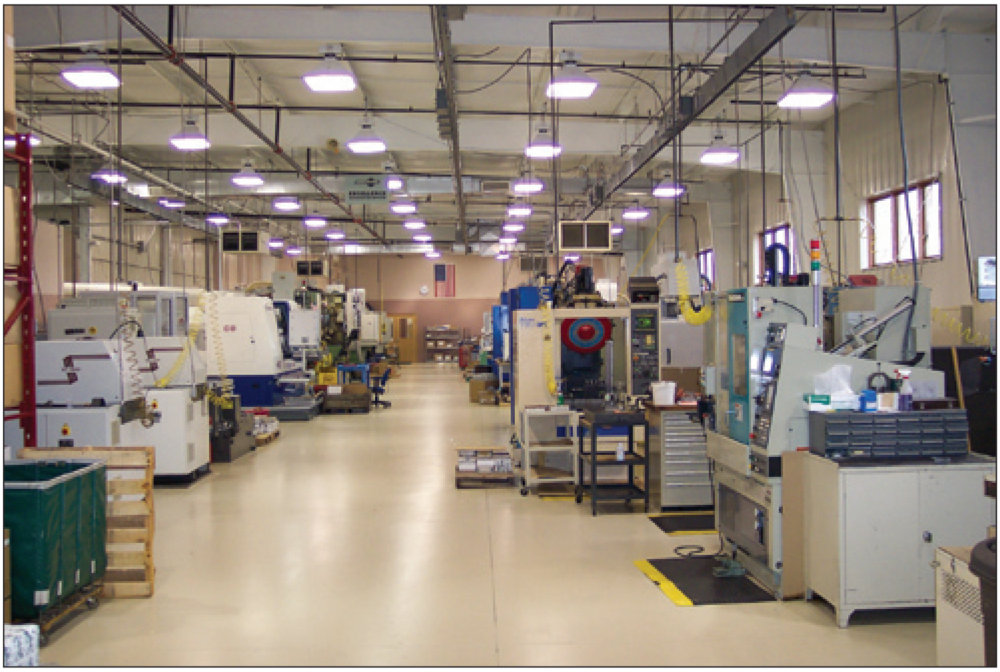
Reinvesting in New Equipment Pays Dividends

Frederic M. Young, president, Forest City Gear Corporation



Spending money (on new machinery) to make money has worked well for Forest City Gear.

Recently, I was approached by a colleague who is a manufacturer outside the gear industry. He was impressed by Forest City Gear's ability to continually acquire new manufacturing equipment, and he wanted to know more about our capital investment strategies. I responded to my colleague by e-mail, but I thought the readers of Gear Technology would be equally interested in some of my comments.

Our strategy over the years has been to buy new equipment to gain the experience of higher productivity and quality. Generally speaking, we end up expanding our size range and technology with each new machine, allowing us to pursue jobs for which we may not have been competitive previously.

A further benefit is the marketing gain you realize when customers see all the new toys on your floor. Your employees will take more pride in their work, and with each new acquisition, there is an opportunity for additional employee training on state-of-the-art equipment, allowing you to produce faster.

We receive cross-pollination when training with the setup guys who come in to install new equipment, as they have been exposed to benchmark shops all over the world and have been challenged to conquer very difficult work at their individual customers' locations.

You should have more uptime on newer equipment and should not have any significant maintenance expenses. Because we have been purchasing so much new equipment for so long, our depreciation allows us to continue to buy lots of new stuff courtesy of the depreciation tax advantage.

Finally, over time, we have developed quite a list of potential buyers for our surplus equipment, selling it to customers, competitors or trading it in against newer equipment. Usually you are better off if you can sell it yourself versus trade-in, as your vendor has to buy low enough to allow him to warranty and bury sales expenses.

We also get a fair amount of work steered in our direction by the folks from whom we purchase our equipment.

As I am fond of saying, your customers want you to have the equipment on your floor with people already trained to use it, rather than your potential offer to go out and purchase new if they give you an order.

By buying new, we've been able to expand our productivity without adding a proportionate amount of people. For over 30 years, I have been re-investing 25–40% of our gross revenues in new equipment, much to the chagrin of our accountant, lawyer and bankers. Needless to say, I believe I've finally convinced them this is a safe and viable option which will ensure the survival of our company and allow us to grow.

A cancer in our country is the need for short-term return, which seems to be driven by accountants and stockholders. The Europeans and Asians seem to take a longer-term view—say over a 10-year period versus six months or a year in the USA.

Without reinvestment, one day you'll wake up to discover you are sitting on a hollow shell—a dinosaur which is worth nothing. In the interim, you have lost your ability to compete in a global marketplace. I hope to bequeath a healthy, world-class operation to my successors with a reputation that will continue to abet their success.

If I were to change the modus operandi, it would be to purchase the equipment myself, setting up a separate corporation to take advantage of tax deductions for me. This, of course, depends on whether you are a C or S corporation and your personal tax situation. Also, because we have bought so much foreign equipment, I have suffered through some currency fluctuation cycles when the cost of equipment is artificially higher due to the exchange rate. With lots of crystal ball gazing, I would be sure to purchase lots of equipment when the dollar is strong. Usually, that occurs at a low point of the business cycle for us, when it is hard to justify buying new stuff for lack of work. However, I have discovered that you can offset or attract a bigger market share by having newer equipment, which negates that argument.

Once you get the snowball rolling downhill, it acquires its own momentum.

Our bankers seem to applaud these efforts because of the significant cash flow from our acquisitions and the higher profit margins we obtain by being able to produce gears upon which few can compete.

To encourage my employees to take advantage of the potential gains from the new equipment, I have often sent them for training directly to where they are made and at the same time tried to get them in other shops who are benchmark manufacturers. Naturally, sending an employee to Europe is expensive, but I am paid back by their loyalty and enthusiasm for the new equipment.

Hopefully, this conveys my strategy and philosophy on reinvesting in new equipment. I have been lucky enough to convince a few of my peers in the gear industry of the wisdom of this strategy, and in each case, they report to me the benefits of this approach.

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