

THE ECONOMY

BUSINESS TURNS ON THE TAP

At last, Corporate America is spending again—thanks to soaring profits, increased demand, and tax breaks

IT HAS BEEN LIKE WAITING FOR *Godot*. Ever since a bust in business spending put the economy on the skids in 2001, economists have been looking for the corporate confidence that's needed to revive and move the U.S. into a sustained expansion. But each time Corporate America got ready to join consumers in the recovery, something went wrong—from the spate of corporate scandals in the summer of '02 to the long buildup to war in early '03.

Once again, Corporate America seems about to shake off its skittishness. But this time the revival looks real. Rising sales and profits, coupled with hefty business tax breaks, are giving companies the ability and the incentive to spend. On Oct. 30, the Commerce Dept. reported that corporate capital outlays soared 11.1% in the third

quarter, the steepest climb in 3½ years. The spending surge was broad-based and helped push the overall economy ahead by a dramatic 7.2% in the period. Further increases in business investment are probably in store, with capital goods orders excluding aircraft rising 4.7% in September. “An increased number of CEOs describe themselves as having the wind at their backs,” Cisco Systems Inc. CEO John Chambers told analysts on Nov. 5, after the technology bellwether announced a 76% increase in net earnings for the quarter ended Oct. 25 on a 5.3% rise in sales.

Even battered manufacturers are on the mend. The Institute for Supply Management said on Nov. 3 that its gauge of manufacturing's health rose in October to its highest level in nearly four years. Production, orders, and exports all climbed,

as inventories fell. “At last, there's pervasive strength throughout our customer base,” says D. Scott Davis, United Parcel Service Inc.'s chief financial officer. “The brightest light is manufacturing. It's the first time we can say that in three years.”

The pickup in business outlays is clearly welcome. Since the recession ended in November, 2001, consumers have been carrying the load, helped along by repeated bursts of tax cuts and mortgage refinancing. But the economy can't rely on debt-driven consumer spending forever. For the expansion to last, businesses have to kick in and do their share.

BARE SHELVES

IT LOOKS AS if that's starting to happen. While consumer spending is forecast to slow sharply from its torrid third-quarter

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pace of 6.6%, the economy is still expected to turn in decent growth of about 4% in the fourth quarter, thanks to business spending on capital goods and inventory rebuilding. Surprised by the recent strength of the economy and consumer demand, businesses have been forced to draw down heavily on inventories to meet customers' needs. Banc of America Securities economist Mickey Levy reckons inventories are now so lean that restocking may add as much as a full percentage point to growth in the next year.

After several false starts, many corporate chieftains remain cautious, especially when it comes to hiring. So far, companies have been able to meet orders for their products by working employees harder. But there's a limit to how long that strategy will work in the face of rising demand. Indeed, there are already signs that the job market finally may be picking up. The Labor Dept. was expected to report on Nov. 7 that nonfarm payrolls rose for the second straight month in October. "We could see a breakthrough in hiring," says Jeffrey Joerres, CEO of Milwaukee-based temporary-help outfit Manpower Inc. (page 160).

Surging profits are already helping corporate confidence—and providing the cash to finance big investments. According to *BusinessWeek's* quarterly Corporate Scoreboard, aftertax profits at about 900 large U.S. companies, excluding extraordinary items, shot up an astounding 41% in the third quarter from a year earlier (page 80). What's more, the profit explosion wasn't just the result of savage cost-cutting. Revenues rose a sharp 9% as well, providing companies an incentive to spend to meet the stronger sales. Further increases in profits are expected next year, although the growth rate will slow.

Corporations, of course, also have the option to go outside for financing, where they're finding it cheap and plentiful, thanks in no small part to the Fed's ultra-

easy monetary policy. "We're seeing some pretty good loan activity and loan demand," Bank of America CFO James H. Hance Jr. told investors on Oct. 14. So far, companies are only putting credit lines in place, not using them. But that should change as the economy pushes ahead.

Thanks to cutthroat competition and continued innovation in the tech industry, corporate buyers are finding that they can get more bang for their buck when they do decide to put their money to work. Computer prices, for instance, were 17.5% lower in September than a year earlier, according to the Labor Dept.'s producer price index. "Prices are coming down enough to make a difference, so that people are saying they don't want old machines," says June E. Drewry, chief information officer at AON Corp., the Chicago-based insurance brokerage.

Pricing has also played a role in the surge in server sales, which rose at a year-over-year rate of 21% in the third quarter, according to Gartner Group. That's the third consecutive quarter unit shipments increased by more than 10%. Still, with demand growing on the low end, not for the six-figure servers that were selling fast three years ago, revenues will not increase as much as unit sales.

DOUBLING DOWN

AS IF LOWER prices and cheaper financing weren't enough, Uncle Sam has also sweetened the pot with tax breaks, most notably a 50% bonus depreciation provision that would allow companies to write off much more of their equipment in the year it's purchased. With the provision,

contained in this year's tax-cut bill, due to expire at the end of 2004, companies are altering investment plans to bring forward spending into next year. Burlington Northern Santa Fe Corp., for one, will take

delivery of 350 locomotives in 2004, vs. 200 in '03. "We simply looked at the difference that [the tax break] made in terms of returns," says CEO Matthew K. Rose. "We're going to double down our investment in locomotives."

So far, the turnaround in business spending has been centered in tech outlays—much of which has been spearheaded by small companies. They tend to be nimbler and can move faster as conditions improve. One example: Ticker Technologies

Inc., an eight-person company in Glen Head, N.Y., that generates stock quotes, charts, and news for about 150 Internet sites. While Ticker's quarterly spending plans govern its IT investment, it can turn on a dime as circumstances change. Since landing a new customer in mid-September, Ticker has scurried to add capacity in the form of 10 new Dell servers at a cost of \$1,600 each.

There are signs the pickup in business spending is slowly broadening beyond high tech and small companies. The Association for Manufacturing Technology reported on Oct. 13 that machine tool consumption jumped 16.6% in August from a month earlier, raising hopes that the worst is over in that depressed sector. And some tech execs report that Big Business buyers are showing some signs of life. "They are still under budgetary constraint, but spending is improving gradually," says PeopleSoft Inc. CEO Craig A. Conway.

Certainly, few economists are forecasting a return of the boom in capital spending seen in the late '90s. But given how long—and how far—corporate spending has fallen, even a modest revival is a welcome sign that a full-fledged economic expansion may finally be at hand. ■

By Rich Miller in Washington and Peter Coy in New York, with Andrew Park in Dallas, Jim Kerstetter and Peter Burrows in Silicon Valley, Roger Crockett and Robert Berner in Chicago, and bureau reports



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BUSINESS GETS IN GEAR

