

# THE WOOD WORLD MONITOR

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## Proving The Obvious

The late President Ronald Reagan once said, "An economist is someone who sees a policy work in practice and wonders whether it will work in theory." Hidden in his sarcasm about the economics profession, Reagan was saying that some conclusions don't require extensive analysis.

One such conclusion is that mimicking the business model of an industry's best operator is death to profits. Consultants McKinsey & Company call this phenomenon *strategic herding* and blame it on the substitution of excessive benchmarking for creative strategic thinking. You've seen it. A new, innovative product with a nice profit margin sells like hot cakes. In next to no time competitors rush knock-off products into the same market. The field becomes crowded, prices fall, and the product quickly becomes a commodity.

Recent history is full of examples. Look first at personal computers. In the late 80's computer makers crowded the market with PC's based on the Microsoft-Intel standard. Product differentiation was virtually

non-existent. As a result industry margins fell by 56%. Many companies disappeared. Survival required building a value chain that delivered low-cost, commodity computers and advertising heavily to create a brand name. Dell survives by doing just that – excelling in execution not product design.

Another example is furniture. A product niche like casual dining creates a buzz at the High Point Market. Competitors from around the world soon jump into the market with their versions of the hot item. Proving once again that product is not a strategy, profit margins decline. The industry's players set off hoping to be first to market with the next hot creation. Execution takes the back seat. Anecdotal evidence is all one needs to conclude that the furniture industry suffers from herding.

Ikea, the world's largest furniture retailer, is an exception. The Swedish firm built a value chain on its manufac-

turing knowledge, investments in its suppliers, and a focus on instant delivery of a high quality product. There's really nothing remarkable about their product, but Ikea has multiplied its revenues 40-fold in 20 years.

In reality few industries are immune from the herding instinct. One can speculate on whether herding will strike the kitchen cabinet industry. Knocking off door styles and cabinet configurations is prevalent. Manufacturing methods are non-proprietary. The fate of that industry rests in the minds of senior executives who are charged with sustaining profitability.

**Bottom Line** - Don't rely on copycat thinking. To earn real profits use your head. Be different.

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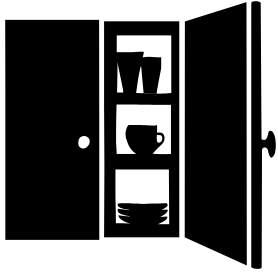
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# A Hot, Healthy Cabinet Industry

“...2004 sales have grown by nearly 19% through June on top of last year’s 13% growth.”

Fueled by easy money for home buying and remodeling, U.S. cabinetmakers now ship over \$12 billion of their products annually. According to the Kitchen Cabinet Manufacturers Association’s monthly survey, 2004 sales have grown by nearly 19% through June on top of last year’s 13% growth.

The industry is now big business. In 1964 total sales were just over \$100 million. Yorktowne Cabinetry, then known as Colonial Products, shipped \$13.5 million. This year sales at the eleven largest cabinet

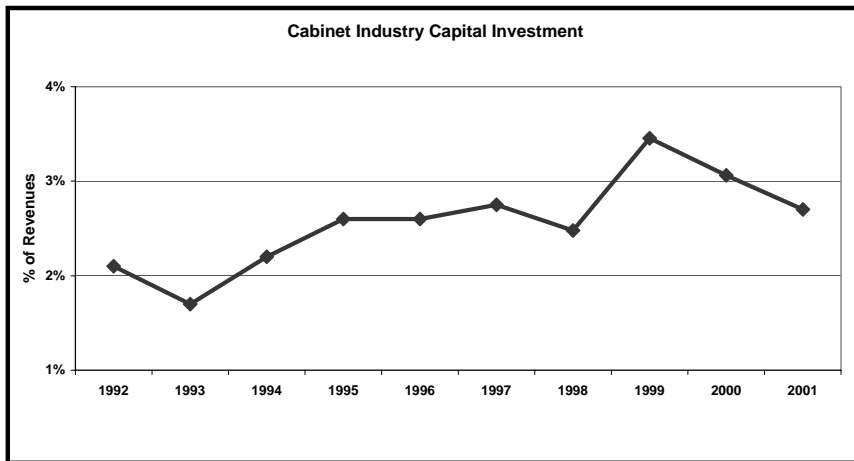
companies will exceed 1964’s total industry volume according to *K+BB* magazine’s annual survey.

As a result, fewer firms are generating a larger share of industry sales. The ten largest producers now account for 85% of domestic sales in *K+BB*’s survey. The two industry giants, Masco and Masterbrands, combined for 54% of the domestic market.

Two sales channels – home centers like Home Depot and local dealers – evenly split about 56% of the mar-

ket. Sales to builders and distributors each account for about 20%.

