's actually then taking the existing workforce and upskilling them. You know putting them in more of a review role or monitoring role of that instead of the physical doer, and so it's upskilling them, which is fun and exciting for them and makes them feel more valuable in the company. So it truly is honestly a win win.

You know, on the hundreds of thousands of job openings and manufacturing and we're expecting that to be in the multimillions just in five years, 10 years from now, that has to get solved somehow. And so technology has to come in and start playing a role in that, and it will and it has been.

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David Sites:

That's fascinating. So you're predicting there'll be millions and millions of unfilled manufacturing jobs in 5 or 10 years from now?

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Kelly Schindler:

It's not my prediction. It's out there. There are studies that are showing that.

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David Sites:

OK. I'll have you back, God willing, in five or ten years on the podcast, we can we can check on that. So, I'm gonna wrap up. I got a question I'd like to ask. So, I always like to ask people about that one DC political or regulatory thing that they're watching very closely between now and, say, six months from now. So let's go with between now and year end. What are you watching?

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Kelly Schindler:

I am watching, as well as all the companies that I talk to, what's going to come out with China and Canada and Mexico. What are the trade negotiations that are going on? What're the results going to be? How's it going to come out because one or all of those countries is impacting directly or indirectly every manufacturer and every individual. There's a ripple effect that comes through this, even in tourism, right, and hospitality and restaurants, you know. So it's it is there, it is impacting. It's the one thing I am certainly keeping my eye on.

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David Sites:

Yeah, it is it that is right. I mean those three together when you put them all together, that's a huge chunk of our trade, right. And where we settle out with those countries, significant issues.

So Kelly, huge thank you for joining me today. I love talking about the manufacturing industry with you and thank you to everybody who tuned in. If you have questions or want to learn more about how your manufacturing business might be impacted by DC policy developments, don't hesitate to reach out to Kelly or any of your friends at Grant Thornton.

And be sure to keep an eye on the DC dispatch, which can be found on grantthornton.com for timely updates on tax and regulatory developments that matter to your business. Until next time, thanks for listening.