

THE FURNITURE INDUSTRY (CASE GOODS)

The Future of the Industry United States versus China

Industry Economics: March 7, 2003

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CONTENTS

Executive Summary

Industry Overview

China's Market Presence

What's Next?

Competition

Manufacturers

Retailing

Supply Chain

Furniture Sourcing by United States firms

Furniture Production in China

Understanding the Supply Chain Models

Furniture Distribution in the United States

Industry Entry/Exit

Recommendations

EXECUTIVE SUMMARY

The United States furniture industry is in trouble. In particular, the case goods segment is experiencing a dramatic change in the way companies manufacture and distribute their products. Lower cost structures, improved quality and efficient distribution from overseas producers are forcing US firms to source goods off-shore from countries like China. With one-third of this market residing in North Carolina, the local economy is struggling to survive. Unable to compete on a cost-basis, companies are closing down their domestic operations and jobs are being lost.

It is our view that the future of the case goods industry in North Carolina and throughout the United States, will rely on the following three efforts: industry consolidation, protecting processes which enjoy a comparative advantage (design, finishing) and leveraging local knowledge on the retail-side of the business. The remainder of this paper provides information on the industry in general, describes the competitive environment, discusses the shifts in supply chains employed and provides our recommendations on how United States firms can survive.

INDUSTRY OVERVIEW

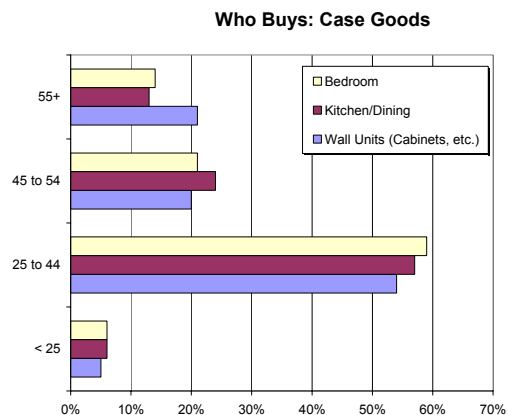
The household furniture industry is a highly fragmented market that generated approximately \$23 billion in 2001 from wholesale shipments and \$64 billion in retail sales¹. The two major segments that make up the household furniture industry include case goods and upholstered furniture. Our focus for research purposes will be limited to case goods, where possible, and will attempt address the wholesale and retail side of the industry.

Case goods are defined as any home furnishing product made with wood. These products are typically large items that are shipped by manufactures in case crates (hence the name). Case goods include items such as bedroom sets, kitchen and dining room sets and wall units (e.g., cabinets, dressers, media centers, etc.). According to the American Furniture Manufacturers Association (AFMA), case goods account for approximately 47% of the total US furniture shipments (in 2001). Wholesale shipments of residential case good products approximated \$10.9 billion in 2001.

The case goods sector within home furnishings requires a capital intensive manufacturing process due to the customization of products and hand-finishing that is often required. There are a variety of design styles, wood options and price points within the category.

Design Styles	Wood Options	Price Points
American	Cherry	Low
Contemporary	Oak	Medium
European Country	Maple	High
Oriental	Primavera (white mahogany)	Premium
Eighteenth Century American	Mahogany	
Eighteenth Century English	Birch	
Other (traditional styles)	Pine	

The largest consumer group for case goods is the 25 to 44 age segment². This market segment encompasses the majority of new home buyers as well as individuals interested in replacement old, low-end furniture with higher-end pieces. However, the over 45 segment is also important because of their replacement/remodeling tendencies and their increased disposable income.



¹ American Furniture Manufacturing Association

² Furniture Discovery Center: High Point, North Carolina

The furniture industry as a whole has experienced a six-year growth trend, through 2000. According to AFMA, retail sales were fairly flat in 2001, and wholesale sales declined over 10%. However, since September 11, 2001 – perhaps because people are cherishing time with their families and focusing on their residential environment – there has been a renewed interest in home furnishings. This renewed interest, as well as the following additional variables, is expected to contribute to the recovery of the furniture industry over the next few years (see **Appendix A** for additional economic indicators):

- Low mortgage rates: people buying more houses
- Low interest rates: improves consumer confidence
- Baby boomers hitting peak income spending stages
- Houses are getting larger: more furniture needed

The AFMA predicts that the market for case goods is expected to grow by about 2.2% in 2003³ - particularly with the introduction of countries like China into the marketplace.

