CONCRETE THOUGHTS

Do Twinkies Have an Expiration Date?

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Lessons from Hostess's demise and what Congress can do for our entitlement programs

Goodbye Twinkies, or at least Hostess Twinkies. It appears as if the iconic baking company will be liquidated, after the largest union representing Hostess employees decided to play chicken with management and lost. The result is that 18,500 jobs will be vaporized. While reading about the plight of Hostess, one can draw an analogy between the maker of Ho Hos, Ding Dongs, Drake's Cakes and Wonder Bread and our entitlement programs like Social Security, Medicaid and Medicare.

Since the national election a couple of weeks ago, I have been asked by reporters from various media outlets what the impact of going over the fiscal cliff would be on the commercial real estate market. While there are several possible outcomes of going over the cliff (none of which is good for commercial real estate), the more important issue in all of the things Congress must address is entitlement reform. All of the other items, whether it be a payroll tax holiday or capping a certain expense item, are merely parsley on the plate. Without someone having the courage to deal with entitlement reform, we are simply kicking the can down the road, and these programs may end up like Hostess, in bankruptcy and unable to do much for anyone who was relying on them.

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Hostess, which has been around since the 1930s, had previously been in and out of bankruptcy, and in its most recent slide was able to negotiate concessions from some of its many unions. Last year, Hostess had gross revenue of about $2.5 billion, but posted a loss of $341 million. Clearly, the national trend away from junk foods did not help its performance, but some of the work rules created redundancies in operating expenses. For instance, bread and cake products had to be packed, delivered and unpacked by three different people and on two different trucks, as those who touched bread were not allowed to touch cake. Additionally, on many delivery routes, another different employee was required to move the products from the back rooms out onto the shelves.

In all, Hostess had 372 collective bargaining agreements, which mandated that the company maintain 80 health and benefit plans as well as 40 different pension plans. On top of last year's $341 million loss, its numerous labor agreements required $31 million in increased costs in 2012 and even more next year. Hostess asked for an 8 percent concession on wages and a higher contribution to the health plan from members of several of its unions. Many agreed, but the members of the Bakery, Confectionery, Tobacco Workers and Grain Millers International Union voted not to agree to the concessions. Hostess, having no other choice, obtained approval from the court to modify collective bargaining contracts, and the union members opted to walk out and go on strike rather than accept the court's decision.

Many of the members who voted to reject the proposal said in interviews that they thought the company "could make a better deal" for them. This was clearly a gross miscalculation, given the precarious position the company was in from a cash-flow perspective. The numbers were so bleak that the company was unable to sustain the strike, a reality that should have been very clear to stakeholders given the existing debt, revenue and expense metrics that Hostess was facing. The numbers for an operating business must make sense in order for the business to succeed. Businesses, after all, exist to make money, and if they don't make money, they eventually fail to exist.

While our entitlement programs are not "businesses" that exist to make money, there is a lesson to be learned from Hostess. Its fate illustrates that a system of any kind, if unsustainable, must change with changing conditions, or ultimately it gets wiped out. Our entitlement programs are paying out more than they are taking in, and each year when the Congressional Budget Office recalculates the numbers, the estimate of how many years each has until it runs out of money shortens significantly. And those calculations are based upon growth rates that are fictional, meaning that they are more underfunded than we think.

Let's hope that these programs are reformed so that they are allowed to exist for as long as folks need them. We can learn from Hostess and all of the other entities that were unable to adapt to new realities and were therefore unable to exist.

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