

United States Senate Committee on Finance

Hearing on
Trade and Tax Issues Relating to Small Business Job Creation

Invited Testimony of Spencer Williams, President/CEO West Paw Design



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The Honorable Max Baucus (Montana), Chairman
Testimony of Spencer Williams, President/CEO
West Paw Design
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Thank you Chairman Baucus, Ranking Member Grassley, and members of the Committee for inviting me to the Senate Committee on Finance. I am grateful for the opportunity to share my experience, observations and opinions with you regarding export trade and how small businesses can increase jobs in our country.

West Paw Design Company Background

Based in Bozeman, Montana, West Paw Design has built a reputation for manufacturing high-quality bedding, toys and apparel for dogs and cats throughout the company's 13-year-history. West Paw Design's team of 36 employees are extremely proud that 100 percent of the company's products are manufactured in the United States – a characteristic that sets West Paw Design apart from a competitive field that largely manufactures overseas. More than 2,800 pet retailers carry West Paw Design products domestically and products are also sold in 24 countries internationally. Distinguished by a commitment to creating eco-friendly, safe and quality products, West Paw Design has experienced continued growth even during the economic downturn. In the summer of 2009, construction crews broke ground on a facility expansion that will more than double the size of West Paw Design's production floor when it opens later this month.

Our Products

As much as West Paw Design values pets, the company also values sustainability for the global environment. In all its manufacturing West Paw Design uses recycled raw material wherever possible. A commitment to recycling is inherent in the designs of its bedding, toys and apparel. Beds are stuffed with recycled post-consumer plastic from plastic soda-pop bottles that creates a soft and durable material that is a better quality fiber than conventional bedding. All materials used in manufacturing West Paw Design's innovative Zogoflex® toys are engineered to be recyclable and environmentally friendly. Unusual in the plastics world, West Paw Design creates virtually no waste from the manufacturing process of these toys.



Current Economic Climate

Domestically West Paw Design has experienced strong sales growth but 2009 was a difficult year to grow. However, we were successful at increasing our sales in 2009 by 1.3 percent over 2008. Export sales have grown faster than domestic sales over the last three years and export revenue was critical to our growth in 2009. By continuing to invest in product development and marketing we were able to successfully launch new products when many of our competitors waited for better economic times. New products, along with sales promotions and an effective sales team, helped our retailers feel a sense of excitement about our brand in a time when there was little good business news to be excited about. Also, we hired new high-level staff to both our sales and production teams to help the company economize our operations and be more progressive. Our investment in people helped us grow in 2009 and begin 2010 with momentum. Sales for 2010 are currently 33 percent above 2009 and 1 percent above our forecast.

Future Growth

West Paw Design continues to invest in our company growth and we plan to increase revenues by 11 percent in 2010. This comprises growth in pet specialty stores, along with continued growth with corporate customers. Our forecasted success is also partially based on a 140 percent projected growth in exports. This optimistic forecast is predicated upon three opportunities. First, we will introduce mainland Europe warehousing and logistics. By contracting with a company to warehouse our best-selling products and to fulfill orders to our European distributors, we can cut lead times and reduce transportation costs. Second, we have introduced multi-language packaging on our Zogoflex dog toys, which is anticipated to increase sales in German and French-speaking countries. Third, we anticipate future partnerships to materialize from a strong list of prospective distributors and plan to develop new distribution relationships at a large international trade fair in Germany.

Expansion

By March 2010 West Paw Design's production floor expansion will be complete. By doubling the size of our building to nearly 31,000 square feet, we will have the ability to grow. New production space will house much-needed inventory, along with our first in-house injection molding equipment for the production of Zogoflex toys in addition to a dedicated area for large order and export order staging and processing.

Simply put, West Paw Design is a small but mighty manufacturer that believes in making a positive impact, not only in the pet industry, but in the larger picture of our community and environment as well.

Export Sales History

During the last two years, we have realized growth in our export sales, which accounted for 16.9 percent of our 2009 revenue. Our export sales in 2009 represented a 133 percent growth over 2007 export sales. West Paw Design exports to 24 countries with the majority of sales going to Canada, the European market and Australia. Our growth has in part allowed us to promote one sales employee to a position in export sales and also to hire a sales director who will help oversee international sales.