China's Market Presence

China's presence in the furniture industry has grown significantly over the last decade. In 2000, over 50,000 Chinese furniture manufacturers employed approximately 50 million workers and produced \$15 billion value of goods, representing a 15.4% increase over the previous year. Like the US, the industry is fairly fragmented with only two large public firms and numerous small manufacturing producers. However, it is geographically centralized primarily in the south China provinces. Approximately 30% of the total shipments from China and 50% of the export are from one south China provinces—Guangdong.

Chinese furniture exports have increased by 335% from 1994 to 2001, and have replaced Italy as the largest furniture export country in the world. China has also replaced Canada as the largest exporter of furniture to the US market. In 2001, China exported \$2.8 billion of furniture to the US, which represents 30% of the US total furniture imports. Since 1996, *case goods* imports from China have grown at an annual rate of over 35%, reaching approximately \$1.8 billion in 2001. Continual pressures of sourcing and direct-to-retailer make China a real threat to the United State's current market positioning.

³ S&P Industry Report: Household Durables Industry Survey, October 2002

What's Next?

International sourcing has changed the way the furniture industry operates. According to the US Department of Commerce, US furniture imports have grown over 200% in the last 5 years (1996 – 2001) – whereas exports have only grown 14%. Approximately 40% of case good products sold in the United States are manufactured overseas – with China leading the pack on imports⁴. Over 40% of all household furniture imports come from China, the majority of which are case goods. The United States furniture market, North Carolina in particular (representing approximately 1/3rd of total US market⁵), is being forced to source production off-shore due to significant cost advantages resulting from low-cost wages and improved quality and delivery time.

Lower cost structure, improved quality and efficient distribution from overseas producers are changing the ways US firms compete in the furniture market. US case good producers are focusing more on competencies in which they have a comparative advantage, including design, finishing, vendor relationships and domestic industry knowledge. The key to this business model is the ability to leverage the sourcing relationships from overseas while maintaining existing relationships with retail vendors. US producers/distributors have the ability to increase control of quality, timing of shipments and price negotiations given the quantity of products they import. Although the threat of overseas manufacturers going direct to retailers exists, most retailers don't have the infrastructure or capital to bypass the US producers and distributors⁶.

The threat of direct import from overseas producers as well as the increase in cheaper, imported goods by US producers has contributed to the lowering of price points throughout the case good market. From the low-end to the premium-priced goods, retailers are reducing prices to consumers in order to increase sales during the economic recession. Although direct import threat is one reason, price cuts have also been driven by the highly fragmented nature of the furniture industry⁷.

⁴ SunTrust Robinson Humphrey Analyst Report, January 2002

⁵ Wood Household Furniture (Encyclopedia of American Industries)

⁶ SunTrust Robinson Humphrey Analyst Report

⁷ Ibid

COMPETITION

Manufacturers

Competition in the case goods manufacturing sector is highly fragmented. Industry estimates by Ethan Allen place the number of domestic manufacturers at over 1,000⁸, with additional competition coming from foreign producers. Successful players are categorized by branding strategies and established names. The two largest manufacturers, La-Z-Boy (“LZB”) and Furniture Brands International (“FBN”), have acquired or built significant brands and are able to drive sales through brand recognition. FBN was the only \$1 billion case goods producer in 2001, with 4.2% market share. LZB followed with \$651 million in sales or 2.6% of the market. Ethan Allen is the only other manufacturer with more than 1.0% of the market, with revenue of \$395 in the case goods segment. The success of strong marketing in the industry can be demonstrated by correlating market share with brand recognition, as demonstrated in Chart [1].

CHART [1]: BRAND RECOGNITION AMONG RESIDENTIAL FURNITURE MANUFACTURERS

Brand	Brand Ranking	Total Company Sales (1)
La-Z-Boy	1	\$2,150
Ethan Allen	2	\$904
Broyhill (FBN)	3	\$1,891
Thomasville (FBN)	4	\$1,891
Lane (FBN)	5	\$1,891
Bassett	6	\$306
Sauder	7	N/A
Barcalounger	8	N/A
Berklene	9	N/A
Drexel Heritage (FBN)	10	\$1,891

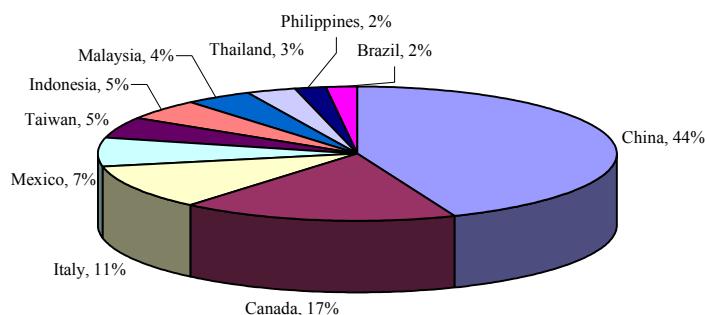
(1) Includes both case goods and non-case goods.

