

**GLOBAL COMPETITION:
AN OPPORTUNITY FOR OUR
DOMESTIC WOOD PRODUCTS INDUSTRY**

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DOVETAIL PARTNERS, INC.



Global Competition

An Opportunity for Our Domestic Wood Products Industry

Executive Summary

For at least fifty years, large segments of the wood products industry have been in the standardization phase of their organizational history, with many of their products trapped in the mature or declining phase of their product life cycles. During that time these companies have excelled at minimizing costs, increasing efficiencies, and eliminating waste. However, competition from developing countries with “cents-on-the-dollar” wages, access to low cost fiber and access to capital for new machinery and equipment is throwing the concept of incremental improvement out the window. Many segments of the wood products industry are at a crisis point in their history; in some cases organizational survival is at stake. A new paradigm is needed.

However, the glass is clearly half full. This is the chance for industry to re-tool and rethink itself, and to seize the opportunity to move away from the low-margin, equipment-centric commodity approach of the past fifty years to a more flexible, higher margin, people-centric vision of the future. The opportunity is in redefining success in terms of profits earned and job satisfaction. For many, this situation gives leaders permission to re-create their businesses in ways they’ve always desired, but couldn’t because they weren’t able to find their way off the commodity treadmill.

This article discusses those key activities that can affect the ability of wood products companies to compete in the future. Foremost among these is recognition that *the most critical change must occur in the boardrooms and executive offices*, not in the factories and warehouses. Research suggests that there are three primary ingredients to successfully addressing this change. First, a clear, motivating vision is essential; and that vision may need to be significantly different than the one of the past. Second, organizations need to seek out, welcome, nurture, and institutionalize a higher level of creativity in all that they do. Third, deeper and broader relationships with customers, vendors, and employees are critical to identifying and implementing positive change. Ultimately, wood products businesses must begin to excel at: not making more, but making different; not eliminating costs, but adding value; and not increasing efficiency, but instead increasing intimacy.

Background

In the Dovetail article “Trends in the Global Forest Sector and Implications for Forest Certification” we pointed out that there are a number of mega trends indicating a major change in the global forestry and wood products sector. Three of these mega trends are of specific and direct importance to wood products companies in the US. These are:

1. Abundant labor in China and developing countries is giving those regions a significant competitive advantage in global wood products markets

2. Significant capital investment in infrastructure in developing regions is supporting the development of their forest and wood products sector
3. Expected high volumes of wood from new sources will keep raw material prices stable, and may even create excesses that depress prices for some materials

Abundant Labour

Not only is there an abundant labor pool in rapidly developing countries, but there is a significant number of under-employed and highly educated people in many of those regions as well. The economist Paul Samuelson noted a few years ago that not only are there regions of India and China where employees can be hired for dollars per day, but those employees are likely to have engineering degrees as well. As an example, a few years ago a hacker was able to obtain access to computers in the Pentagon. The FBI said that the good news was that only someone with exceptional math and computer skills could have accomplished that. The bad news was that 60 million Chinese have those skills.

Significant Capital Investment

China now has the world's most rapidly growing economy. This achievement follows adoption of internal reforms and trade liberalization policies. It is increasingly apparent that industrial and economic growth is not haphazard, but rather the result of careful, targeted planning that is focused on development of labor-intensive industries. The wood products industry is on the forefront of those efforts. For years the Forest Products Laboratory in Madison, Wisconsin had gone relatively unrivaled in size and capability. In recent years China has built six similar facilities.



*Wood Products Research Facility
in China*

New Wood Sources

Relative wood abundance in Russia is now attracting a massive influx of new capital to the wood products industry of that country. For example, investments in the Russian forest industry (including logging, woodworking and pulp and paper) amounted to \$540 million in 2002, and over 4 million cubic meters of new sawnwood production capacity is currently under development in western Russia from investments scheduled for 2002-2006. In addition, markets for Russian wood in China are growing rapidly, and large, well-capitalized processing facilities are under construction along the Russian/Chinese border. As in China, labor rates and costs of regulatory compliance are lower than in the U.S. In addition, wood costs are generally lower than in the U.S.

Not only is there investment in processing facilities in new regions, but also in infrastructure as well. China recently signed agreements committing to over \$30 billion in investments in Latin America alone over the next few years as part of agreements that would assure them of long-term supplies of resources from that region. Investments will focus on infrastructural improvements ranging from roads and bridges to dams and harbor improvements.