Starting at Interzoo 2000, our first international trade fair, West Paw Design sought out international sales as a means for growth in future years. I had little understanding of the challenges involved with exporting and also I had no concept of how long it would take to realize success in exports. Marketing our product was difficult from the beginning because we had to compete with less expensive products made in Asia. Utilizing information we learned over the years we focused our efforts on a new product line introduced in 2004 — Zogoflex. This product line was an opportunity because it was very safe for dogs, as its material is FDA-approved. It was also recyclable and this is a bigger selling point in the European market than domestically. Finally, it was durable and backed up by a guarantee, even with our foreign distributors. Our branding focus was to utilize Montana and US-made quality, safety of materials and craftsmanship, recycled content and recyclable products, along with organic and non-toxic materials. This quality and environmentally safe brand positioning, along with the weakened dollar, opened up the opportunities that we see continuing to grow our sales.

By utilizing my fluency in German, I was able to make Germany our first strong market for export and it was good fortune that the world's largest pet trade fair was held in Germany. Utilizing both a good education and luck, we were able to finally pick a great distributor that serviced Germany in 2008 and our international sales took off. By being aware of the cultural and linguistic challenges to doing business in Europe, I was able to build strong relationships throughout 2008. In 2009 we added Australia and are working on identifying a strong distributor in Japan in 2010.

West Paw Design is unique in that we do export a larger percentage of our products than an average Montana manufacturer. In 2008 Montana manufactured \$10 billion in output value, of which \$750 million or 7.5 percent was exported. With 16.9 percent of our sales being to foreign companies, West Paw Design exports more than twice the amount of an average Montana manufacturer.

	2007	2008	2009
Total Sales Growth on Previous Year	4.0%	42.8%	1.3%
Export Sales Growth on Previous Year	70.2%	125.1%	3.8%
Percent of Sales to Foreign Companies	10.5%	16.5%	16.9%

Products Exported and Export Locations:

The majority of our exports are Zogoflex toys for dogs. These toys are uniquely differentiable from less costly Asian products because of durability, safety and environmental benefits. In addition to its US customer base, major markets for West Paw Design products include: Australia, Bermuda, Brazil, Canada, Cayman Islands, Czech Republic, Denmark, France, Germany, Hong Kong, Israel, Italy, Japan, Mexico, New Zealand, Puerto Rico, Singapore, Spain, Sweden, Switzerland, Taiwan, The Netherlands, United Arab Emirates and the United Kingdom.



Federal Programs Used

Small Business Administration – SBA 504 Loan Program

West Paw Design received SBA approval in 2009 on a 504 loan for the expansion of the existing building, in partnership with First Security Bank of Bozeman. The loan will close and fund this summer, once all phases of our building expansion are complete. According to an economic impact analysis completed by the Prospera Business Network, the expansion project is supporting 29 local jobs and will generate over \$2.5 million in total economic benefit to the community.

Our loan qualified for two benefits under The American Recovery and Reinvestment Act of 2009 (Recovery Act). We were eligible for the elimination of two program fees: 1) Third-Party Participation Fees and 2) Certified Development Company (CDC) Processing Fees. Both saved us a total of \$26,442. By not having to pay these fees, the monies were directed to other business investments. One investment of those savings was toward the down payment of a large machine to assist with production. The machine will be delivered to West Paw Design in early April. It is not only a taxable asset, but has allowed us to create 1.5 full time equivalent positions in our production team. These positions are not low wage positions, but rather mid-level positions with full benefits, including generous paid time off, health care, a 401k and profit sharing.

The compounding impact of the Recovery Act, the 504 loan and building expansion, along with the equipment purchase and the 1.5 FTE positions demonstrates the power of these programs and the way it is helping to support jobs and increase economic opportunity.

US Commercial Service – General

Through my experiences and in my discussion with others, I believe the the US Commercial Service is a great value and exceeds services that are available in the private market for small manufacturers. Montana's representative has worked with other third-party entities to assist companies with exports. These entities include the State of Montana, the Montana World Trade Center and the Montana Manufacturing Extension Center (MEP-Center). By collaborating to help West Paw Design grow, they each provide a necessary specialized service and utilize the US Commercial Services' diverse resources.

