Know that adage about turning lemons into lemonade? Donald E. Washkewicz does, and how. Appointed CEO of Parker Hannifin Corp. in February, 2000, and president 17 months later, Washkewicz took the reins amid the worst industrial recession in decades. As the world's No. 1 maker of motion-control products -- hydraulic and pneumatic components for aircraft, construction equipment, and even theme-park roller coasters -- the company was beset by declining orders and falling profits. Washkewicz lopped payroll by 15% (about 7,650 employees), froze pay from top to bottom for a year, and shuttered almost 100 plants.

Nonetheless, Washkewicz says some good came from the downturn. To further cut costs, he imposed "lean manufacturing" throughout the company. Cells of factory employees now manage their own workflow, from parts procurement to job assignments to filling just-in-time orders from customers. Because the slump was so long, with orders sluggish until late last year, Washkewicz says this lean approach has become imprinted at every one of Parker Hannifin's 105 business units, boosting productivity while reducing inventory and capital-equipment needs.

The results are promising, even as the effort continues. In the fiscal fourth quarter, which ended June 30, the company reported record revenues of $7.1 billion, up 11% and meeting Washkewicz' double-digit growth target. Profits soared 76%, to $346 million, thanks largely to a surge in industrial orders. That made Parker Hannifin's fiscal 2004 operating margin 10%. Not bad, but the CEO is aiming for 15%.

Washkewicz, 54, is an unlikely agent of change. An engineer, he came aboard at Parker Hannifin's hose products division in 1972, fresh out of Cleveland State University. Typical of Parker Hannifin, where the top 44 executives average 19 years with the company, he has never worked anyplace else. Sitting in his corner office at Parker Hannifin's headquarters in Mayfield Heights, Ohio, Washkewicz talked recently with Senior Correspondent Michael Arndt.

Parker Hannifin survived the recession by downsizing and shifting focus. Are you hiring again?
The word is selectively. If we can serve our customers without adding space, equipment, or people, we'll do it. At the end of the day, we've had to add some people back, but not nearly like before. In recessions we've had before, you'd lay off 10% of your workforce, then you'd hire them all back. In past recoveries, it was bring on the equipment, bring on the people, work the overtime. That's not how it works any more.

How did the push into lean manufacturing help your survival strategy?
We found that we freed up 25% or 30% of the square footage of our plants just going "lean" and getting rid of lots of waste. Here's an example. In the past, you had to justify your machine tool by the setup time: It takes me 25 hours to set this thing up, at $50 an hour, so I've got to run a batch of 1 million widgets to justify that setup time. What you ended up doing was using all your capacity to make inventory that nobody needed. In the meantime, your customer service suffered because you didn't want to break in on that machine run to fill new orders. Nobody wins.

Now when the orders come in, you start the process and you ship it out the door. Nothing sits on shelves anymore.
Nothing is queued up. That's what's really driving efficiency and inventory reduction throughout the company. That's basically the concept of lean.

**But don't you lose efficiency by going to this build-to-order approach?**
No. Instead of buying that big $1 million machine tool that will make a million products at lightning speed, you tend to buy lower-cost and smaller capital equipment that you can change over quickly, and that is more efficient. So, in fact, you don't suffer in the end. You can maintain low setup costs in cellular manufacturing.

Workers like this, too. It tends to make their jobs easier. Each worker is the inventory control manager for raw materials. When he needs materials, he orders them himself. In the prior process, you had to staff a whole purchasing department and send a requisition in to them, and you'd bring in too much invariably because you had to stock up on materials. Now we have the raw materials delivered only when we need them.

**Yet as part of this strategy, you've cut capital expenditures to about 2% of sales. Can you get by at that level of investing?**
In the downturn I had third-shift capacity sitting idle. I didn't need to buy any more machines. Now with this whole lean concept, we're going to do more with the capital we've got. Where we see a bottleneck, we're not going to put in a whole new line. We're going to address the problem and buy just one piece of equipment. We say we should be able to survive at a cap-ex spending rate of 3% to 3.5%. We'll see how that works out.

**If your customers follow a similar strategy, won't it hurt your business?**
We've thought about that, too. But there's plenty of demand. Smaller U.S. companies are making investments. And overseas markets are growing, too. There's a tremendous amount of infrastructure going up in China, for example. They want to build 50 airports over the next five years -- that's good for us.

**Where does the U.S. fit in today in Parker Hannifin's operations?**
We are all over the world, in 40-some countries. We tend to manufacture close to our customers. So if the customer goes to China, that's where we'll set up shop. Likewise in South Korea or Eastern Europe. We're not sending every job to China or to Mexico. We'd be crazy to do that. We've got about 30,000 employees in the U.S. and 3,500 jobs in Mexico. There's a balance. We see a constant ebb and flow of jobs going all over.

**What is your outlook for overall growth?**
I'm no economist, but my sense is that we'll be in the 3% to 4% range for gross domestic product growth. The real wild card is interest rates. Rates are going to go up next year. It's going to moderate the GDP growth a little bit. But hopefully, the good times are here. We see all the industrial markets really hitting on all cylinders.

**The Fed just boosted interest rates by 50 basis points. Are you worried that higher rates will hurt your business?**
Am I concerned today? No. Going from a rate of 1% to 1.5% will not make much of a difference. It's a matter of just how much they raise. If they ramp up rates at a very fast pace, without giving the economy an opportunity to respond, they could stop the expansion completely. The key is to do this in a measured fashion: Give the economy enough time to respond to what you're doing before you take the next action.

**Inflation is a big concern for the Fed. Are you raising prices?**
We've been passing costs on to the best of our ability. Our big customers understand because they've had to do the same things themselves. When you sell to a large original-equipment manufacturer on incremental margins, you can't absorb a 20% price increase on a raw material -- you've got to pass it on. We're not 100% successful, but we're reasonably so.

**I would guess that's very different from where you were a year ago.**
Absolutely. Today customers are more concerned about getting products than they are about the price. That's not to say they're not concerned about the price -- they're always going to be pushing back. But in the heavy-duty truck market, for instance, several of our customers have said to us: "Do we have to find other suppliers, or are you going to be able to keep up with us?" We say: "You give us the orders, we'll do it." There's still plenty of capacity left.