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## **Many auto parts suppliers failed to widen base**

**By Sharon Silke Carty**

DETROIT — A few years ago, Plastech Engineered Products was considered one of the auto supply industry's success stories.

The plastics company, which had revenue topping \$1 billion in 2004, was heralded as a triumph in the auto industry. And CEO Julie Nguyen Brown and her plastics company were seen as the gold standard to which other minority-owned firms should aspire.

In February, however, Plastech crumbled under the pressures facing the entire automotive supply chain, filing for bankruptcy-court protection and ending up in a nasty public dispute with Chrysler, one of its primary customers.

Plastech was one of two plastics suppliers to file for bankruptcy protection last month, and industry watchers say more parts makers are on their way. The pressures building in the industry are too great.

"I can't in my 21-year history in the auto industry think of a time when it's been more difficult than this," says Laurie Harbour-Felax of consulting firm Stout Risius Ross. "More Chapter 11 filings are imminent in the next three to six months."

A multitude of economic factors are depressing the supply industry, including:

- Vehicle sales are expected to plummet to the mid-15 million range, after topping 17 million in 2000. Automakers are working hard to restrain production to stay in line with actual demand as the economy weakens. Ford announced earlier this month that it will slash second-quarter production by 10% to its lowest output since 1982.

- Pressure from automakers to cut parts prices continues to intensify as they restructure their operations.

North American suppliers must compete not only with each other but with suppliers in China and India, where labor costs are much lower.

- Raw material prices, from oil (to make plastics and transport parts to assembly lines) to metals used throughout cars, are on the rise.

In the current environment, suppliers often can't pass those cost increases along to their customers, the automakers.

- Credit lines are drying up, making it difficult for cash-strapped suppliers to survive while waiting for their customers to pay their bills.

Auto suppliers must have plenty of cash on hand, because they often don't get paid for at least 30 days after parts are delivered — and sometimes wait 90 days.

"I don't think you'd be going out on a limb to say that the current economic environment for North American suppliers is probably the worst it's ever been," says Stephen D'Arcy, global automotive leader for PricewaterhouseCoopers.



Steve Britton, a machinist at Schmalz Tool & Die for 19 years, works at the Burton plant.



Laurie Moncrieff, third-generation owner of Schmalz Tool & Die in Burton, Mich., says the auto industry's downturn surprised many small suppliers.

### **Rough road after boom years**

The automotive supply sector has been undergoing a slow restructuring process for almost a decade. In 1998 and 1999, auto suppliers were posting record years. They

boosted employment in the industry to more than a million people for the first time since 1978, and earned steady revenue as automakers pumped out profitable SUVs.

But when problems arose in the industry, the suppliers hadn't equipped themselves well to deal with them.

In the good times, many did not invest in upgrading manufacturing processes to be leaner and more cost-efficient. Harbour-Felax says many suppliers couldn't see the longer-term benefit in investing the large amounts of money needed to reconfigure their manufacturing operations to be more competitive.

Some used the profits to grow by taking on new projects — using the same systems and technology they had been using for years. Some went on acquisition sprees, buying up smaller parts makers and expanding their operations further.

Many also were content to continue to rely on the same customers rather than try to diversify their base while business was strong.

The attraction to continue doing business with the same buyers — most North American parts suppliers are heavily dependent on U.S. automakers, and some do the majority of their business with just one — seemed to make sense when times were good and loyalty was rewarded with more contracts.

"In the glory days of the 1980s and 1990s, there were a lot of suppliers that sprang up just to support GM, Ford and Chrysler," says Harbour-Felax.

"A company would spring up with a certain product line. Ford, GM or Chrysler would fall in love with it, and the next thing you know, you'd have a big business built around it." That kind of business strategy made many companies rich for years, Harbour-Felax says.

But sales peaked in 2000, and when business began declining, even in small increments, suppliers got crunched.

The downturn in business hit hardest in the automakers' most profitable lines — SUVs. And the hurt went deeper for domestic automakers, who began losing market share faster than ever to Asian rivals such as Toyota and Honda.

Some suppliers reacted to the downturn by becoming leaner and diversifying their products and customers, Harbour-Felax says.

Others didn't.

"There are many suppliers who were living in denial, and now that's all catching up with them," she says.

## **Small suppliers change habits**

Laurie Schmalld Moncrieff, the third-generation owner of Schmalld Tool & Die in Burton, Mich., says the downturn took many small suppliers by surprise. Business flattened out until 2000, then took "a steep dive," she says.

"We always had the luxury of being order-takers and focusing inward," she says. "The phone always rang, and orders always came in.

"But now, because the market is turning over a lot, you have to continually be replacing customers. It's a new intensity of getting out there and keeping up with the market."

And that can be especially difficult for smaller suppliers, who often earned business through personal connections and word-of-mouth, and didn't even keep a sales staff on hand.

The smaller companies' products often go into the parts assemblies of larger suppliers, who in turn sell those to the automaker.

Moncrieff says she's working to diversify into growing markets, such as helping other suppliers make parts for alternative-fuel vehicles.

And she's attempted to earn new customers who work with automakers such as Toyota and Honda, but getting business from those companies can be difficult.

Asian automakers take a long time to decide whether they want to do business with a new supplier, and will often visit the supplier's plants and the plants of the supplier's suppliers.

It can be a grueling process for many small companies, but the payoff is big. Once an Asian automaker picks a supplier, the relationship could last decades.

The Asian automakers "are very, very demanding" on quality issues, says D'Arcy of PricewaterhouseCoopers. "However, once you are established, they tend to be very good customers."

## **Big suppliers heirs to high costs**

Some of the biggest suppliers face special problems. Companies including Delphi, Visteon and American Axle all were once subsidiaries of an automaker. When they were spun off into independent companies, they were saddled with the same high labor costs as their former parents.

That's part of what's behind the current strike at American Axle, formed by GM as a separate business in 1994, as the company attempts to get its labor costs in line with other suppliers of similar size. Delphi, a GM unit until 1999, has been under bankruptcy court protection for nearly three years, and Visteon, a Ford unit until 2000, has posted seven-consecutive unprofitable years.

But they also share many of the same problems as smaller suppliers. They're working to diversify their customer bases, struggling with rising raw material costs and working to cut their prices.

For many of the largest suppliers, which sell parts directly to the automakers, the answer may be a Chapter 11 bankruptcy filing. Under court protection, the companies can renegotiate contracts, break agreements in unprofitable areas and shed labor contracts and high-price workers.

The February bankruptcy filings of Plastech and Blue Water Automotive Systems, another plastics company, are "just the tip of the iceberg," says Pat Furey, automotive manager for consultant Ariba. "Unfortunately, more will come."

### **A shakeout coming**

Bankruptcy filings seem idyllic compared with what Craig Fitzgerald, a partner at Plante & Moran, predicts. He expects 50% of small and midsize suppliers will go out of business in the next five years, either selling their operations to larger suppliers or just closing up shop.

Part of the problem, he says, is that suppliers can't persuade enough engineers and sales managers to work for them.

"They don't see a future in the business," he says.

Taking the Chapter 11 route means the company owners see a viable long-term business when it emerges from court protection. But Fitzgerald says a lot of suppliers will realize their hopes to stay in business are far-fetched as they see more operations move abroad and sense a growing desire by automakers to work with fewer suppliers.

"Many of them would prefer to sell their business," he says. "But for many, that's not going to be realistic, and they'll simply wind the business down."