West Paw Design has taken advantage of research from the US Commercial Service including:

- how to export to Canada, which involved a discussion of duty charges, how to work out duty charges when the buyer uses their own broker, and how to cover duty and tax charges on shipments dispatched to Canada via courier services
- how to manage for risk via the proper selection of Incoterms
- how to manage for risk via export credit insurance
- how to find foreign duty rates and VAT charges
- identification of ocean freight rates for shipment to Denmark along with an introduction to a freight forwarder to facilitate this shipment



- identification of the proper Harmonized Tariff System (HTS) classification for display stands in connection with the dispatch of bamboo display stands to the Interzoo show
- the product exhibition at a catalog show in Taiwan, which resulted in one trade lead that was delivered to West Paw Design from a Taiwanese company interested in purchasing West Paw Design products

US Commercial Service – Gold Key

The desire to expand internationally was driven initially by my personal desire to work in a global community and to supply products to export markets. Unfortunately the decision was not based upon a market opportunity or vetted by market knowledge. The decision to expand internationally was naïve for us to undertake as such a small company. We had little understanding of the markets, their distribution models and how compatible our products would be to the consumers. In 2000 we attended our first trade show in Europe. It was a disaster because we did not understand where we would fit into the distribution model and how expensive it would be to get products shipped to the European market.

Because of our lack of success in 2000, we tried a different approach with the European market two years later in 2002. We sought advice from our Manufacturing Extension Partnership (MEP) engineer at the Montana Manufacturing Extension Center. We learned that the Montana Export Assistance Center could help us succeed and determined through conversations with our local representative that Gold Key would be the best service for us. Gold Key services arranges one-on-one appointments with pre-screened potential agents, distributors, sales representatives, association and government contracts, licensing or joint venture partners, and other strategic business partners in targeted export markets. Then, we looked at demographics of pet ownership and found that Germany and France were the biggest markets. With that we chose France for Gold Key. Our critical mistake with Gold Key was not looking deeper into the market and its distribution model before agreeing to proceed. What was later discovered was that France had a different distribution model than other countries and that our products did not fit well into that model. Consequently, nearly eight years later, we still have negligible sales in France.

We continue to exhibit internationally and find the trade shows to be very useful. As attested to by our growth internationally, export sales is a cornerstone of our success. As we look to other markets, we are very interested in utilizing more services from the US Commercial Service, especially the Gold Key services.

Gold Key Recommendations

I believe that the Gold Key service can be improved in two significant ways. First, I believe that the people who work for the US Commercial Service are the biggest asset in helping exporters and that more money and time should be spent on finding great people and training them. I believe this is important both in the US offices and foreign offices. This will help to ensure that the level of service is high and comparable across all offices. I also believe that with great people and strong training, the representatives will better know what questions to ask novice exporters to ensure that their first exporting experience is profitable. Second, I believe that the fee to use Gold Key should be eliminated. Other countries, such as Canada, provide a great deal of free assistance to their exporters. We should have the same, long-term approach to helping US companies succeed. I do believe in general that services are more highly valued when the participants pay for their participation. However, with Gold Key, the participants are still contributing money toward all the



related travel expenses to the foreign country, along with sample costs and staff time. These contributions are significant for small companies and do, I believe, fully commit the company to participating because they do have real costs involved.

Export Barriers

Identifying Compatible Partners and Markets

As mentioned above, the US Commercial Service has been helpful in the search for compatible partners and markets. This is the biggest challenge for a small company where there is little time or money to waste on an export venture that is not successful and profitable. Because the risks of failure are high, the more that can be understood before exporting, the better the outcome. Because West Paw Design makes a consumer product that competes directly with much less expensive product, most often produced in Asia, we have to select a market where demand for the high-quality, US-made products exists. This often means that we can not simply select the most established, biggest and most successful partner. The search is complex and requires time and diligence. Many of the benefits of our product make it unique – for example the fact that our products and company are very environmentally friendly. Also, that our products are safe for use in the home and with pets and in fact many of our products are certified by a third-party organization to build confidence. West Paw Design needs assistance getting into new markets and help understanding the business models and cultures.

High Prices

Our prices have been affected most positively in recent years by the weaker US dollar. This has been among the most significant benefits to our international sales. While the complexities of currency rates are difficult to understand and predict, we are very thankful for the opportunity this has brought the company. However, our costs are still high on account of the benefits we provide to our staff and the safe work conditions we offer. Many competing products do not have the cost that we incur because they are made by companies without the same standards for employees.

Logistic Challenges

Our freight costs are relatively high, which is in part due to our location in Montana, but also due to the sheer distance to our markets in Europe and Australia. Our overseas distributors often order containers of product from China. They find it easy to consolidate shipments from various factories to reduce shipping costs. When they order from West Paw Design in Montana, there is no opportunity to consolidate locally and only occasional opportunities to consolidate in a US port. Because of the usual paperwork to ship products from the United States to foreign countries, along with payments and logistical issues, there is an increase in overhead costs to our foreign distributors that acts as a deterrent to ordering.

