

West Michigan Supply Management: A Year in Review

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Despite the weakened condition of Michigan's economy, the west side of our state was able to hold its own throughout most of 2007. Although the West Michigan economy was far less robust than it was in the late 1990s, the economic performance for most of the year was positive.

For firms associated with aerospace or defense, it was a banner year. Because of the high level of spending for defense, almost all of our area firms were at or near capacity throughout most of 2007. Furthermore, aircraft component manufacturers, especially those selling to domestic airframe manufacturers such as Boeing, applauded the demand for new aircraft brought on by renewed profitability for the major airlines.

The office furniture industry, one of the key industries for the west side of Michigan, has a business cycle that is different from most other industries. For instance, the so-called dot-com boom of the late 1990s resulted in the creation of new office space at an unprecedented level. At that time, many of our local office furniture firms set record levels for sales and production. When the dot-com bust began to take hold in late 2000, the market was loaded with a vast amount of unused and unsold office furniture, resulting in about a 30% drop in furniture sales. It took our local firms about six years to recover.

Although the office furniture industry began in 2007 on a positive note, the tide began turning late in the summer as the sub-prime credit problem began to spill over into the commercial construction industry. As with any industry, there are exceptions, and some types of furniture are still selling very well. However, overall sales of office furniture are now lower.

Other firms respond to the overall market. For instance, industrial distributors largely derive business from the activity level of all of the manufacturing firms in the area. Firms that either supply or service the building trades have obviously not been doing well since the onset of the housing crunch. As local business conditions have softened, it follows that capital equipment manufacturers have had their orders reduced, unless they have been able to identify replacement business outside of the state.

By far, the most challenged industrial sector for 2007 has been firms associated with the production of auto components for the Big Three auto firms. Throughout the year, sales for the domestic nameplates have been fading, resulting in incremental reductions in order releases. For several firms, this has resulted in workforce reductions brought on by the lower demand for shipments as well as the continued squeeze on costs. Many local firms are also struggling to successfully attract new business from the Japanese and Korean nameplates where sales continue to rise.

About the Survey

The monthly survey of business condition, published under the title of "Current Business Trends," first debuted in Kalamazoo in February of 1979 and was expanded to Grand Rapids in 1988. At present, the survey encompasses 45 purchasing managers from N.A.P.M.- Greater Grand Rapids and 25 from N.A.P.M. Southwestern Michigan. For both surveys, the respondents are purchasing managers from the region's major industrial manufacturers, distributors, and industrial service organizations.

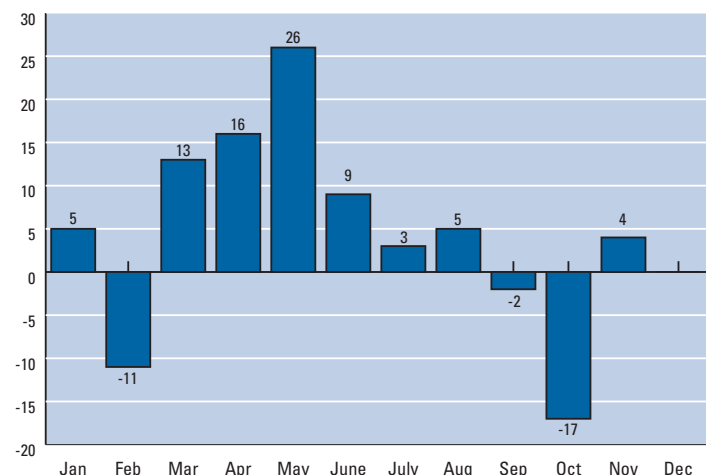
Patterned after the nationwide survey conducted by the Institute for Supply Management, the strength of the survey is its simplicity. Each month, the respondents are asked to rate eight factors as "SAME" or stable, "UP" or improving/rising, OR "Down" as in declining/falling.

New Orders

As the name implies, this index measures new business coming into the firm, and signifies business improvement, or business decline. When this index is positive for an extended period of time, it implies that the firm or organization will soon need to purchase more raw materials and services, hire more people, or possibly expand facilities.

As Figure 1 illustrates, early 2007 showed some considerable improvement in new orders. By mid-summer, the growth rate subsided considerably, and was sharply lower for the month of October.

Figure 1: NEW ORDERS
Percent "Up" vs. "Down"

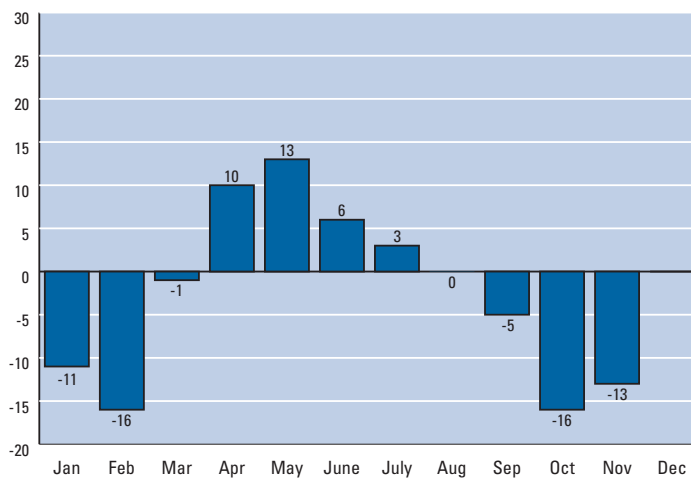


Production

As new orders come in and materials arrive at the loading dock, production schedules are posted to meet the customer's needs. Although production schedules respond to demand, they also respond to seasonal factors such as holidays, external factors such as bad weather, materials shortages, and other uncontrollable influences.