Source: HFN Magazine

Internationally, competition takes place on the basis of cost. BB&T Capital Markets estimates that there exists a 20:1 differential in factory worker wages between eastern Asia and the United States. Wachovia Securities estimates that the landed cost of imported products is somewhere between 3% and 6% of revenue lower than domestic production. In response to lower labor costs, major United States manufacturers have begun to source goods from overseas. As demonstrated in Chart [2] (and as discussed previously), China is the largest producer of imported furniture.

The bulk of the impact of imported goods has been felt by United States’ factories and workers. For

CHART [2]: TOP FURNITURE IMPORTING COUNTRIES



Source: Department of Commerce

⁸ From form 10-K dated December 31, 2002.

example, imports represented 21% of case goods sales for La-Z-Boy. LZB has cut their domestic case-goods production by 45% over the past two years. According to SunTrust, Furniture Brands International sources 70% of its Hemingway line from foreign producers. Wachovia Securities estimates that FBN, Ethan Allen, LifeStyle Furnishings International, and Stanley Furniture announced or completed case goods plant closings in 2001 totaling approximately 6.5 million square feet.

Another trend is the acquisition of off-shore plants by United States manufacturers. Maitland-Smith Company (FBN) recently acquired plants in Indonesia and the Philippines. Separately, FBN struck a deal with Hong Kong Teakwood to outsource \$120 million of production to their 500,000 square foot plant in China. If domestic manufacturers continue to use imported goods, domestic job losses will persist.

Retailing

Similar to the manufacturing sector, the United States retail market is highly fragmented. According to HFN, a furniture industry magazine, consumers prefer furniture stores and chains (71% of the retail market) over department stores (11%), specialty stores (10%), and mass merchants (8%) when purchasing case goods. Consumer preferences have led to a multitude of retail establishments. The top ten U.S. retailers represent only 16% of the market as demonstrated in Chart [3]. SG Cowen

CHART [3]: TOP TEN FURNITURE RETAILERS

Company	2000 Sales	Market Share
Ethan Allen	\$1,193	2.5%
Rooms To Go	\$1,040	2.2%
Berkshire Hathaway Furniture	\$832	1.8%
Pier I Imports	\$777	1.6%
La-Z-Boy	\$744	1.6%
Haverty's	\$681	1.4%
Value City	\$625	1.3%
Art Van	\$575	1.2%
Ikea	\$550	1.2%
Levitz	\$535	1.1%
Total - Top Ten	\$7,552	16.0%

Source: Furniture Today

believes that furniture retailing is a marketing-driven business where store owners are able to grab market share by differentiating their brand and serving niche markets. Manufacturers have found that, because they own the brand, they are able to go directly to the consumer through branded retail outlets. Ethan Allen has been a pioneer in this model and others have followed (see discussion below in Entry/Exit section).