Intellectual Property

West Paw Design has invested significantly in product design, materials, packaging, and branding. These elements are worth protecting and we are diligent in doing so domestically. The cost to register trademarks and patents in foreign markets is high and has not been something we have done. However, I also see a role the US Government can play in helping to protect the innovation and intellectual property (IP) of small companies. Without strong and fair protection, IP infringement reduces the value of our innovation and can prevent us from expanding into countries where we perceive



there to be little protection. For example, I see the pet supply market in China as a rapidly growing opportunity. I am not comfortable selling into that country because I believe our designs and materials will be copied and used in the pet market.

Export Opportunities

Free Trade Agreements

Free trade is a benefit to both countries when the Free Trade Agreement is fair for both countries. As a proponent of FTAs in general, I look forward to benefiting from them as I have the opportunity to sell in those countries. However, I believe that although small companies like mine may know about the FTAs, many will not necessarily prioritize exporting to these specific countries with FTAs. My experience is that I first look toward the market, economic trends and sales opportunities. Small companies don't have the experience or staff to understand FTAs and will generally seek a larger sales opportunity before investing in a smaller market despite the FTA.

However, NAFTA is a tremendous advantage for us and we are very thankful for our sales to the Canadian market. Competing product coming from outside NAFTA has a 6.5 percent to 18 percent tariff, which is not applied to our products, which helps to keep them competitive in that market. Another example of an FTA that is benefiting us is with Australia. As mentioned above, our transportation costs to Australia are far greater than many of our competitors that ship from China. There is a General Rate tariff in Australia of 5 percent and yet it is 0 percent on our US products. This 5 percent is a real help in creating a more competitive marketplace for our products.

USA Brand Image

Over the last year I have heard some positive comments about the more open and cooperative position the US is taking in its view to the world community. I believe that the reemergence of a positive "Brand USA" is a great benefit to US exporters. When the US acts as a collaborative member of the global political and economic community, it reflects positively on US companies, products, and citizens. In all our business dealings we desire to support the positive image of the US and its people. It is a benefit to West Paw Design and small exporters that this positive image is also supported by our country's policies and actions.

Global Concerns that Impact Competitiveness

Protectionism

As a proponent of liberal trade, I believe that innovation is born out through quality education, a free business environment and strong competition. West Paw Design has great competitors in the United States and also in our export markets. When the onslaught of inexpensive plush dog and cat toys from Asia started to erode our traditional sales, we invested in something we had never done before — we developed a plastic moldable material called Zogoflex. Competition forced us to innovate and in doing so, opened the company up to a world of opportunity. Zogoflex is now our top revenue-generating product category.



I am reminded of the free spirit that accompanies the Winter Olympics Games that are currently underway. The competition pushes athletes, who come from all over the world, to develop new techniques to out-perform their competition. There are no barriers that create disadvantages for athletes from different countries. It is a quest for perfection and innovation that is at the heart of this competition. We should remember that American companies perform best when the competition is open and fair.

Human Rights and "Fair Trade"

I believe that we have a real opportunity to enhance trade while also enhancing the livelihoods of US citizens and also poorer world citizens. The United States needs to increase its efforts to enforce basic human rights initiatives that protect individuals who help make the products many Americans buy. To only talk about ending child labor, forced labor, and slave labor is to ignore the real cost of these dire conditions. We must demand that our trading partners and the products they provide have a higher and more consistent degree of regard for basic human rights. By doing so, we not only help to foster a more just and better world, but we also more fairly reflect the true costs of producing products. By encouraging more "fair trade" with our partners we will also be able to compete in a fairer and more just manner.

Global Pollution and the Environment

Pollution is an issue that also affects the cost of global trade. West Paw Design is known for going above and beyond regulations to help protect the environment. That is our choice and is how I have chosen to run the company. However, many products in the United States are made with less environmental impact than similar products produced in developing economies, such as China. Agreeing to global standards regarding the environment will not only benefit the Earth, but also help to better assess the impact of harmful manufacturing practices that keep competing products at an artificially low cost. The environmental costs impact all of us on the globe and also unfairly undervalue the true price of products.

Summary

The livelihoods of approximately six employees depend on our export sales. Those people depend on a well-functioning global marketplace, from which West Paw Design attains 16.9 percent of its revenue. By making the US Commercial Service an even better organization through great hiring and training and by providing more manufacturers access to its programs by eliminating fees, US small manufacturers can grow their exports and increase employment.

Closing

Chairman Baucus, Ranking Member Grassley, and Committee Members, thank you for this opportunity. I appreciate your time and interest in helping small and mid-sized manufacturers be more successful and create new jobs.