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Survivors' burden: Smaller suppliers that weathered recession find success isn't enough to attract capital

By Michelle Martinez

NATHAN SKID/CRAIN'S DETROIT BUSINESS

Chuck Dardas, COO of Livonia-based Alpha Group, is itching to add equipment but says funding is scarce.

Chuck Dardas has a wish list of laser-cutting and milling machines he'd like to buy to help his company compete with other suppliers in the automotive, defense and alternative energy markets.

But for now, he's just window shopping.

"The only way to get at it is to fund it ourselves," said the COO of the Livonia-based Alpha Group. "We just have to invest as we can, as we accumulate cash. There's not a pool of funding available to us like the big guys."

Alpha had $22 million in revenue in 2009 and expects to record about $30 million by year's end.

"We weathered last year, and we think that we are coming to the banks with a strong business plan. But the banks tell us that our gains aren't "seasoned.' I'm very frustrated. We don't have a voice."

Many tier-one suppliers emerged from last year's crunch with restructured costs and healthy books of business, as well as the wherewithal to access credit markets, said David Andrea, vice president of industry analysis and economics for the Troy-based Original Equipment Manufacturers Association. But as the turn in fortunes has been trickling its way down the supply chain, smaller suppliers are still finding it difficult to access credit lines to retool for new vehicle programs or to diversify into other industries.

That's especially true for companies that bring in less than $100 million a year, Andrea said.

Banks recovering from battered portfolios are skittish about lending to automotive suppliers that don't have several years of solid financial performance under their belts or enough collateral to back the loans, analysts say.

Property, plant and equipment loans plummeted by about 80 percent during the past two years, said Paul Brown, manager of capital markets development for the Michigan Economic Development Corp. For many suppliers, new appraisals designate them as high risk, even if they've had a long relationship with the bank. Federal regulations require banks to either remove such loans from their portfolio or increase their reserves to support the loan, "which they don't have the capital to do," he said.

"At first I thought this must be the bankers, they must be the villains in this, but they aren't," Brown said. "A lot of this is happening to valuable, long-term customers."

Nonetheless, the problem is hovering over smaller suppliers at a time when accessing capital can mean the difference between winning new business and withering on the vine. Many suppliers are just recovering from the deep trench in business in 2009, when many slashed costs to the bone to survive, said Steven Melnyk, a professor of supply chain management at Michigan State University. Now that business is returning, suppliers are discovering it's not exactly business as usual.

Automakers are building their futures on a smaller number of global platforms and are seeking suppliers that have sophisticated technology and design skills, as well as the ability to juggle multiple platforms, said a 2009 report from Chicago-based consultancy Grant Thornton LLP. As important is a geographic footprint that matches automakers and larger suppliers in North America and beyond, the report said.

Such requirements are difficult to meet without access to capital, Melnyk said.

"Supposing the economy turns around, they're not in a position to expand quickly," he said. That's particularly true compared to German and Chinese suppliers that have been sharpening their skills and investing in their facilities, anticipating an upturn in business, he said.

"They're in a beautiful position because they maintained the skill level of their supply base," he said. "My concern is that you're going to have a situation where there's not enough of a diversified pool of qualified suppliers (here)."

State programs such as the MEDC's Michigan Supplier Diversification Fund have aimed to leverage federal and state dollars to back up collateral value so healthy suppliers can access bank loans. But despite successes, the demand has so far outstripped supply, Brown said.

"The state put in $13.3 million that was quickly exhausted. It put in another $13 million, and we're quickly reaching the end of that. We knew we would," he said.

Michigan is eligible for $81 million in federal dollars under the $1.5 billion state small business credit initiative — part of the Small Business Jobs and Credit Act of 2010, Brown said. Leveraging required private dollars could free as much as $800 million in credit assistance to businesses looking to retool, diversify or expand.

But long-term recovery relies on a return to stability in the automotive industry, said Jim McTevia, managing member of Bingham Farms-based turnaround consultancy McTevia & Associates — something that may be a long time coming.

"With all due respect to my economist friends, the industry has far from stabilized," he said. "It's in tremendous transition."

But quarterly reports from large suppliers so far have given reason for optimism. Local companies like BorgWarner Inc., Visteon Corp. and Lear Corp., for example, all reported a jump in third-quarter sales.

Smaller suppliers see smaller victories, but also more troubled times ahead.

"During the last three or four months, it has steadily improved" said Tom Mullen, owner of TNT EDM Inc., a Plymouth-based tool and die shop. "We're starting to get jobs back from customers we haven't heard from in a year."

About five years ago, the company diversified into medical equipment, aerospace and power generation and bought a five-axis machining center.

"If I had to make the investment today, we'd be in trouble," he said. "I've heard a lot of war stories."

Automotive still represents about 70 percent of TNT's business. And although business is improving, Mullen says it's hard not to feel as though surviving this long is only half the battle.

"We're the ones that have survived," he said, "and we're paying the price for it."

To Melnyk, such sentiment indicates a broader problem that could punch holes in auto's supply chain.

"You have to look at the supplier base like a baseball franchise looks at its own system," he said. "You have to manage the minor leagues."

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