Who Killed Hostess?

Scott Shackford - Nov. 19, 2012

Once upon a time, Hostess' products – particularly Twinkies and Wonder Bread – had significant amounts of cultural recognition. They were once part of the largest commercial bakery in the world. They were once indelibly associated with the very idea of snack foods for both the Baby Boomer and Gen. X youths.

But the market has changed and Hostess really hasn't. They are no longer culturally relevant in any market other than nostalgia. And whether they'll be around to change is going to be up to whoever ends up in control of what's left of its assets. After two bankruptcies over the past decade and a strike by bakery union workers, Hostess Friday said it's liquidating its assets and shutting its doors, a move that could lead to firing of nearly 18,000 employees.

A judge this afternoon urged mediation between Hostess Brands and its unions to prevent a shutdown, but the company's future remains very unstable, to be sure. As the possibility of Hostess' demise grew, analysts made with the pointing fingers, calculating who, where, and how the bakery had been murdered, not unlike a game of *Clue* (another mid-to-late 20thCentury nostalgia reference of limited modern day cultural presence).

The Bakers Union at the Negotiating Table with a Picket Sign

Hostess Brands cited its enormous pension debts and labor costs for its bankruptcy and stated the Bakery, Confectionary, Tobacco Workers and Grain Millers (BCTGM) Union's refusal to negotiate reductions as culprit. Courthouse News Service looked over the latest bankruptcy filings and noted that eight of Hostess' top 10 creditors are pension funds. It owes almost $1 billion to the Bakery & Confectionary Union & Industry International Pension Fund alone.

The Teamsters even turned against the bakers union, putting out a statement encouraging them to hold a secret ballot vote as total company meltdown approached to see if people really wanted to risk everybody's livelihoods:

> Teamster Hostess members and all Hostess employees should know this is not an empty threat or a negotiating tactic, but the certain outcome if members of the BCTGM continue to strike. This is based on conversations with our financial experts, who, because the Teamsters were involved in the legal process, had access to financial information about the company.

Management at the Executive Suite with a Checkbook

Of course, the counter-narrative to blaming the unions is always executive greed, hedge funds, Wall Street, et cetera.

The BCTGM responded to the attempt to lay the blame on them withaccusations of their own:

> Over the past eight years since the first Hostess bankruptcy, BCTGM members have watched as money from previous concessions that was supposed to go towards capital investment, product development, plant improvement and new equipment, was squandered in executive bonuses, payouts to Wall Street investors and payments to high-priced attorneys and consultants.
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> BCTGM members are well aware that as the company was preparing to file for bankruptcy earlier this year, the then CEO of Hostess was awarded a 300 percent raise (from approximately $750,000 to $2,550,000) and at least nine other top executives of the company received massive pay raises. One such executive received a pay increase from $500,000 to $900,000 and another received one taking his salary from $375,000 to $656,256.
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> Over the past 15 months, Hostess workers have seen the company unilaterally end contractually-obligated payments to their pension

> plan. Despite saving more than $160 million with this action, the company continues to fall deeper and deeper into debt. A mountain of debt and gross mismanagement by a string of failed CEO's with no true experience in the wholesale baking business have left this company unable to compete or survive.

According to David A. Kaplan at *Fortune*, who wrote a lengthy and extremely fascinating look at Hostess' financial situation back in July, many of those raises were proposed but never actually happened. In fact, the new CEO brought in earlier this year dropped the salaries for four top executives to $1 for the remainder of the year.

The union was correct about the failure of company leadership to improve factories and modernize. But some problems could be laid at both their doors:

Management promised to turn around the company's fortunes through innovation and workplace efficiency. It tried a limited-edition return of original banana-cream Twinkies and published *The Twinkies Cookbook*, which included such half-baked epicurean delights as Twinkie Sushi and Pigs in a Twinkie. But ancient delivery trucks and plant equipment didn't get replaced. The company's pricing often didn't keep pace with that of competitors. And Hostess still had ludicrous work rules: The Teamsters had separate drivers for deliveries of such goodies as Yankee Doodles and Nature's Pride Nutty Oat. (Of course this jobs-preserving work rule was agreed to by Hostess in the last labor negotiation.)

The Free Market at the Grocery Store with Competition

Kaplan points out further that the market was not enjoying their Ding Dongs the way it used to:

> By late 2011, Hostess was getting, well, creamed. Its sales last year — $2.5 billion — were down about 11% from 2008 and down 28% from 2004. (Twinkies remain the best individual seller — 323 million of them in the 52-week period ending June 29, give or take a splurt.) Overall, Hostess lost $341 million in fiscal 2011, 2½ times the loss of the prior year — and by early

> 2012, primarily because of burgeoning interest obligations, its debt had grown to about $860 million.

There is so much competition now in the grocery store for bakery products, much more than in Hostess' heyday. Does anybody actually still eat Wonder Bread?

Doug Mataconis at Outside the Beltway notes that maybe the days of Hostess are simply over, regardless of any debts, protectionist union agreements or creaky factories:

> There's no doubt that labor costs were a huge problem for the company, but it's also clear that there were a number of other factors that appear to have contributed to their troubles. Among these are what seems to be a rather antiquated distribution system and the fact that consumer tastes have changed significantly over the years. Most importantly, these aren't the 1970s when Hostess snacks were a ubiquitous part every kids' lunch box, at least in my neck of the woods. (I was a fan of the fruit pies personally) The bread side of the business was likely suffering from the fact that that particular market is saturated right now and that a lot of grocery store consumers are preferring to purchase breads made fresh on-site rather than branded products. So, yes, the Union was the proximate cause of today's decision to shut down the business but my feeling is that it would've happened anyway.

The Sugar Lobby in the Halls of Congress with Tariffs

The *Christian Science Monitor*, pulling from a Cato Institute report, questions whether America's protectionist racket with sugar growers bears responsibility:

> Since 1934, Congress has supported tariffs that benefit primarily a few handful of powerful Florida families while forcing US

> confectioners to pay nearly twice the global market price for sugar.
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> One telling event: When Hostess had to cut costs to stay in business, it picked unions, not the sugar lobby, to fight.
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> “These large sugar growers ... are a notoriously powerful lobbying interest in Washington,” writes Chris Edwards of the Cato Institute in a 2007 report. “Federal supply restrictions have given them monopoly power, and they protect that power by becoming important supporters of presidents, governors, and many members of Congress.”

Some food manufacturers have moved facilities to Mexico and Canada. While the assumption may be the move is to save money on labor costs, it allows companies to buy sugar on the world market for a cheaper price than they would in the United States.

If Hostess is either liquidated or sold, one of the big names being bounced around is Mexico’s Groupo Bimbo, which already manufactures and distributes Wonder Bread south of the border.

Rich People on Giant Yachts with Their Armies of Servants

Checking in from some other planet is alleged economist Paul Krugman, who participates in no actual analysis of Hostess whatsoever despite writing a column that is allegedly about it and instead engages in class warfare via nostalgia about how even the rich people during the ‘50s were so much better than the class of rich people we get today. Also unions had a lot more power:

> Nor were high taxes the only burden wealthy businessmen had to bear. They also faced a labor force with a degree of bargaining power hard to imagine today. In 1955 roughly a third of American workers were union members. In the biggest companies, management and labor bargained as equals, so much so that it was common to talk about corporations serving

> an array of “stakeholders” as opposed to merely serving stockholders.

Eh, what? Hostess’ failure is almost assuredly in part to caving into the unions on unsustainable pensions and work protection regulations, a disaster that all sides played a role in. Is there anybody outside Krugman who thinks Hostess failed because the bakers union wasn’t powerful enough?