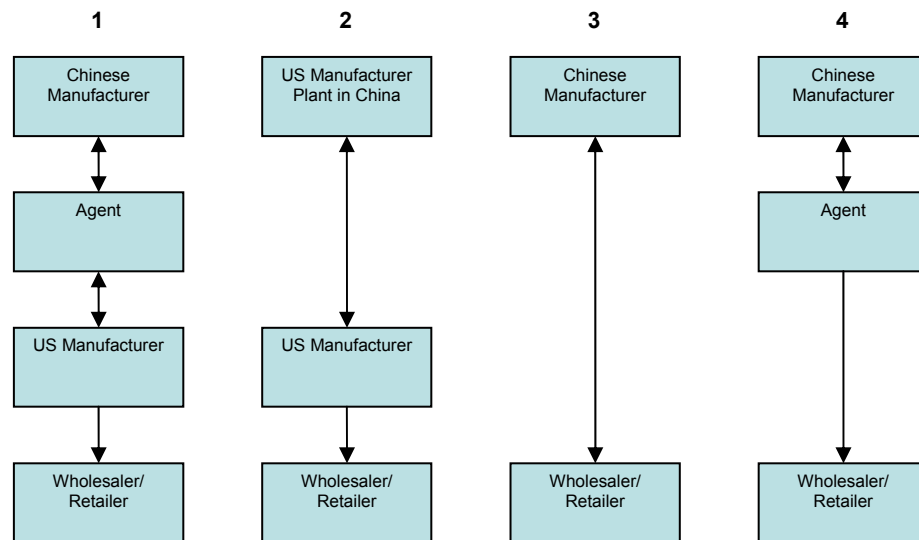
SUPPLY CHAIN

Furniture Sourcing by United States firms

As most US case goods manufacturers have moved from producing to sourcing goods, we have seen shifts in the traditional supply chain model. With the rapid growth in imports from China, US firms and retailers have employed different production strategies. There are largely four forms these import-based supply chains take:

1. US manufacturers source products from China with the help of an Agent Company that is located abroad.
2. US manufacturers produce their furniture in China, directly investing in infrastructure.
3. US retailers buy directly from Chinese manufacturer.
4. US Agents source products in China and sell them directly to small retailers.

In the first two cases, US manufacturers may choose to source some products from China, and produces others domestically. The following chart illustrates the different supply chain models described above.



With states like North Carolina suffering from jobs lost to foreign factories, it is crucial that we understand the competitive advantages of each country. In the following pages, we will analyze and compare the supply chain of furniture production in China versus the United States. We will then look at the strengths and weaknesses of the abovementioned importing models to determine the profit maximizing structure for US firms.

Furniture Production in China

1. Capacity

Currently, the majority of Chinese Manufacturers producing goods for the United States market are running at full capacity and most are planning to increase capacity. The average throughput rate of a Chinese manufacturer is 600 containers per month. If, on average, the value of a container is \$ 12,500, then a Chinese manufacturer is producing about \$100 million annually.⁹ According to Wachovia Securities, many manufacturers are increasing their wood furniture capacity for the US market by 25-30% a year. Analysts estimate that strong demand from the United States and Europe will likely absorb about 20-30% of this capacity extension in the next few years. However, there is considerable concern that the market is heading toward over-expansion, which would create price erosion.

2. Technology

Many plants were built with limited equipment and technology, using labor to overcome the cost of automated equipment and sophisticated production lines. While this has enabled Chinese manufacturers to reduce the initial investment costs of most of these facilities, an increased focus on productivity and quality is accelerating the adoption of new technologies in China. With the enhanced use of technologies, some plants have experienced cost savings of 30-40% in raw materials alone.¹⁰

3. Raw Materials, Components and Services Supply

Lumber

Most of the lumber used by Chinese manufacturers is sourced through US trading agents and is shipped overseas “green,” where it is then treated and dried. One of China’s weaknesses has been the difficulty meeting the US’s maximum moisture content standard (wood that contains too much moisture is of substandard quality). However, great strides have been made in this area and the quality gap between US and Chinese products is quickly closing.

Finishing & Hardware

Another weakness of furniture production in China has been substandard finishing techniques. According to one industry analyst, finishing and assembly is what can make or break a product. As such, given the difficulty of achieving the desired stain color in a consistent manner, many US firms had typically imported furniture unfinished and hired domestic

⁹ Wachovia Securities, September 2002

¹⁰ UBS Warburg, December 2001

craftsman to complete the product. However, Chinese manufacturers have been addressing this issue by developing infrastructure to ensure adequate finishing. The more aggressive furniture manufacturers have their own color labs set up to perfectly match the quality, color and consistency of the finish that is being used in the US.

Increasingly, Chinese manufacturers have become vertically integrated and many have started to manufacture their own hardware rather than relying on imported components. The existence of established capacities in China and stable sourcing from US firms have encouraged US hardware and finish manufacturers to install plants in southern China.¹¹ According to Professor Meenu Tewari at UNC-Chapel Hill, with the arrival of state of the art finish producers, Chinese manufacturers have secured low-cost finishes and technical assistance that are crucial to competing in the US market.