Impacts on US Wood Products

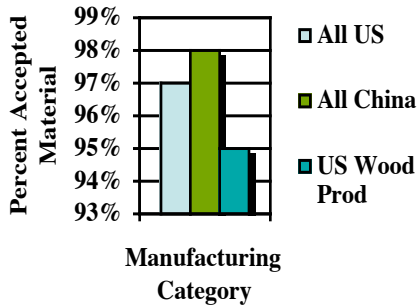
Global mega trends are having a huge impact on US wood products manufacturers. Chinese gains in the U.S. household furniture market alone cut domestic hardwood lumber consumption by the U.S. furniture industry by almost 60 percent, and overall domestic lumber consumption by over 20 percent. A similar though thus far less dramatic trend can be seen in paper markets. It is interesting to note that Chinese companies sometimes utilize US wood, and then offer the resulting products in U.S. markets at prices well below those of U.S. producers. Further growth of Chinese industries is expected, as is further loss of U.S. market share to Chinese products because of these price advantages.

Although they are accelerating rapidly in pace today, these trends are not new to US businesses. We have seen the virtual demise of both the shoe and textile industries in the US over the past 50 years, and certain segments of the wood products industry have been impacted as well. Maine's unique specialty wood products industry that at one time produced everything from sleds, to tongue depressors, to turnings has been decimated in the past twenty years by foreign competition.

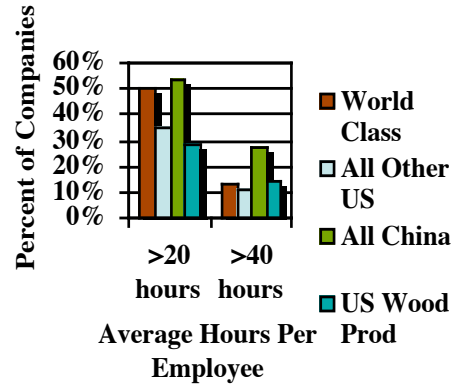
Yet it is vital to get past depression and angst over what can't be controlled, and to become empowered to take charge of what can be controlled. In the late 1970's and early 1980's the auto industry faced a similar challenge, and still does today. Clearly there are lessons to be learned from this industry's approach, which has been a combination of growing the overall market, creating new niches and brands, and buying both parts from and parts of their foreign competition. All of these strategies were required to move away from an approach that emphasized what was bad about the competition and to move ahead with product improvement, redefining positive attributes of product lines, and in some cases even enlisting support from the competition!

In moving beyond their assumptions, it is imperative that companies understand when assumptions are well founded and when they are not based on reality in the marketplace. There are several commonly held myths about businesses in the developing world in general, and China specifically. Among the most important are: myth #1 – goods manufactured in developing countries are of poorer quality than those produced in the US, and myth #2 – workers in the factories of developing countries are poorly trained. Although there are clearly cases where these characteristics are true, results from a 2003/2004 census of manufacturers and China study performed by the Manufacturers Performance Institute in conjunction with Industry Week Magazine indicate that this is hardly the norm. The following charts clearly demonstrate that the reliability of Chinese products is higher than US goods in general, and significantly higher than US produced wood products. They also demonstrate that Chinese firms are putting significantly more effort into employee training.

Comparison of Quality Performance



Comparison of Time Spent Training



Source: 2003/2004 IW/MPI Mfg Census & China Study

Source: 2003/2004 IW/MPI Mfg Census & China Study

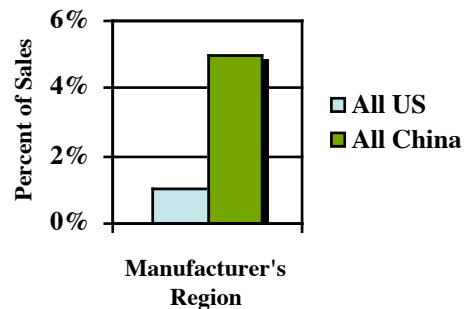
Investment Focus on Communications

It is also enlightening to look at where China is focusing its investments. From the chart below it can be shown that China is placing a significantly higher level of importance on investment in new information technology. Evidence suggests that good communication systems lead to increased customer access, increased company access to new product ideas, new sources of creativity and increased awareness of opportunities for technology. These capabilities enable firms to adapt to changes more readily and more rapidly.

The Keys to Successfully Competing in Today's Markets

Rudyard Kipling defined insanity as “doing the same thing over and over and expecting different results.” To a certain extent, continuing to try to compete with developing countries on commodity items is a losing battle. At best, they have the same cost of capital, same cost of materials, and lower labor costs. In the worst cases they have access to government funds for capital, regional material sources that are less costly, and labor pools that are well educated, well trained, and paid ten cents on the dollar. That model for competition isn't going to work. But there are advantages and there is still opportunity.

