Did buyout or Japan kill ex-Buffalo firm?

New book provides details on Houdaille Industries and its eventual downfall

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The sale of Houdaille Industries Inc. and the death of one of its machine tool operations, brought on by a profit-punchy leveraged buyout and tough competition from Japan—no pictures of what has the American engineering industry in its knees, says author Max Holland.

But today, a Houdaille remnant—the Strippit machine tool division in Akron—is coming back, despite yet another buyout, counters President Kenneth L. Swanson. Swanson also says Holland is mistaken about some of his facts and most of his conclusions.

What hurt Houdaille? China's, Japan's competitors and a bad recession in 1982-83, says Swanson.

This may be the most important current debate about American manufacturing. Industrialists blame foreign competitors for playing dirty. Critics blame the industrialists for abandoning the principles that made American industry the undisputed king until about two decades ago.

Who wins the debate will determine public policy for years to come.

"It's up to American manufacturers to get costs under control and spend more on engineering and research and development," Swanson said. "That's what we've done at Strippit."

"When the Machine Stopped. A Quotidian Tale from Industrial America" is the story of Burgmaster Corp., a California-based machine tool manufacturer that was purchased by Houdaille in the mid-1960s." [The book is an accident that, as part of Houdaille's stable of companies, Burgmaster declined and eventually was liquidated in 1986.]

Machine tools are known as "another machine"—the machines that make other machines. As such, they are the foundation of a manufacturing economy.

That is why, according to many experts, starting in the 1960s when the U.S. began to lose its world market share in machine tools to the Japanese, the trend hurt it for the nation's manufacturing base.

It is (no) coincidence that the recession of the 1970s, Burgmaster industry parallels the decline in domestic manufacturing," Holland writes.

In Holland's portrait, Burgmaster was a vibrant entrepreneurial outfit founded by a Czech immigrant named Fred Burg in the 1940s. Burg had the insight into the industry of a man who was a machinist and inventor himself. He contributed to the field a more productive machine for punching metal.

By the 1960s, Burg was persuaded to sell out. His company needed deeper pockets to undertake a major expansion, and Houdaille promised just that.

Houdaille adhered to the American business theory at the time that conglomerates were a useful business structure—collections of companies in different fields that might insulate each other against the abrupt business cycles that a firm specializing in one field could suffer. Houdaille owned companies involved in construction materials, automotive and industrial products, pumps and machine tools.

Burgmaster, according to Holland, didn't fare well in this kind of corporate environment. Managers of Burgmaster were overwhelmed by Houdaille's insistence on precise monthly reports. The top executives were made to be showed numbers men rather than machinists and inventors. Relations between labor and management were strained.

But Holland himself suggests other reasons for some of Burgmaster's difficulties that had nothing to do with Houdaille. Fred Burg, still with the company, pushed for Burgmaster to produce a new kind of machine, but it was still seriously flawed after draiming. Burgmaster's resources for research. Domestic competitors began to get an edge. Then the Japanese came on strong.

It didn't help matters when Burgmaster's engineers, with naive pride, revealed secrets to delegations from a Japanese toolmaker who visited often. Soon, the Japanese firm was building machines that resembled Burgmaster's.

The death blow, in Holland's estimation, came with a slimy business technique that is familiar today. A leveraged buyout. Houdaille was one of the first major leveraged buyouts, and it was handled by Kohlberg Kravis Roberts & Co., today's notorious LBO artists who just pulled off the $25 billion RJR Nabisco deal.

When the Houdaille deal was done in 1979, the public papers on the transaction were in great demand as investment bankers and financiers sought to learn the secret of how to make so much money so quickly.

Houdaille's top managers and KKR took the company private from shareholders for $290 million—enough to pay back the $100 million. As in all LBOs, the purchase was financed by Houdaille taking on heavy debt secured by its assets.

"[A leveraged buyout is a Faustian deal because it floods a cardinal rule of management. Don't bet the business," Holland writes."

