

Tough economic times call for new business models and creative products

By Brooke Baldwin Wisdom

Modern Woodworking interviewed Art Raymond, president of Raleigh, N.C.-based A.G. Raymond & Company, a management and technical consulting firm specializing in wood products, for his thoughts on how the wood processing industry is coping with today's economy.

How is today's economy affecting the wood processing industry?

I would be more optimistic if we could finally see a bottom to this economic downturn and start understanding what kind of future is out there for us. We're starting to see signs that a bottom is forming, but we must remember that a bottom is only the first step toward recovery – we still have to go up the other side of the graph. The good old days when housing starts are at or near 1.5 million a year are some time away. That level of starts seems to be an equilibrium point. Every cycle that takes us beyond that number like 2005 when we built over 2 million houses ends up in a painful downturn. Right now we're running at about 0.5 million housing starts a year. Last year was the first year since 1959 that less than 1 million houses were built in the U.S. We – the banks, the builders, the politicians, all of us – too easily forget that there is a demand side to the housing equation. One good sign is that the banking system is being repaired and starting to make money. Bankers look like geniuses when the yield curve is positive. They can borrow cheap short term money, loan at higher rates over the long term, and earn the margin in between. Ultimately that situation will be good for housing starts and the wood economy.

How is the economy affecting the furniture sector in particular?

The furniture sector's import-based model may be broken. As we all know, China has become the dominant supplier of wood furniture, American companies have closed their U.S. factories, and replaced that production with imported furniture. In recent years U.S. furniture retailers have attempted to replace the middle men in that equation – the U. S. furniture manufacturers that had morphed into importer/distributors. Over time, more and more retailers decided that they could increase profits by dealing directly with foreign manufacturers. That strategy put them in the business of designing and sourcing product from foreign suppliers plus handling logistics, warehousing, and distribution. Managing that supply chain has not proven so easy especially in a downturn. Retailers had to cobble together the skill sets needed to run that type of business model. They neglected to remember that the pipeline from China to the U.S. consumer can be 120

to 180 days long from design concept to delivery of first cuttings. Given that duration the ability to forecast demand is a lot less precise than buying from a U.S. furniture manufacturer who offers a much shorter delivery time. What happens when product is ordered 150 days in the future against an optimistic forecast, and business turns bad? The pipeline continues to pour furniture into stateside warehouses well after demand has turned soft. The model made it easy to be in the furniture business when times were good but has showed its flaws as the retail environment here turned south.

With Vaughan-Bassett expanding its Galax, Va. facility and Swedwood/IKEA opening its new plant in Danville, Va., could domestic furniture manufacturing be making a comeback?

Vaughan-Bassett's expansion of its Galax plant is the first significant capital investment in the wood furniture industry in years. While they shuttered their Elkin, NC, plant last year, management there clearly believes that a domestic manufacturing presence can be viable. But as we celebrate that at least one U.S. producer is investing in their production capabilities, we can't have a victory parade marking the return of domestic furniture manufacturing yet.

At the same time Swedwood, the IKEA subsidiary, has opened a very high technology, capital intensive factory in Danville, another good sign that somebody believes that furniture can be manufactured competitively in the U.S. Looking at the other side of that picture, however, the product they manufacture in that plant is not what traditionalists would call wood furniture. It's much different from the product Vaughan Bassett will make in its expanded facility, for instance. The key point is this - somewhere between Vaughan Bassett's and Ikea's types of furniture, products do exist that can be manufactured effectively on Swedwood-type technology. Following that line of thinking can lead to a rebirth of furniture manufacturing in the U.S., and I'm more optimistic about that possibility than I have been in a long time. But U.S. furniture manufacturers are going to have to reinvent themselves somewhere in that middle ground. Traditional U.S. case goods furniture can't be built on the type of machinery that was installed in Danville. Everything goes back to the product, and what consumers really want. We also need to look at what consumers are going to want for their money coming out of this recession as opposed to what they may have wanted for their money when times were much better. I'm calling it the 'new normal' – the consumers' purchasing attributes when we come out of this recession vs. two or three years ago.