Comparison of Investment in Information Technology



Source: 2003/2004 IW/MPI Mfg Census & China Study

Firms don't need to throw out what they do well today. The core tenants of cheaper, better, and faster are just as true as ever. In fact these programs continue to expand beyond company borders in ways unanticipated in previous eras. Today cheaper, better, and faster include:

Cheaper

- Efficiency systems such as LEAN are essential, and if a company doesn't have such a system in place they are 50 years behind the times.
- Inventory needs to be eliminated – especially the customer's. According to general accounting practices (GAP) inventory costs a company from 25-35% of its average value annually. So eliminating a million dollars in inventory from each of multiple channel members has a huge impact on total product cost.
- Pricing systems need to be evaluated. Evidence suggests that companies significantly under price specialty items. Often the price of some specialty products can be doubled or even tripled, and the impacts on the bottom line are enormous. A number of companies have discovered that they could increase their customer satisfaction by doubling the price on 5% of their sales (the highly specialized products) and lowering the price on the balance by a percent or two – with a net gain in profitability. This approach has arisen out of a careful understanding of the real needs of customers, and recognition that firms often have some products that are very competitive and some products whose price isn't an issue.
- Activities that don't bring specific value to the end customer should be minimized or eliminated. For example, do customers conduct an incoming inspection of your products? What would it take to save them the costs of that inspection? Under what conditions would they consider eliminating that process? Are they stacking and un-stacking your product, or packaging and un-packaging it? Can you work with them to eliminate these valueless activities?

Better

- Quality systems are essential, as customers now expect every product to be perfect. The only difference is in the definition of perfect. Here it is important to note that many wood products firms struggle with certain subjective aspects of quality, and that the statement "it's wood, it's going to vary in appearance so we'll never be perfect" is often heard. Yet perceived quality variation also leads to customer dissatisfaction and hence to material substitution, so it is important to truly recognize when your customer really agrees that variability is acceptable, and when they are simply "settling" with what you have to offer until they find something better.
- Today better is also defined as more variety in styles, sizes, shapes, and colors. As a result companies are finding that smaller, more flexible processing equipment, exponentially broader product lines, and an ability to adapt at the drop of the hat are critical components of their approach.

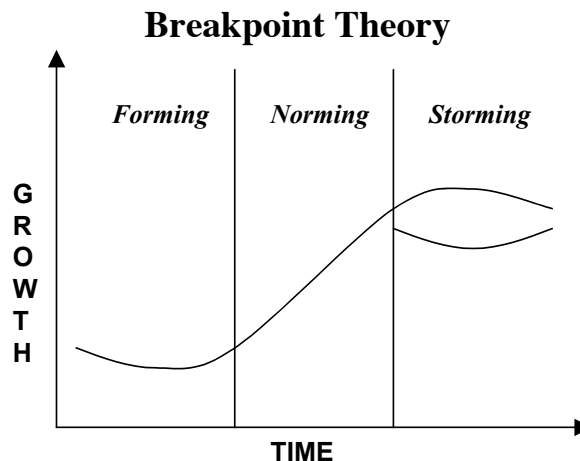
Faster

- We are a drive-through society. So today, companies need to be looking at lead times that are in hours, not days and arrival times that are scheduled, not projected. Many top wood products firms today are serving their customers by not only getting product to the customer in a few hours, but delivering such that products will either go right on the truck to go out or right to the assembly line. This not only has implications for scheduling, but for packaging and manufacturing as well.

But these three things (cheaper, better, faster) can only form the base of a successful company. To address the stresses generated externally by the mega trends occurring in the global marketplace, a company must look internally at the trends within their own organization and recognize the changes that need to occur there as well. Here, a theory called Breakpoint Theory is useful as a tool in understanding those internal stresses.

Break Point Theory

In *Breakpoint and Beyond*, the authors Land and Jarmin suggest that a company over its life span progresses through three clearly defined stages, and the definition of the period of change, or breakpoint, occurs when a combination of stresses lead to the requirement of a new approach to leadership within the organization. The image above is a graphical demonstration of that progression, where the organization transitions through, what we have labeled forming, norming, and storming stages.