4. Costs

For Chinese furniture manufacturers, low labor and overhead costs are significant competitive advantages against the United States. The table below shows a comparison of typical case goods manufacturing costs in the two countries.¹²

**Production Cost Analysis
% of Revenue for a Typical Mid-Priced Case-goods Piece**

	US Factory	% of Revenue	Chinese Factory	% of Revenue
Wholesale Selling Price	\$ 600	100%	\$ 450 +	100%
	<u>US Production Costs</u>		<u>Asian Production Costs</u>	
Raw Materials	\$ 210-240	35-40%	\$ 210	47%
Labor	\$ 90-120	15-20%	\$ 22.50	5%
Overhead**	\$ 198 – 222	33-37%	\$ 45	10%
Freight	--	0%	\$ 105	23%
Est. Operating Profit	\$ 60	10%	\$ 67.50	15%

It is commonly believed that the only cost advantage enjoyed by Chinese manufacturers is cheap labor. Although labor cost is a key issue, the chart illustrates that overhead savings are also quite significant.

¹¹ Meenu Tewari, “The emergence of quasi-buyer driver chains in High Point’s furniture industry”, April 2002

¹² Based on Wachovia Securities’ Report, September 2002, and own sources

Labor

Labor rates in China average approximately \$0.50-0.75 per hour in comparison to \$15 per hour in the United States. The chart below shows the labor rates in a selected number of Asian countries¹³.

Asian Furniture Factory Labor Rates per Hour	
Vietnam	\$ 0.20 - 0.40
Indonesia	\$ 0.30 - 0.40
China	\$ 0.50 – 0.75
Philippines	\$ 1.00 – 1.25
Malaysia	\$ 1.25 – 1.40
Thailand	\$ 1.50
Taiwan	\$ 5.00

Further, China has a seemingly never-ending labor force. Currently, Chinese furniture manufacturers recruit workers from the inland areas where approximately 800 million people live. These people represent an overabundant supply of cheap labor, almost guaranteeing that wage rates will remain low for many years to come. In the past, high employee turnover caused many Chinese manufacturers to operate inefficiently. However, manufacturers are investing resources in training and development to attract and retain skilled employees.

Overhead

Another important cost difference between China and the United States is overhead. For the purpose of this analysis, overhead includes all manufacturing costs, excluding direct labor, freight and raw materials. Whereas steady furniture demand from the United States has pushed Chinese manufacturers to quickly increase capacity, the investment costs have not been a hindrance. Low construction costs in China permit manufactures to rapidly expand while keeping the low cost advantage. Construction in the United States can run roughly \$15 per square foot, but in China it costs \$3-4 per square foot¹⁴. Additionally, Chinese factory owners are not subjected to the same building standards that US firms face. Reports indicate that many Chinese factories have insufficient dust collection systems, poor or no sprinkler systems, and

¹³ Wachovia Securities, September 2002

¹⁴ UBS Warburg, December 2001

lack many other safety and convenience features typically seen in US factories. This minimalist approach not only reduces overhead costs, but keeps the initial investment low.

Freight

On average, it costs \$ 2,800 to ship a furniture container from China to a warehouse in North Carolina. If an average container carries \$12,000 of furniture, the freight adds 23% to the base price of the good.¹⁵ This cost represents an important percentage, but not sufficient enough to close the gap between US production costs and those of China. Even after adding freight costs, the value of the container imported from China is still 20-30% lower than a comparable one produced in the United States.

4. Quality

Quality has long been an issue with imports from China, but the tide is changing. Many Chinese manufacturers are increasing their focus on quality and continuity of supply, and moving away from volume. Most have streamlined their relationships and are now working with a select group of agents and customers; accordingly, they are reducing the number of SKUs being offered. With the help of US producers and different services companies, Chinese manufacturers are improving their quality. Import Agents, most of whom are former US manufacturers now based overseas, are also helping Chinese manufacturers implement more stringent quality control.

Understanding the Supply Chain Models

To recap, the import supply chains for US firms and retailers take roughly four different forms. However, not all supply chains are created equal. As such, it is important to understand the strengths and weaknesses of each in order to determine the best fit for profit seeking companies.

In the first scenario, a US manufacturer sources products from China with the help of an import agent company that is located abroad. In this model, having a strategic relationship with an agent can be a true competitive advantage. A prime example of this is the role that Outlook International (agent) plays for Furniture Brands (US manufacturer). Outlook is the interface in China between the customer and the various source factories and gets involved at the earliest stages of design, all the way through deliveries.¹⁶ Outlook tests all new products in their labs

¹⁵ Wachovia Securities, September 2002

prior to entering production to ensure that there are not structural or design flaws. Further Outlook has quality control personnel monitoring moisture content at the various facilities and advising accordingly. In this case, Outlook is operating as more than an import agent – they are a service company. Many U.S. buyers typically contract with import agents that source product from plants that can provide the best delivery time, and not necessarily the best quality. Traditional import agents serve as facilitators to expedite the trade process, but are not necessarily invested in the production intricacies. As such, Outlooks on-the-ground presence and quality control staff give its customers a sharp competitive advantage.

