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What Is Value?

After defining what business you are in, setting a strategy for your company requires specifying three key elements:

1. What products you offer
2. Which customers you target
3. What motivates those customers to buy your products

That third element is your **value proposition**, and its definition is what makes setting strategy tough. Without defining the value you offer those customers, you have no strategy. Without a strategy, you cannot say how you are going to make a sale, how you will generate revenue.

Products alone, you see, do not make a strategy. It's the attributes in which you wrap your product that differentiate you from your competition.

We all know the attributes that determine Value - Quality, Service, Cost, and Time. How do those four attributes relate to create value? Baldor Electric, a leading producer of motors and generators, has created a simple formula that provides a neat answer:

$$V = \frac{Q \times S}{C \times T}$$

Put simply, if the other factors or attributes are maintained, the formula gives simple advice: increasing Value requires maintaining or improving Quality or Service while reducing or maintaining Cost or Time.

Unfortunately Baldor's formula can only show direction, not compute a precise score. Value is a nebulous concept. You as the seller create it. But it's defined by your customers. Thus it's hard to measure, and worse yet it moves with time.

Thankfully the formula tells you that Value can be created by excelling at only one attribute. Rarely can a company be the leader in Quality, Service, Cost, and Time. After all, for example, only one company in any market can be the low cost provider or number one in quality. Focus, therefore, is a good trait when striving to create Value. You should strive to deliver the most important attribute while matching your competitors in the others.

The key then is to identify **the** attribute that is **most** critical to your target customers. Some customers may emphasize the T attribute and want fast delivery. Others may require extra Service after the sale. Such segmentation will help you pinpoint the customers that best match your present core competency. More importantly, it will enable you to develop a pricing structure that fully pays you for providing the primary attribute that each customer type requires. For example, those customers who want full truck load orders with 30-day delivery pay less per unit than ones who require quick shipments of small order quantities. After all, if you don't cover your costs, your profitability will suffer.

Bottom Line - Know your customers. Period.

Art Raymond
President



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“Ikea’s growth and profitability are driven by relentless cost cutting and attention to performance.”

Ikea—The Cult Furnishings Brand

Ikea has brand power. They say that one out of every ten Europeans is conceived in an Ikea bed and that Ikea is Swedish for particleboard. Name another home furnishings company that has created a legend like that. As *Business Week* recently said, “Ikea has become the curator of people’s lifestyles. It’s a one-stop sanctuary for coolness.”

By far and away the company is the world’s largest home furnishings retailer with sales of \$17.7 billion and 226 stores covering Europe, Asia, Australia, and the U.S. Last year over 410 million shoppers visited an Ikea store to choose from over 7,000 items arranged in a circular route covering 300,000 square feet. Ikea is proving that there indeed is a huge global middle class.

Other Ikea numbers are equally staggering:

- Over 160 million copies of their catalog were printed last year, more than the Bible.
- One third of its product line is replaced every year.
- Their operating margin is estimated to be 10% (yes, that equaled \$1.7 billion last year).
- Nineteen new stores are scheduled for 2006 at a cost of \$1.25 billion.

Five of those new stores are planned for the U.S., and the company aims to have 50 stores here by 2010.

Ikea’s growth and profitability are driven by relentless cost cutting and attention to performance. At their offices key data like weekly sales growth by national market and the ranking of best selling products are displayed on huge bulletin boards. The goal is to lower prices across its entire line by two to three percentage points every year. One of its best selling sofas, introduced in 1999 at \$354, is now priced at \$202.

This cost obsession is paired with a culture for design. The idea is to design beautiful products that are inexpensive and functional. No product, however, makes it to the store floor unless its price is affordable.

Ikea has over 1,300 suppliers in 53 countries and is constantly searching for more. By 2010 the company will need twice as many suppliers given their current growth rate.

All is not perfection at Ikea. The company stumbled badly in its early foray into the U.S. market. Like others, they were slow to learn that European tastes and lifestyle do not translate

one for one to the U.S. Another failure was experienced in Japan where consumers are not as fixated on low prices.

The main challenge facing Ikea is the eventual aging-out of its first generation of managers that grew up under Ingvar Kamprad, now 79 and officially retired. The culture he established will be tested once his direct influence fades.

