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Companies are boosting their spending: Could jobs be next?

By Paul Davidson, USA TODAY

Federal Express (FDX) is snapping up more airplanes. Caterpillar (CAT) is expanding factory capacity. And Wynn Las Vegas (WYNN) is remodeling all of its 2,716 rooms.

Caterpillar 793F mining trucks loaded on mine site haul their loads

Cash-rich U.S. corporations are sharply increasing their capital spending this year after scaling back drastically during the economic downturn.

The trend has emerged as a bright spot in a recovery that lately has lost momentum and prompted worries that the U.S. could slip back into recession. Many economists believe business investment could help pick up the slack and eventually spark job growth that lifts the economy from its doldrums.

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"People are way too focused on the consumer," says Joseph LaVorgna, chief U.S. economist for Deutsche Bank. "The health of the corporate sector eventually will give way to hiring."

Capital spending tends to ripple through the economy as purchases and construction boost business and create jobs.

Other economists say payroll growth could be more subdued than after previous investment binges because much of the spending is to increase efficiency and replace old equipment after firms put off such purchases in the downturn. Also, a healthy portion of the expenditures is in booming overseas markets.

Recently, the recovery has sputtered as consumers have reined in spending, the housing market has stalled and job gains have slowed, leaving unemployment stuck at 9.5%. Consumer spending makes up about 70% of the economy.

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Meanwhile, the annual rate of business spending on equipment and software in the second quarter was up 21.9% from the first quarter, the biggest increase in more than a decade, after plunging at annual rates of as much as 32% in 2008 and early 2009. Such spending accounted for the lion's share of the economy's modest 2.4% growth in the second quarter. Expenditures were especially robust for computers and software; trucks, cars and aircraft; and industrial machinery. Even outlays for commercial structures were up 5.2% from anemic levels.

Myriad industries are reaping the benefits. FedEx is boosting its capital budget by 14% to $3.2 billion as it buys more planes to import Asian products and expands its U.S. ground network. Ford (F) is shelling out $4.5 billion, up from $3.5 billion last year, to retool factories to make fuel-efficient vehicles. And Coca-Cola (KO) increased investment by 15% in the first half of 2010 for new lab and plant equipment as North American sales in the second quarter grew for the first time since 2006.

Companies have deep pockets. Non-financial firms had a near-record $828 billion in cash at the end of the second quarter, Standard & Poor's says. Second-quarter earnings of S&P 500 companies are up 38% from a year ago, Thomson Reuters says, as they benefit from rising sales and ruthless cost-cutting.

Until last fall, they were too nervous about the recovery's durability to spend much of their reserves, but they've steadily increased outlays since then. Early this year, they replenished inventories depleted in the slump. Now, they're scrambling to meet demand in fast-growing markets such as Asia as well as modestly rising U.S. consumption.

In a late July survey of 400 large and midsize companies by The Corporate Executive Board, 51% said they plan to increase capital spending the next 12 months, up from 39% in the fourth quarter.

Will jobs follow this time?

If history is any guide, the initiatives should spawn jobs. Studies show hiring has uncannily tracked capital spending movements over the past five decades. "When firms decide to expand on the investment side, the employment side typically will follow, with some lag," says Dean Maki, chief U.S. economist for Barclays Capital.

Why? For one thing, companies buy new machines and expand factories to grow and snare a bigger share of rising revenues — the same reason they hire more employees, Maki says. Plus, he says, "You do need more bodies to work that equipment." There's also a ripple effect as the suppliers they buy from similarly increase output and staffing. One reason equipment purchases come first: They're easier than hiring, and possibly having to lay off, workers.

An analysis by Barclays showed that when equipment and software purchases increased by double digits from the year-ago period, as they did in the second quarter, U.S. employment the following year rose an average 3%. Maki estimates that would translate into job growth of about 300,000 a month — more than double the 125,000 forecast by many economists for the second half of the year. The latter number is barely enough to keep the jobless rate from rising as more people enter the labor force.

LaVorgna says monthly payroll gains could be that high, but most economists are less bullish. Maki says job growth — spurred by capital spending and falling productivity growth as companies can no longer wring more work out of exisiting employees — will reach about 200,000 a month by early 2011.

Paul Ashworth of Capital Economics says the link between capital expenses and job growth is more tenuous in this recovery, partly because replacing worn-out machines typically doesn't require new employees. And firms that buy equipment to increase efficiency can produce more with fewer workers.

Still, many businesses are responding to increased sales. Caterpillar, the top construction-equipment maker, boosted its capital budget to $1.8 billion worldwide this year from $1.3 billion in 2009. "When credit markets were in seizure, we wanted to have more cash should we need it," says company spokesman Jim Dugan. "Those markets have eased."

Caterpillar had nearly $4 billion in cash and short-term investments last month. "Shareholders typically don't like companies that sit on a lot of cash, so we'll put that to work," Caterpillar CEO Doug Oberhelman recently told Bloomberg TV.