Source: "Breakpoint and Beyond," by George Land and Beth Jarman, 1992

During the early or forming stages of a company, successful leadership is often characterized as creative, energetic, risk-taking, entrepreneurial, explorative, and often passionate. There is often a sense of living on the edge, and some entrepreneurs describe this "rush" as a critical component of why they are in business. However, at some point in the organization's life, the firm's markets start to change. As an example: a customer comes into a small cabinet company and says something like, "remember the cabinet I bought from you last month? Well, I now need a hundred of them just like it!" The same leadership skill sets that enabled the firm to switch from product to product and react to

every whim of the customer now faces a whole new type of challenge; sometimes leadership may not even recognize the challenge for what it is because deep in their hearts they may never truly grasp why the customer wants a hundred exactly the same anyway. How often have you heard a young company leader say something like: “well, it shouldn’t matter that the hinges on this cabinet are a little different than the others, because it is going in a different apartment anyway. Besides, it works fine and is actually a more costly hinge.” Yet, how often are there also significant “quality” problems related to the fact that there are variations of some sort between cabinets, in spite of the fact that each individual cabinet is functionally and visually fine?

At this point the firm is at a break point, and needs new leadership within the company. It requires leadership committed to repeatability, reliability, stability, and continuous improvement. It is unlikely that the same leader that led the company through the entrepreneurial stage will share these traits. These skills can be hired, but it also needs to be recognized that the core needs of the organization may now conflict with the core skills and traits of the entrepreneur – and the new manager may experience conflict with that entrepreneur in trying to implement control programs. It is at this break point that firms often fail, thus the recognition that it is often not firms with too little business that go bankrupt, but rather those with too much.

Assuming that the firm survives the transition through the “norming” stage it continues to get better and better at improving efficiency, increasing on-time performance, increasing general reliability, and eliminating areas of disruption and risk from the company. It is during this phase that companies implement programs like LEAN, six sigma, and Total Quality Management. Statements like “if it is measured it is managed” and guidelines like Safety, Quality, Service, and Productivity (SQSP) are developed and can be repeated by all employees. Yet there also comes a point where improvements become more and more difficult to achieve, and the marketplace becomes excessively competitive. Just as products go through a mature and decline phase in their life cycle, so too is the possibility for the firm if it does not adapt and change.

At some point the stress of market competition and continuing declines in margin force a firm to reconsider its approach in the marketplace. They need and want to try something different, but the change process itself conflicts with the controlled, measured, managed, and risk-avoidance approach.

Much of the wood products industry may be at this new breakpoint, referred to here as *the transition to the storming phase*. It could be argued that many firms within the industry have actually been at this breakpoint for years, if not decades; and it is only their exceptional skill at becoming more and more efficient that has allowed them to continue in the norming phase for so long! There are at least three key ways to recognize that a company is at the breakpoint between norming and storming:

1. Margins are shrinking
2. The company has more than one type of efficiency program
3. The company is losing market share

The challenge here is that a dramatic change is again needed in leadership style. It is interesting to note that people are generally accepting of the fact that the entrepreneur will eventually need help but are often resistant to the changes necessary for the “storming” phase. What is now required to break into a new growth cycle is not a return to the entrepreneurial style of the forming phase, but rather an increased recognition that “change” in itself is essential and welcomed. Land and Jarmin suggest that the key traits of leadership required in this phase are:

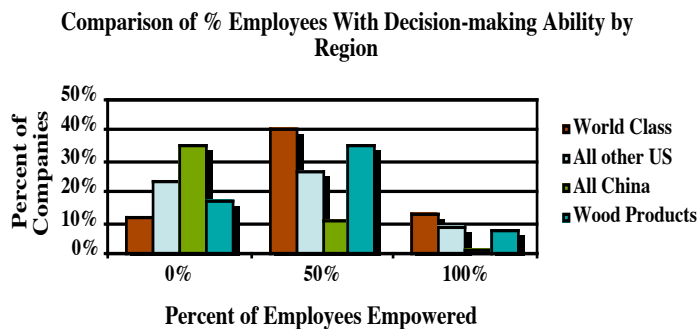
- A clear company vision (what made you great in the first place)
- Shared leadership (you need to rock the boat AND keep it from sinking)
- Increased creativity in all areas of the company
- Welcoming and encouraging all manners of diversity

Again, the same leader that made sure everything was repeatable, reliable, and controlled is unlikely to be the person that shares that control easily, or takes the risks necessary to try the dramatically new approaches necessary to make real change. And the longer the company has been in the norming phase, the greater the change that may be required. What we’re really talking about here is – the firm may again need a new boss!