Bottom Line - Ikea proves what Henry Ford first espoused about price and cost, “One of the ways of discovering what the cost of a product ought to be is to name a price that forces everybody to the highest point of efficiency. A low price makes everybody dig for profits.” Such focus on great product engineering and manufacturing execution can work even in the furniture business.



Business Quote...

“An enterprise’s most vital assets lie in its design and creative capabilities.”
Kun-Hun Lee

“Management matters to a company’s economic success.”

Management Matters

Golf Quote...

“Golf is 20 percent skill and 80 percent management.”

Ben Hogan



Philosophy Quote...

“If I had eight hours to chop down a tree, I’d spend six sharpening my ax.”

Abraham Lincoln



A recent study by consultants McKinsey & Company made it official: management matters to a company’s economic success. The quality of its managers can enable a company to trump the negatives of the industry, the regulatory environment, and the country in which it operates. This finding should open the eyes and minds of managers who work in industries beleaguered by tough competition, foreign or domestic.

McKinsey found a solid link between success and three critical managerial factors:

1. Lean manufacturing on the shop floor – How extensive a company adopts lean production methods.
2. Target setting and performance management – How a company sets goals and rewards their achievement.
3. Talent management – How a company attracts, develops, and retains valuable employees.

Success comes only from intensive implementation and regular use of good practices in these areas.

For example, performance management must become an everyday part of your company’s culture. The best companies not only display their key metrics widely across the office and plant floor but also meet front line workers every day to discuss the daily goals and the previous day’s performance. Plus, monthly meetings are held to provide every worker an overview of the strategic direction of the business and to explain the linkage between profitability and attainment of established targets.

Mediocrity in any of these areas goes hand and hand with second-rate results.

In comparison, participating companies who scored strongly in all three areas excelled in critical economic measures like return on capital employed, sales per employee, revenue growth, and market share.

Three other interesting findings were identified in this survey:

1. Mismanagement correlates directly with company age – Old companies are

less likely to implement newer processes such as lean manufacturing due to institutional memory, the fear of change, and discomfort associated with the loss of strict control.

2. Better-managed companies invest more time and money on training and hire more college graduates.

3. Implementing new practices requires a workforce that is ready and willing to change – This readiness is directly related to training and the level of empowerment down the organization.

Even if you utilize best-in-industry practices across the board, this achievement will only gain you a short-term advantage. It takes continuous improvement to defeat rivals who can learn and implement many of your practices. Resting on your laurels will not work for long.

Bottom Line - Proof exists: great companies are well-managed from stem to stern. You have no excuses. Get cracking!

Economic Factoid

Everyone is aware of the \$9.6 billion U.S. trade deficit in wood furniture. But the trade situation in other forest products such as lumber, panel boards, and millwork is equally bleak. In 2005 the U.S. imported \$18 billion of these products more than it exported, up from \$5.7 billion in 1997. The primary source country is Canada with a trade surplus of \$12.2 billion of which 53% is attributable to softwood lumber shipments to our markets. The only significant forest products in which the U.S. runs a trade surplus are hardwood logs and lumber.

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“ The cost of a building suitable for light industrial application...rose 7.6% in 2005.”

Building Costs Off and Running

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The cost of a building suitable for light industrial application like millwork or cabinet production rose 7.6% in 2005. That rate is well above the 3.4% gains in consumer prices and 5.4% in wholesale prices last year.

Many culprits were to blame. Structural steel was up 4.2%; cement, 12.3%. Higher oil prices made delivery costs rise as well as the price of anything plastic. These run-ups are tied to

heavy demand from China, the disruptions caused by Hurricanes Katrina and Rita, and higher labor costs for skilled tradesmen.

The rising cost puts pressure on justifying projects that require new space. That situation in turn is forcing managers to downsize space or settle for an existing building. Add higher financing costs, and many projects may be postponed or even cancelled. The boom that fueled a record

\$1.12 trillion in construction spending last year may be at risk.

Bottom Line - If you are budgeting a new capital project, factor in for rising construction costs. If your business depends on a healthy construction industry, be prepared for rough sledding ahead.

Sources: *Investors Business Daily*, 3 March 2006 and *USA Today*, 31 January 2006