Nick's Niche

Guest Column

Are you supposed to be depressed when there is an economic depression?

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As I write this, the US Congress just passed the $700 billion "bailout" bill. Economic pundits are all saying that the country may be heading into the next Great Depression. My 401K looks so bad that I might be able to retire at the age of 80, if ever. No wonder I'm depressed!

I can't help to think that some of the practices of publically traded manufacturing companies are partially to blame for the current set of circumstances. Maybe it's just that the blame lies more with the CEOs of these companies than the companies themselves. Here's why I have such strong feelings about this subject.

Capitalism then

Capitalism used to be based upon several simple principles. Successful companies made a profit. This profit was partially sent back to stockholders as a dividend, and much of the profit was reinvested into the business. This investment made sense, because if you're successful in what you're doing, why not invest to do more of it, better, and invest in innovation to ensure long-term viability. Wall Street judged these companies on their profitability and long-term strategy to continue, or improve, their position in the marketplace and their ability to continue to make a profit. Shareholders wanted to purchase stock in these proven companies, eventually leading to increased shareholder value by improving the stock price. Success was measured in years, not in quarterly stock reports.

The new capitalism model started in the mid-1980's when companies went on a cost-cutting program with a vengeance. At first, this was a necessary strategy as there were plenty of issues in manufacturing companies that had to be corrected to ensure profitability and competiveness. This was a great time to be selling capital equipment (in my case powder coating systems). Back then, you were successful in convincing management to spend money on equipment that could be "paid back" in operational savings in 4 years or less. This provided a 25 percent return on investment (ROI), a much better investment rate than was available anywhere else. It was normal practice to judge the merits of a capital equipment purchase in terms of a 4- or 5-year payback, and the tax code reflected this back then.

These projects had a remarkable effect on the profitability of these public companies, resulting in better stock prices and dividends for the stockholders. Manufacturing engineers were charged by management with the task of finding similar cost savings by evaluating all aspects of the manufacturing process within their organization. Often, these engineers' "bonus plan" was based upon how successful they were in investing in capital equipment to improve product quality, improve productivity, and reduce manufacturing operating costs.

Capitalism now

Eventually, by the 1990's all the "low-hanging fruit" was picked clean. However, Wall Street still expected the same, or better, profitability from these companies. This challenged the CEOs of these public companies to come up with new and quicker ways to continue to show improvements in profit. Boards of directors started to tie executive compensation to the value of the company's stock price by issuing future stock purchase options as the primary means of paying their CEOs. The stockholders became impatient and wanted high returns in shorter time periods. Overall, expectations for profitability shifted from years to every 3 months, timed with quarterly stock reports. Finally, purchasing stock in a particular company became no more than pure speculation based on the hope the prices would go up, and go up fast. This was the advent of "day traders" who would purchase and sell a stock in the same day, instead of holding on to it for long-term growth.

All of this resulted in payback timelines that were remarkably short. Capital purchases had to be paid back in months, not years. It wasn't uncommon for a capital project to be rejected by management if it didn't meet "payback" goals of 1 year or less (100 percent ROI). This situation is more clearly defined in the tax code as an "expense purchase" and not a "capital purchase," which traditionally had a much longer pay-

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back because they were depreciated over years.

Now, the powder equipment salesperson couldn't get the CEO's attention with any cost improvement capital project that couldn't be paid back in 1 year or less. This meant that US manufacturing companies started to become less and less efficient. The CEOs were still under pressure by their boards to increase profit without spending money and had no choice but to shut plants down and move them offshore. These decisions yielded substantial savings very quickly and met all the expectations of Wall Street. Finally, it became difficult for any publicly traded manufacturing company to justify spending any capital funds in US plants when they could get a greater "bang for their buck" by making the investment offshore. This explains the state of the US manufacturing industry in this new millennium.

It's not all "doom and gloom" in the US manufacturing industry. Why? Because there is a large group of manufacturers who don't have to live by Wall Street expectations. This group is made up of privately held companies, who have to answer to a small group of stockholders (normally their families) and not Wall Street.

Back to the future

It's not all "doom and gloom" in the US manufacturing industry. Why? Because there is a large group of manufacturers that don't have to live by Wall Street expectations. This group is made up of privately held companies, who have to answer to a small group of stockholders (normally their families) and not Wall Street. Their expectations are more closely matched to the 1980's when 25 percent ROI was still a great investment. Here's where the powder coating equipment suppliers have still been able to sell their goods. The only problem is these companies have smaller requirements, resulting in smaller equipment purchases. This is seen in the current market for powder coating equipment being approximately half of what it was in 2000.

Now you may be asking yourself: "How does this affect me?" Well, the answer is really quite simple. The powder equipment companies have had to invest their resources in the parts of the world that are still growing at a high rate. This means that all these companies have become "global" in their planning and staffing. Every manufacturer of powder coating equipment is much smaller in the US than they used to be, and some have gone out of business entirely. This results in fewer people being available to answer the telephone when you order parts or to come to your company to fix your equipment or to visit you to see if you should upgrade your system. This makes you very frustrated when you can't get the customer service that you once received.

What's the solution? As an engineer I'm always looking to solve problems, even ones that seem impossible to solve. It's time to go "back to the future" and begin evaluating capital investment projects that have 25 percent or more ROI. These are still great investments as there are few other places where you can get this kind of high return on your investment, especially in today's economy. It may take some courage to invest in your business under the current economic circumstances, but at least you'll be in control of your own fate. This risk can be mitigated if you used sound judgment in evaluating the benefits of this investment and didn't use overly optimistic savings goals. If you're having trouble getting the support you want from your suppliers when doing these projects, or just want someone to help provide you an objective evaluation of your pending investment, give us a call.

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Editor's note

For further reading, see the "Index to Articles and Authors 1990-2007," Reference and Buyer's Resource Issue, *Powder Coating*, vol. 18, no. 9 (December 2007), or click on the Article Index at [www.pcoating. com]. Have a question? Click on Problem solving to submit one.

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