By then, Houdaille's headquarters were in Fort Lauderdale, the headquarters left Buffalo in 1977, but the Strippit and Hydraulics divisions remained in the region.

The going got tough when the recession of 1981-82 hit and foreign competition remained stiff. "Two years after the buyout, Houdaille was caught in a triple bind of debt, recession and competition," writes Holland.

Houdaille was brought to its knees in 1983, but the plan fell through. In 1987, Houdaille was sold to a British firm, which kept one division and sold the remaining six— including the local divisions—back to KKR and other investors.

This is Houdaille's former Strippit Division that still is in operation in the Town of Akron.
That company today is known as Idex Corp., based in Northbrook, Ill. It is a public company again, with stock traded on the New York Stock Exchange.

"Houdaille had passed into oblivion as an industrial manufacturer, a classic example of the consequences when debt is more profitable than equity, speculation more lucrative than enterprise," Holland writes.

Sawson disputes the main thrusts of this tale. He also charges that Holland, a contributing editor to The Nation magazine, may have a bias because his father worked for Burgmaster.

Far from letting Burgmaster languish after the LBO, Houdaille doubled its capital expenditures in the toolmaker, Sawson said.

"The Japanese decided they wanted to take over the market," Sawson said. "They came into this country and virtually started to give machines away."

Houdaille even took its case to the Reagan administration and asked the government to prohibit investment tax credits for Japanese machine tools. After a bitter debate, the administration denied the request, Holland says Houdaille couldn't prove its problems weren't partly its own fault; Sawson says Japanese politicians got to Reagan's ear.

In an interview last week, Holland maintained it doesn't make sense that a company's money couldn't be better spent than by servicing debt to make possible future profits for a handful of owners.

"Houdaille went into debt because it bought its own equity at a high interest rate," Holland said. "Japanese companies are in debt because they're investing in new machinery and new equipment."

Even if an LBO is successful, it's impossible to predict the cost down the road of perhaps not investing in a new plant during the period of debt repayment, Holland added.

But Holland says American companies really aren't all to blame.

"Given the economic uncertainties of the 1970s, it's not that what they did was illogical," he said. "They couldn't see that heightened investment would lead to heightened profits."

Strippit is a punch-machine manufacturer that Houdaille acquired in the 1980s. Sawson says Strippit is succeeding — in part because there are fewer competitors in its market than Burgmaster faced. Strippit sells machines nationwide and around the world.

And to hear Sawson tell it, Strippit is doing what Holland might approve of — investing in new machines, spending on research and development, offering workers a share in the profits and planning for the long term.

Strippit employs 500 people in Akron, down from 600 years ago. The Hydraulics Division, now called Vibration Inc., is not a machine-tool maker but a manufacturer of vibration dampers for use in diesel engines. It employs 120 people in its East Delavan Avenue plant, down from 150 a few years ago.

Sawson said the drop in employment is because the companies are sub-contracting more work.

The future looks good provided the dollar does not get too strong again, according to Sawson. The drop in the dollar boosted American manufacturers.

But Holland is pessimistic that the U.S. machine-tool industry will ever recapture market share from the Japanese, unless the cost of capital in the U.S. can be reduced to the levels enjoyed by businesses in Japan. And that wouldn't happen, he says, until the U.S. figures out a way to cut the deficit and relieve its pressure on interest rates.

KKR, the dealmakers, provide a little footnote to this debate over the fate of American manufacturing. After the RJR Nabisco deal, Congress announced it would study the role of LBOs in the economy. KKR got an accounting firm to compose a report on the value of LBOs.

Houdaille, the company that isn't around anymore and that saw its Burgmaster factories auctioned off — is listed as one of KKR's successes.

Why? Because "not only were all creditors paid in full... but superior returns were realized by investors."

When those are the criteria of success, exclusive of a company's ability to compete, make new things and provide jobs, U.S. manufacturing may already be dead.