Competition in this booming market now occurs along two planes: (1) a wide choice of product styles and configurations and (2) fast delivery. To compete cabinetmakers have invested heavily in streamlining their processes. As shown in the graph below, investment increased from 1.7% of sales in 1993 to 3% by 2000 and reached a high of nearly 3.5% in 1999.



These expenditures equipped producers to cope with the complexity of longer product lines and to create faster throughput. The table on page 3 highlights three performance metrics that underline the benefits of these investments:

- Annual shipments per worker measures labor productivity. In five years this metric has increased by nearly 19%.
- Ratio of shipments to work in-process inventory indicates producers are taking less time to manufac-

ture. WIP is roughly the amount of material released to production per day times the number of days in the manufacturing cycle.

- Ratio of shipments to finished goods inventory shows producers lowering

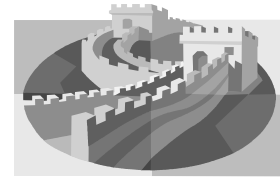


## Going to the Dogs...

“Don’t accept your dog’s admiration as conclusive evidence that you are wonderful.”

Ann Landers

**“Economists are divided on the reasons for this shortage.”**



## Chinese Labor Costs Rising

### Golf Quote...



“Reverse every natural instinct, do the opposite of what you are inclined to do, and you will come close to a perfect swing.”

Ben Hogan

Seems Chinese labor is getting costlier. According to Chinese newspapers the Pearl River Delta, the center of today’s furniture universe and source of many other export products, is short two million workers.

How could this situation happen in a country of 1.3 billion people and high unemployment? It’s called competition. Fewer farmers in rural areas are motivated to seek factory jobs due to higher agricultural subsidies set by the Chinese government. Local authorities are also forcing improvements in working conditions by reducing allowable overtime and raising minimum wage rates. Many companies are responding by air conditioning factories and adding

libraries or gymnasiums for their workers. These non-wage benefits increase the cost of labor.

Competition is also coming from newer manufacturing hubs in other parts of China. Companies in these areas are choosing to pay workers a higher wage in lieu of providing housing and related fringes.

Economists are divided on the reasons for this shortage. Will the enormous population and high unemployment rate solve this problem in the short term? Or is this predicament a structural change stemming from rising educational standards and slower work force growth? One China hand predicts that total

labor costs could increase by 40 to 50% as companies around the Pearl River compete for fewer available workers. Companies will move to the hinterlands, leave the country for places like Vietnam, or shift from furniture to higher-value products.

**Bottom Line** - Wage advantages don’t last forever. Remember that the cost of labor drove the furniture industry from New England, to Michigan, and finally to North Carolina and Mississippi before leaping the U.S. border. Expect the same shifts to happen worldwide.

Source: *The Wall Street Journal*, 16 August 2004

(Continued from page 2)

their stocks of finished cabinets. This measure reflects the shift to JIT order fulfillment and more customized, kitchen-at-a-time production where cabinets are built to order rather than stock.

Clearly the cabinet industry is responding to the demands of their marketplace and benefiting from its investments.

**Bottom Line** - When the tide in your market is rising, you

must keep your boat ship shape. To do so takes a willingness to change and to invest your capital.

### Philosophy Quote...



“The greatest leader is not a person who does great things but one who gets the people to do great things.”

Ronald Reagan

### Cabinetmaker Performance

	Shipments Per Worker	Ratio of Shipments To WIP	Ratio of Shipments To Finished Goods
1997	\$113,292	43.9	44.1
1998	\$114,796	45.6	44.3
1999	\$125,792	52.8	67.1
2000	\$128,122	48.4	66.7
2001	\$134,544	49.6	62.8
% Increase	18.8%	13%	43%

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THE  WORLD MONITOR

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*This newsletter is made possible by earnings from the world's forest products - the only renewable natural resource.*

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**“With the memory of devastating wildfires fresh in their minds, Congress passed the Healthy Forest Restoration Act last fall.”**

## **More Fire Control + Better Utilization = Forest Health**

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Any issue may be downloaded in Adobe PDF format for easy printing.

With the memory of devastating wildfires fresh in their minds, Congress passed the Healthy Forest Restoration Act last fall. This legislation promises more funds for eliminating the fuel that feeds wildfires in our national forests. In 2004 four million acres are tagged for fuel reduction programs involving either thinning or prescribed burning. The budget for this effort is \$475 million, over five times the average amount spent on hazardous fuel reduction during the 90's.

At the same time the Forest Service is seeking innovative uses of our wood resource. These applications are aimed at reducing logging in the old-growth forests that are coveted by

environmentalists. The key is utilizing smaller wood components to fabricate beams and other construction materials rather than using larger, solid stock that requires century old trees. Developing these applications is a sizeable opportunity for forest products firms, universities, suppliers, and others in the industry's technology chain.



Source: *The Wall Street Journal*,  
17 June 2004