What exactly do you think consumers will be looking for when times get better?

People are going to look at quality, products that last plus have a smaller environmental footprint over their life cycle. But consumers will place more emphasis on real value for their money – more for less, perhaps more function than form. Such a trend may swing the pendulum back toward mass production and away from mass customization. Over the last 15 years or so, domestic manufacturing focused on semi-customization, a model that served the kitchen cabinet industry very well and allowed it to defend its market from Chinese imports. But if you're aiming

for value – more for less, higher volume/higher speed production may be the answer. That's what IKEA is doing at their position on the product spectrum. If you look at their selling prices, their customers are getting a tremendous amount of function for their money. Again I believe there's an opportunity somewhere in the middle of the product spectrum between traditional U.S. case goods and Ikea-style ready-to-assemble furniture to apply the available leading edge technology. If we're intelligent and creative about our product design, we can offer what a lot of consumers are looking for and at the same time make attractive, functional wood furniture competitively here in the U.S. with the benefits of a shorter supply chain.

What about the cabinet segment?

The wood furniture sector was impacted by what economists call structural change where a more permanent shift in the industry's structure occurred. On the other hand, the cabinet industry has been hurt by the business cycle, that is to say, cyclical change. Housing starts dropping from 2.1 to 0.5 million and the downturn in remodeling hit the cabinet industry. That sector's model was working effectively by supplying attractive product quickly. By doing so, imports have not adversely impacted domestic cabinetmaking. In fact, less than 5 percent of the cabinet market is supplied by foreign producers as opposed to 2/3 of wood furniture. Its business will come back eventually when housing starts recover and people remodel their homes again.

Will they hang in there in the meantime?

Just like in the furniture business, we're starting to see plant closures and layoffs. For example, KraftMaid has closed their new, high-tech plant near Salt Lake City. Some of Merillat's plants have been closed. Others have had large layoffs and are running at much lower staffing levels. When the economy recovers, some of that unused capacity may not be needed. In my opinion, ramping up to 2 million plus starts won't occur any time soon. If you look at a graph of housing starts since 1959, you see that every time we go past 1.5 million starts to 1.8 or 2 million, we hit a ceiling and then have a tremendous downturn. We need to reduce the amplitude of those swings, cycle closer to the equilibrium level of 1.5 million starts. Continually overbuilding then under building is wasteful. Somehow we've got to get the home builders and bankers more in synch with underlying demand so that the cabinet manufacturers, saw mills, and the window and door manufacturers that supply the homebuilders don't get whipped like the proverbial tail on the dog. The builders and their supply chain must do what the furniture sector guys did but for a different reason – rationalize capacity. For any form of manufacturing to prosper in the U.S. we simply must utilize our capital and our labor much more effectively.

What should the small to mid size shop owner be doing?

The smarter cabinet manufacturers who have the right kind of equipment and are innovative in their thinking have been broadening their target market by tackling commercial applications such as casework for hospitals, doctors' offices, and the like. Granted, that opportunity won't last forever because non-residential construction is now slowing. But changing the way you do

business is a good lesson learned from this recession. Your bread and butter will most probably not last forever. Tomorrow will probably not be like yesterday. And as companies gravitate to strong markets, competition will get tougher. Capitalism is Darwinistic – only those who adapt best to the changed environment will survive.

Cabinet manufacturers should also be looking beyond the kitchen and the bath to built-in opportunities in different parts of the house such as home entertainment areas, home offices, and bedrooms. In time, houses will be getting smaller. We're already seeing that reflected in the data. As we've discussed, consumers will emerge from this recession looking for more value. We will have more multi-functional rooms. Formal living and dining rooms will continue to disappear. More open space plans particularly with the kitchen and great room merging will require continuity of design and finish. Home buyers will demand more furniture-grade finishes. Wood will remain in vogue, but remember the renewed emphasis on value. Perhaps hard maple and cherry will be replaced by less expensive species. A plus for cabinetmakers is that these projects can be financed in the purchase of the house, unlike furniture.

The bottom line is that companies of all shapes and sizes must evolve to fit the changing marketplace. For those who have that bias for change and action, the future holds great promise.