In the second scenario, US manufacturers produce their furniture in China in a company-owned facility. With the existing gap between US and China manufacturing costs, and the profit margin lost to foreign factors, some US manufacturers have installed plants in China and many others are exploring the possibility of direct investment. However, the source abroad vs. produce abroad decision involves many factors. U.S. firms may choose to manufacturing directly in China for the following reasons: to capture the profit margins of Chinese manufacturers (about 10-20%), to gain more control of production schedules and delivery, and to have the ability to manufacture any type of product, especially those products which Chinese manufacturer have little expertise. However, direct investment into China is a risky venture for a host of reasons. For example, building rather than sourcing requires much higher capital investments. Also, there is wide speculation that over-expansion will tend to reduce prices, favoring firms who source abroad and hurting producers. And finally, many consider China to represent significant political risks with many unknowns.

In the third supply-chain model, US retailers skip the middlemen and buy directly from Chinese manufacturers. For example, Walmart, Ethan Allan and Rooms To Go have all established a long-term sourcing relationship with one of the biggest Chinese pinewood goods manufacturer, Markor, Inc. Ethan Allan has even signed a long-term strategic contract with Markor where the company would not only buy large amounts of goods directly every year from Markor but would also join with Markor to exploit the furniture retailing business in China.

This supply chain does not involve any US manufacturer or agent and the advantages are obvious—the transit time is shorter, the gross margin is bigger for both sides and the market information could be transferred to the manufacturer quicker and more accurately. However, this model typically works only for large US retailers and large Chinese manufactures because big firms are more likely to establish long-term relationships with each other for better quality

control and better supplying stability. Large Chinese manufacturers are also financially strong to be able to extend credits to retailers to facilitate the transaction. We expect this supply chain model will be a continuous industry trend in the future.

In the fourth scenario, US import agents source products in China and sell them directly to small US retailers. These agents purchase products in bulk and warehouse inventory in the US, selling to small retailers who do not have the capacity to buy directly from China. In this case, even small retailers rely on Chinese produced products. However, this model occurs on a much smaller scale as Agents have fewer resources to finance such bulk purchases, and because sitting on large amounts of inventory is a risky endeavor.

Finally, some US manufacturers have a mix of domestically produced goods and one of the above import models. Occasionally US manufactures may find it more efficient to produce some of their goods domestically. There are several reasons for this. First, these goods could be time-sensitive so that they have to be produced domestically to save the transit time. Second, they may require special or more advanced treatment which is not available in China. Finally, these goods may be produced in such a small volume that outsourcing abroad not worthwhile (i.e. highly customized products or high-end specialty goods). However, the trend is increasingly moving toward full sourcing. Whereas Chinese manufacturers were previously able to handle only large volume production, with technological direction from US partners overseas factories are now able to handle much smaller batch sizes.

Furniture Distribution in the United States

The furniture retail landscape is highly fragmented, with 45% of the sales concentrated in the first 100 retailers.¹⁷ The retailer business is mainly dominated by regional chains, as discussed previously. In the last years, two trends have been changing the retailer landscape. Firstly, the continued push of manufacturers into retail. Because of the increased cost pressures created by sourcing, US organizations are recognizing that sustainable profits are found primarily on the retail side of the business. However, retailers have a difficult job of maintaining relationships with suppliers, moving the product to the consumers and meeting demand with the appropriate amount of supply. The difficulties in successfully operating a retail store have caused retailers to struggle over the last few years.