In early 2007, production schedules were slow. These schedules rebounded in the middle of the year, and some forecasters thought that these stronger numbers would foreshadow a strong finish for the year. Unfortunately, as noted by Figure 2, the last few months of the year did not turn out to be positive.

Figure 2: PRODUCTION
Percent "Up" vs. "Down"



Industrial Inflation

Although inflation was a problem for most West Michigan buyers throughout 2007, experienced purchasing managers will recall other years that were far worse. Most of the problems were related to the price of oil, which resulted in higher fuel prices, higher freight costs, and higher cost for plastic resins and petrochemicals.

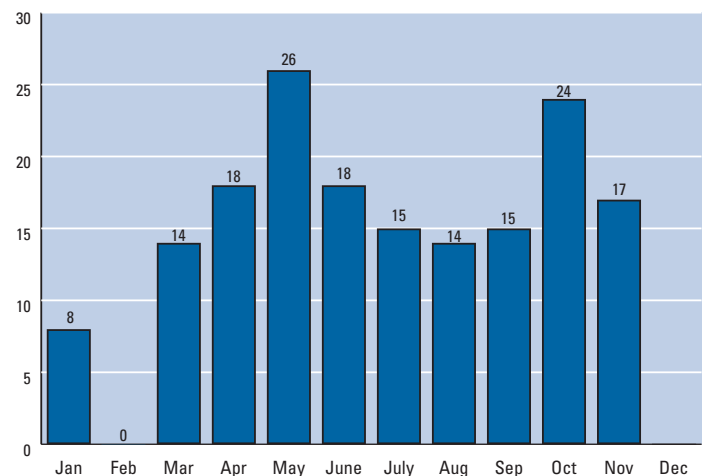
As 2007 draws to a close, the base prices for many key commodities such as aluminum, lead, zinc, copper, and nickel are lower in price than they were just six months ago. However, except for our April report, DELIVERED prices have been slow to come down, and many firms are still complaining about the high prices for these commodities (See Figure 3). Hopefully, 2008 will see some price relief for most of these major commodities.

For domestic consumers, inflation limits their ability to buy as many goods and services as they would like. For most

industrial firms, industrial inflation results in a nearly direct deduction to bottom line if the higher costs cannot otherwise be offset. Many years ago, higher costs of doing business could be passed along to the customer in the form of higher prices. The market for most industrial goods was fairly well contained within the United States, and most competing firms faced similar cost structures.

In today's "world market" environment, ANY attempt to pass along higher costs is often met with the threat from the industrial customer to terminate the contract and take the business overseas. In the case of the Big Three auto companies, they simply refuse to listen to pleas for higher prices to relieve the stress of higher raw material costs—even though most firms have little or no control over the markets for commodities such as plastic resins, steel, or copper. In fact, the Big Three are now pressuring their West Michigan suppliers to seek offshore sources as means of cost reduction. Clearly, this is not a positive trend for the Michigan economy.

Figure 3: PRICES
Percent Reporting "Up" vs. "Down"

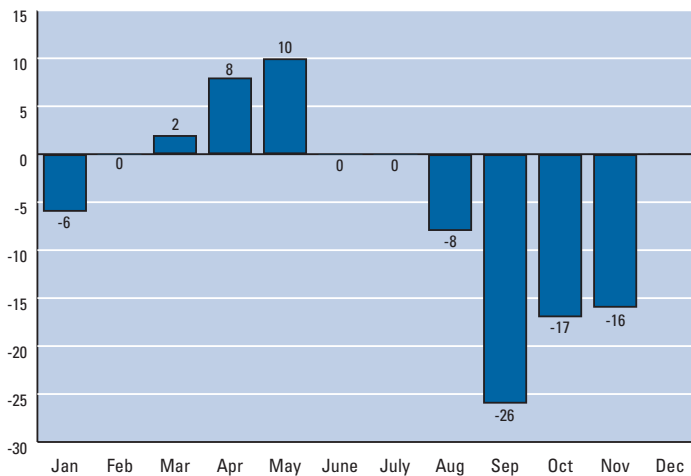


Employment

The employment index measures the expansion and contraction of the firm's entire workforce, including office and production personnel. Many firms will remain stable for long periods of time, until significant economic events result in new hires or layoffs. Others will add or subtract people one or two at a time.

Even though the economy remained fairly positive for much of 2007, the number of firms adding new jobs was fairly limited. Regrettably, as Figure 4 shows, more firms are reporting workforce reductions in the later part of the year.

Figure 4: EMPLOYMENT
Percent Reporting "Up" vs. "Down"



Looking Ahead to 2008

The mood of many West Michigan businesses turned decidedly negative in October when Lansing lawmakers passed a new sales tax on a wide variety of services that are purchased by most industrial and non-industrial firms. Although these new taxes were repealed, they were replaced by a surcharge on the new Michigan Business Tax. When all is said and done, most businesses will be looking at a higher tax burden in 2008 than they faced in 2007.

Although most of our local indicators have turned slightly negative, we are still uncertain about how deep the sub-prime quandary will cut into the economy as we look forward to 2008. Whereas tightening of loan requirements have clearly been felt in the slumping housing market, the auto finance firms as well as every other form of consumer credit have seen tightening as well. At the national level, declines in automotive and housing have been offset by strong demands for export goods, including those associated with the aircraft, machinery, and agricultural industries. On a nationwide basis, job losses in Michigan have been offset by job gains in other parts of the country. With the U.S. Treasury officials and various committees in Congress working on band-aid solutions to the problem, we can hope that there will be enough fiscal and psychological relief to keep us out of a recession. At this time, there is still at least a 60% chance that a recession can be avoided. However, we will certainly enter 2008 at a slower pace.