2016 Industrial products outlook

Industrials are facing challenges and opportunities driven by product innovation, changes in talent requirements and energy disruption. These changes present a unique opportunity for savvy players to emerge as leaders in the coming year, says Joe Zale, Principal, U.S. Industrial Products, Deloitte Consulting LLP. In the following interview, Zale shares his thoughts on growth opportunities and industry trends for industrial products companies to be mindful of in 2016.

2016 will mark a critical moment for industrial products. Buffeted by a slow-down in China and the large pull back in oil and gas, capital allocation choices will increasingly center on an emerging set of opportunities. These opportunities include: new technologies such as the industrial internet and advanced manufacturing; the skills needed to manage embedded technology and analytics; the continued hyper-active pace of M&A; and the changing energy grid.

Where do you see the opportunities for growth in your sector?

The advent of smarter products and Internet of Things (e.g., products with embedded sensor technologies) provides both a huge opportunity and a conundrum for Industrials. If capitalized and managed correctly, these innovations can support step changes in productivity by allowing firms to more actively monitor and optimize plant, asset and supply chain performance. For example, more advanced practitioners are directly linking RFID sensors that track parts performance and wear with order fulfillment systems that automatically coordinate ordering, delivery and technician visit coordination. Other companies have linked sensors that track consumables directly into ERP systems to automatically trigger re-ordering and billing.

This proliferation of smarter products and embedded sensors in combination with enhanced communication infrastructure is leading to greater volume, velocity, and variety of information available to the manufacturer. Firms are using these analytics to not only increase aftermarket productivity and improve operations, but also to improve product lifecycle management and in some instances commercial arrangements. For example, companies that provide equipment used in production processes are increasingly packaging their offerings as solution that include performance commitments. If performance stays within an agreed-to tolerance range for extended periods then the provider gets a performance bonus; while performance outside the ranges generates penalties. The use and application of analytics increases the confidence in both committing to these arrangements and delivering the offering cost effectively.

What should businesses be mindful of as they plan for growth?

Until recently, the hiring focus for industrial products firms was on attracting, recruiting, retaining, and training hardware engineers. However, the advent and proliferation of advanced technologies, will create a demand for employees who understand traditional hardware, as well as those that understand software and programming. The ideal industrial products employee of the future will be those who possess the ability to work and balance these two issues – hardware and software. Several large industrials have strode more boldly into this space by setting up software divisions and dedicating themselves to very different hiring profiles.

Another challenge for Industrials is the uncertainty in the Energy segment. The disruption in oil and gas and energy in general has created big questions for industrial firms about how (and where) to play in Oil and Gas and within the broader energy grid, particularly as there are massive disruptions in each. Oil and gas prices falling to historical lows in real terms has braked the growth that the steady expansion of offshore and rapid growth in shale drilling had generated. Similarly in the broader Energy segment the utility markets are facing a longer running disruption where power generation and storage becomes increasingly decentralized while customers increasingly have an increased number of options and can more directly influence demand swings. Like all disruptions, there is increased risk in choices falling on the wrong side of structural change; while depressed assets and new stakeholders present the opportunity to gain access to markets and assets at depressed rates. Industrials need to sharpen their decision making and strategy logic and ensure choices consider market insights and the risk posed by a range of scenarios.

What is the next big thing? What markets do you see emerging in the sector?

Supply chain management has and will continue to be a key issue (challenge) for industrial products organizations. While many firms have gone to great lengths over the last several years to increase supply chain efficiency, a consequence of these efficiency moves, has been an increased level of complexity. The time has come for firms in the industry to step back and re-consider operations and assess if material and labor savings justify the coordination and oversight costs involved. Expect to see industrial products firms consolidate in an effort to better control their supply chain – choosing a better balance of simplicity and production costs.

While I anticipate we will see new markets emerge, these won't be from the usual "new market" suspects. Safe to say the bloom is off the rose for China as the economy transitions from unsustainable double digit growth driven by investments and exports to a much more balanced economy based on domestic consumption, with a service sector focus. For years, China has built up excess capacity in core infrastructure sectors e.g. steel and construction materials, which are major end market consumers of industrial products. China's slowing economic growth is having an adverse impact on industrial products sector. Similarly, Brazil is fraught with its own challenges as the economy is expected to undergo contraction in both 2015 and 2016 and there is high distrust of the government and current administration. Private consumption contracted for the first time in a decade as high inflation, tightening credit availability, deteriorating labor market, and corruption issues slowdown infrastructure investment. The combination of these factors will affect Brazilian market's outlook for U.S. industrial products firms.

As a result, sources of industrial growth in the near term are more likely to come from Southeast Asia, India, the Middle East and Eastern Europe.

These challenges and uncertainties create potential opportunities for Industrials to evolve and change their positon and role in the economy. By creatively deploying new technologies, helping to solve for complex needs in the Energy sector, expanding their reach outside their established geographies and pulling from a millennial-driven talent base, Industrials have the chance to re-set their position in the economy and value in the market. Savvy players, who embrace these changes and commit to learning from them and adapting, will be well positioned to grow, collaborate and stay relevant in the coming years.