

Meltdown 101: What Companies Do To Cut Costs

Stephen Manning, AP Business Writer

For anyone looking for signs that the recession may finally be giving up its firm grip on the economy, the steady stream of quarterly earnings reports coming out of the nation's companies could offer some signs of hope.

To be sure, big companies like General Electric, Caterpillar, Coca-Cola, Yahoo and drug maker Merck are showing the pain, with sales and profits dropping as the recession eats away at demand for their goods. But many are still managing to post earnings that don't look so bad considering the economic stress they are under.

So what's going on? How can companies still be treading water when the whirlpool of the recession constantly tugs them down?

A close look at the quarterly earnings reports rolling out this month reveals a common theme — cost-cutting.

Like a household budget, corporations try to maximize the money they bring in while minimizing their expenses. With sales sagging, companies are turning to the cost side of their budgets to find savings and keep profits up.

It's paying off for many — less than a fifth of all companies are losing money despite the worst downturn since the Great Depression, according to Cary Leahey, an economist with Decision Economics.

But what are the long-term effects for those companies and the broader economy?

Here are some questions and answers about what companies are doing to keep those costs down.

Q: Big layoffs have been all over the news this year. Where do those factor in?

A: Job cuts are a huge part of the way companies save money. Often when companies mention "cost-cutting," that's actually a nicer way to say layoffs.

Employee expenses are one of the biggest costs that companies face. The combination of salaries, benefits like health care and pension plans, and the costs of paying for offices or factories where those employees work, adds up to a big part of corporate expenditures. Overall, about 60 to 70 percent of corporate expenses are connected to labor, estimates Brian Bethune, the chief U.S. financial economist at IHS Global Insight.

The painful truth is that the quickest way to reduce costs when a recession takes hold is to slash jobs, reduce benefits or cut wages.

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In this recession, many companies acted swiftly as the recession grew worse. Huge layoffs came from companies like Boeing, Citigroup and AT&T during late 2008 and earlier this year. It's no surprise that unemployment has now pushed up to nearly 10 percent.

Q: How have cuts played into company earnings?

A: Some of those savings are starting to show up on balance sheets.

Take Yahoo, for example. The Internet company has suffered through a drop in advertising sales but reported second-quarter earnings last week that grew by 8 percent. Most of that gain came from reducing operating expenses by about \$150 million from a year ago. That included the effects of work force reductions — Yahoo now has 9 percent fewer employees than it did at the same time in 2008.

Automaker Ford, which is suffering through one of the worst downturns ever for auto sales, reported a head-scratching \$2.3 billion net profit last week. But a closer look shows much of that gain came from lower interest payments and the effects of \$1.8 billion in cost-cutting that included less money spent on manufacturing, engineering and advertising.

Q: What other cost-cutting moves have companies taken?

A: A big option is to cut operations. The logic is fairly simple: If there is less demand for your product, you make less of it. That means you don't need as many factories or to spend as much on other costs like transportation. The expense of selling goods also drops. You don't need as many raw materials or parts, so you can cut back on the amount you pay suppliers.

This can be seen clearly in some manufacturing sectors. Steelmakers have drastically cut production as demand for their products, like big rolls of steel, has swooned in areas like auto manufacturing and construction. As of June, steel production in North America was down 47 percent in just a year, according to the World Steel Association.

Other companies are also contracting. Starbucks has said it will close 900 stores and cut up to 6,700 jobs — cost-trimming that helped it beat Wall Street profit forecasts this month. Shoe maker Nike also beat analyst expectations, thanks in part to efforts to limit its supplier base and control its inventory.

Q: Are there little things companies are doing to cut costs?

A: During difficult times, no expense is too big — or too small — to cut back.

You've probably seen this at your own workplace, where even items like office supplies might be hard to find these days. Or you've seen it on airlines, which are notorious for trimming even the smallest of costs, like free snacks or drinks. Conference calls replace business trips and catered lunch meetings become brown bag affairs.

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Even Google, which boasts some of the cushiest employee perks out there, no longer provides free bottled water at its headquarters.

Q: So companies may make their bottom lines look good by cutting costs, but what does it mean for the long term?

A: It may not be good news, despite the rosier earnings.

A company that slashes its staff or drops suppliers to save money may be helping its own results, but it can be trouble for the larger economy. Layoffs push up unemployment. Cutting suppliers means those companies have to do their own tightening, which can start a spiral of cost-cutting.

"You create a vicious circle where the corporate sector cannibalizes itself," said Bethune. "That is what makes it so difficult to get out of a recession."

There are also big risks for the companies themselves, said Cesare Mainardi, managing director at the management consulting firm Booz & Co. A company should focus on what it does best and cut elsewhere during difficult times, he said. But too often, the reductions are done without much thought going into how a company will be able to regain its footing when the crisis passes.

"That might help earnings in the near term, but it doesn't position a company to win in a recovery," he said.

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