



The Aerospace Supply Chain Credit Crisis

Despite a federally funded bailout, commercial and investment banks on Wall Street will prolong the current credit mess

MICHAEL J. DYMENT, MANAGING DIRECTOR, NEXA CAPITAL PARTNERS, LLC

Behold an all-too-common story: A commercial cash flow lender awash in billions of federal dollars tightens the credit available for the cash-strapped owner of a small aerospace manufacturing company, insisting on personal guarantees and collateral. Forced to deal with less working capital and unexpected collection delays from original equipment manufacturer (OEM) customers, the owner falls behind on his credit card payments. His personal credit rating, on which the business loan relies, gets a black mark. That is reported to the commercial lender, who tightens terms further or calls the loan.

Ten months after the collapse of the credit markets, we are seeing the damage done when commercial banks impose harsh new rules just as their customers are most vulnerable. Nationwide, bank loans fell to a record low in the first quarter of 2009, and with the end of the second quarter last week that record will no doubt be topped (or more correctly, bottomed). A new analysis by our firm, NEXA Capital Partners, confirms that the aerospace sector is among the greatest victims of the credit squeeze. The crisis threatens to seriously dampen the industry's recovery and imperil its entire supply chain.

In the past decade, commercial banks have forgotten their main purpose – lending capital – and have invented self-serving new ways to make money. They have created products and services of no value to the economy, which they buy and sell among themselves, racking up profits, commissions and bonuses. As President Barack Obama said recently, “It was in pursuit of gaudy short-term profits, and the bonuses that came with them, that so many folks lost their way on Wall Street.”

Commercial banks have a responsibility to lend capital to small and large companies, and not just to their financial counterparts. Federal programs, including the Troubled Asset Relief Program (TARP), lavishly cushion the banks' risks in the current environment. Yet the flow of credit has dried up anyway. According to the White House, businesses “with strong credit histories have seen loan applications denied due to conditions that have nothing to do with their own actions.” The U.S. Small Business Administration typically guarantees about \$20 billion in loans annually, but new lending could drop by as much as 50% in 2009.

An added challenge for aerospace companies is that lenders need to have an acute understanding of highly complex economic issues, global markets and players. Yet many banks have downsized their sector experts or retired them altogether to drive a bigger bottom line. A look

down Wall Street finds that aerospace experts are a vanishing breed. It is ironic that the same banks that created this mess will surely delay an aerospace sector recovery through restrictive new lending policies tied to elevator speeches about understanding sector risk.

Yet there is a bright spot for the smaller aerospace companies. While the big banks repay their TARP infusions so they can quickly increase their executive pay packets, small banks are jumping in to help companies in their local communities. These banks, numbering in the thousands, don't pay hefty executive bonuses for outrageous profits made through incestuous dealing. Their governance models, including community involvement, reward management for lending based on well-understood risk analysis tied to concentrated due diligence. Smaller players in the aerospace sector should end their fixation with Wall Street lenders and concentrate their credit hunt on Main Street.

Another possible solution rests with the OEMs themselves, some 62% of whom, according to a recent study, are greatly concerned about the survivability of their suppliers. OEMs should consider facilitating the availability of credit for their second and third-tier suppliers by taking a two-pronged approach. They can extend their own credit while utilizing their Washington lobbies to create greater small business access to working capital through the Small Business Administration and direct government loans. Similarly, the Aerospace Industries Association should intensely lobby for aggressive solutions.

Action is required now. Like an avalanche, the industry's economic freefall could soon reach a point where its momentum simply cannot be stopped. According to Henry Wheeler Shaw, “The wheel that squeaks the loudest is the one that gets the grease.” It's time for the aerospace industry to make some noise.

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