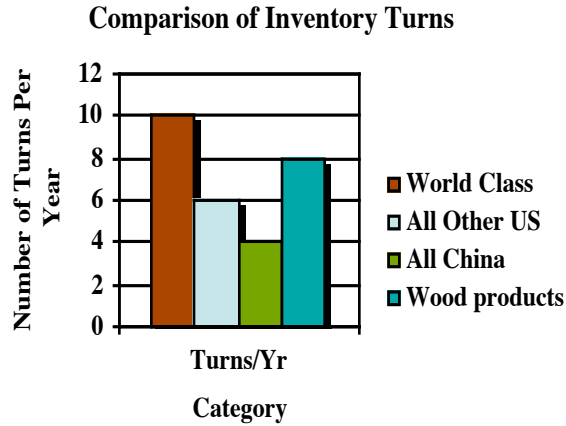
It’s valuable to note that the concepts suggested by Land and Jarmin bear fruit in the research of Manufacturing Performance Institute (MPI). This research attempted to define the unique characteristics of “World Class Organizations,” with “world class” being defined as the most profitable companies in the world. The MPI found that the key characteristics of World Class Organizations are:

- A clear organizational vision,
- An emphasis on building relationships (both internally and externally), and
- A focus on human capital

From the chart of Training above and the chart below it can be seen that World Class organizations focus on human capital both by empowering employees and training them to succeed. At the same time, empowering employees and placing a focus on relationships are keys to sharing leadership, increasing creativity, and welcoming diversity as suggested by breakpoint theory.



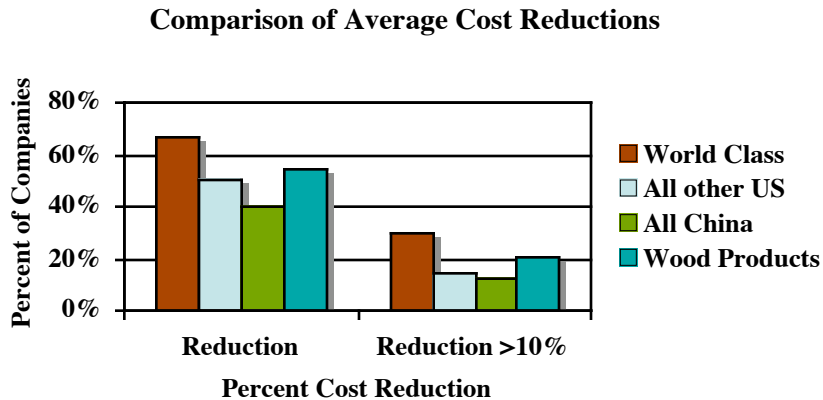
Source: 2003/3004 IW/MPI Census & China Study



Source: 2003/2004 IW/MPI Mfg Census & China Study

The Opportunity for Wood Products Companies

World demand for wood products has never been greater, access to information regarding the tools needed to succeed has never been easier, and U.S. wood products firms excel in many aspects of business with some clear advantages. The previous chart demonstrates that the wood products industry does a great job at empowering its employees to make decisions. From the Charts above and below it can be seen that US wood products companies also excel at controlling inventory and have demonstrated great skill in achieving significant cost reductions. Now all that may be needed is to leaven in those other skills recognized as key elements by both the concepts of Jarmin and the reality of World Class companies.



Source: 2003/2004 IW/MPI Mfg Census & China Study

Conclusion

Today, the US wood products industry faces an unprecedented level of competition. Foreign manufacturers have a clear significant advantage in labor costs, and in some cases in material costs and access to capital as well. Yet opportunities exist. Key steps for achieving success in today's competitive climate will include:

- New leadership must be identified, and that new leadership may need to be at the very top of the organizational ladder! This leadership must be able to direct activities in as broad a range as implementing ISO to inventing the next widget. An important skill set is the ability to hire, train, retain, and share leadership with a high performing group of diversely skilled individuals. *Traditional hierarchies are out.*
- People, not equipment, are the most critical resource: training, empowerment, diversity, creativity are all essentials in today's rapidly changing world.
- Relationships are essential to the future. Organizations must not only understand their customer's needs, but also understand their customer's customer so well that they are able to anticipate and implement solutions to wants and needs that aren't yet obvious.

Dr. Jeffrey Howe specializes in strategic planning, marketing, and coaching leaders to a clearer vision of themselves and their organization. Prior to Dovetail Partners Jeff was the President of Colonial Craft, a MN manufacturing firm recognized for its social and environmental responsibility with awards that included handicap employer of the year and environmental company of the year. This was accomplished while being one of only two companies to be on "Wood & Wood Products" magazine's Top 100 fastest growing companies every year; proving you can be responsible, and profitable. Jeff has a B.S. degree in Biology from Bates College, a M.S. degree in Forest Products Marketing from the University of Maine, and a PhD in Marketing from the University of Minnesota.

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