The company last week said it will break ground in September on a new factory in Victoria, Texas, that will make excavators and employ 500 when it opens in 2012. Caterpillar is also increasing capacity to make mining trucks in Decatur, Ill., and enlarging a factory in Aurora, Ill., to manufacture mining shovels, a new product. The initiatives are aimed at meeting rising long-term demand for electricity and construction in both Asia and North America, executives say.

The company, which laid off 9,000 U.S. workers last year, is adding about 4,200 in 2010 to operate added plant capacity and meet new demand, Dugan says.

Similar dynamics are playing out for some smaller manufacturers. Marlin Steel Wire of Baltimore recently bought a new $400,000 robot to make housings for electrical components, says President Drew Greenblatt. The machine can churn out large orders in a few days vs. existing machines that take weeks. "It's the most expensive thing I ever bought," he says.

The purchase is requiring Marlin to hire two workers — one to operate the robot and another to bend the steel it cranks out into a three-dimensional shape. The company is also hiring four additional employees to run another new $250,000 machine that makes cable brackets and to relieve workers who have been putting in lots of overtime. His 30-employee workforce will grow by 20% this year. Greenblatt describes the economy as "lethargic at best." But he says the faster machines will help him grab sales he previously lost to Chinese makers. "You win jobs you never would have won, and you have to hire people to run the jobs," he says.

For other manufacturers, increased capital investment and hiring are separate responses to surging demand. The Timken Co. (TKR) estimates sales will jump 75% this year as demand rises for its steel and the steel components it makes for aircraft, wind turbines and construction equipment.

In turn, capital expenses of $135 million are up 18% over 2009. Expenditures will feature replacement of a steel production line at a Canton, Ohio, plant to boost output 15%. While the new, more efficient line will not require more workers, Timken has rehired several hundred employees it laid off last year and will add a few hundred more within weeks when it adds a third shift.

"I need people, resources and technology" to meet growing demand, says Tom Moline, vice president of manufacturing.

A big bet on good looks

Services firms are also ratcheting up investment. Wynn Resorts recently completed a $68 million poolside club at its Encore Las Vegas resort that offers blackjack, dancing, outdoor gaming and cabanas. Next door, Wynn Las Vegas is undergoing an $80 million remodeling of all 2,716 rooms.

Las Vegas hotel and casino revenue has fallen amid the downturn and a glut of hotel rooms, says analyst Michael Paladino of Fitch Ratings. Yet Wynn's revenues are up 38% thanks to booming business at its Macau resort. So the company, armed with $1.9 billion in cash reserves, is sprucing up in a bid to snare market share from its debt-laden Las Vegas rivals, which Paladino says don't have the money to spend.

The company is taking advantage of "our capital structure and (making) sure that we're pretty and fluffed up all the time," CEO Steve Wynn told analysts.

While Wynn is not increasing hotel staffing, the two projects have created more than 1,400 temporary construction jobs.

Buying efficiency

But not all of the companies' spending will lead to more jobs.

Intel (INTC) recently increased its 2010 capital budget to $5.2 billion — up from $4.5 billion last year — to speed up a retrofit of factories, including several in the U.S., that will produce its new 32-nanometer chip. Corporations put off replacing PCs and laptops in the downturn. Now, they're clamoring for the chip, which conserves energy while enhancing graphics and security features, says Kevin Sellers, Intel vice president of finance.

But the gear, he says, won't necessarily lead to new hires as it can largely be manned by current workers. Intel says it will boost its workforce of 80,000 by about 1,500 this year as it hires more researchers and engineers.

Other manufacturers are buying new equipment to do more without adding employees. Diamond Casting and Machine of Hollis, N.H., is making $800,000 in capital purchases this year after not spending a dime in 2009 as revenue fell 50%, says CEO Gerry Letendre. The company, which makes brackets for electrical components, is buying a $350,000 die-casting machine after deferring replacement of a 20-year-old model in 2009.

It's also spending $450,000 on computers, software and sophisticated machinery so it can increase output and make more complex castings that absorb the heat given off by certain components. The largely automated technology should help the company win more business and increase production 50% without adding workers, Letendre says.

"This industry has been shrinking," he says. "We made a choice that we would be one of the survivors, no matter what."

Still others are buying technology to trim payroll. Michael Dortch, an executive at research firm Focus, says many small companies are buying software that lets them run applications on remote servers so they can reduce computer support staff.

Global Capacity, a telecom consultant and network manager, this year spent $150,000 on software to consolidate the accounting systems of four firms it acquired several years ago, says President George King. The purchase, which the company delayed in the recession, lets it cut its finance staff from 14 to 10 through attrition and eliminate temporary employees.

King says the salary savings, in turn, "helps me pay" for other capital purchases, including new networking gear.

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