¹⁷ Sun Trust Robinson Humphrey, January 2002

INDUSTRY ENTRY/EXIT

A major issue for domestic manufacturers is the slew of bankruptcies that have occurred over the past several years. Failures have been primarily on the retail side, including Levitz, Heilig-Meyers, Sears Home Life, and “several hundred ‘mom and pop’ retailers” (Wachovia Securities estimate) and are demonstrated in Chart [4]. Bankruptcies have a negative effect on all industry operators and not just those that are going out of business. FBN management estimated that bankruptcies cost the company \$262 million in revenue and \$28.5 million in

CHART [4]: MAJOR FURNITURE INDUSTRY
BANKRUPTCIES

<u>Company</u>	<u>Sales</u>	<u>Stores</u>
Montgomery Ward	N/A	237
HomeLife	\$650	128
Heilig-Meyers	\$2,000	906
Ames Dept. Stores	\$300	452
Roberd's	\$287	15
Lechter's	\$405	325
Levitz	N/A	N/A

Source: BB&T Capital Markets, SG Cowen

lost accounts receivables between 1999 and 2001. Bankruptcies have been brought on by overly-aggressive capital structures and demand fluctuations. While the domestic market size varies each year, financially sound companies have the ability to capitalize on acquisition opportunities.

High operational leverage in the manufacturing sector has facilitated the need to consolidate in order to cut fixed costs. The largest players are also the two most active acquirers, with FBN and LZB making major acquisitions over the past three years (for a list of public company acquisitions, see **Appendix B**). The benefits of acquisitions in the manufacturing industry are two-fold: diversity in product offerings and costs savings. UBS Warburg claims that reduced costs often come through “plant rationalization, increased capacity utilization, and leveraging procurement opportunities.” Successful acquisitions typically result in a holding company structure, where the acquirer will not try to change or manipulate the brands that they acquire. In Furniture Brands acquisition of Henredon, they have continued to produce under the Henredon brand, rather than trying to attach other names to their offerings. Through allocation of fixed costs over more brands and units, acquisitions make economic sense for most acquirers.

Entrants have begun to attempt to grab portions of the market that have been vacated through acquisitions and bankruptcies. A major trend is manufacturers trying to go directly to consumers, rather than through traditional channels. Ethan Allen has been successful in incorporating this model and others have followed. As of February 2002, FBN licensed 150 Thomasville stores and 35 Drexel Home Inspiration Stores. La-Z-Boy has also attempted this strategy, with 48% of retail sales coming through dedicated dealers. Major retailers in non-

furniture segments have also begun to enter the market. Costco, a global membership warehouse, opened its first furniture store on December 15, 2002 with a 105,000 square foot facility in Kirkland, Washington. While discount stores may grab some market share, the ultimate entry threat for United States manufactures will be from foreign producers. If foreign producers are able to establish channels directly to retailers, manufacturers will find themselves out of the loop and struggling to survive.

RECOMMENDATIONS

The North Carolina case goods manufacturing industry is in trouble. With 40% of wood furniture made in China, North Carolina companies and laborers are losing ground quickly. Much of the competition in the industry takes place on the basis of cost. While many would argue that the state and the industry should continue to outsource low-cost manufacturing to China, there may be alternative solutions to the problem. According to Wachovia Securities estimates, overhead costs represent 33% to 37% of wholesale revenue for U.S. manufacturers. If overhead costs could be reduced, U.S. products could be priced more competitively against imports. One method to reduce overhead is consolidation. The highly fragmented furniture industry is full of duplicative departments and employees. The accounting and logistics departments at two different companies could be consolidated to one department in a merger or acquisition. In addition, consolidation between large retail and manufacturing companies could reduce steps in the supply-chain and help manufacturers compete better against low-cost imports. Broad consolidation will help the industry overall, but may accomplish little for North Carolina's income tax base.

The major question for manufacturers is: what will the industry look like in 10 years? Even with broad consolidation, it is unlikely that there will be many opportunities for U.S. manufacturers to compete with foreign producers in an industry where profits are dictated by costs. However, North Carolina has three advantages that they must protect for the future of the state's case goods industry: design, finishing, and retail. North Carolina-based companies that we spoke with continue to believe that Chinese manufacturers have not been able to replicate exactly U.S. designs and finishes to the specifications of the American consumers. These companies will send their own designs to China and receive a semi-finished good from the foreign manufacturer. The local manufacturer will then finish the piece before passing it along to the retailer. If North Carolina can maintain its competitive advantage in these areas, some

furniture laborers will be able to keep their jobs. North Carolina's other competitive advantage resides in its enormous retail markets in High Point and Hickory. High Point in particular has cultivated an international reputation that is unparalleled among other manufacturing cities. By maintaining the mystique of High Point, the state will continue to see tax revenue from furniture laborers, particularly on the retail side. The battle is not over yet, but North Carolina must fight hard over the next ten years to continue to be a major player in the case goods manufacturing industry.

Appendix A: Relevant Economic Indicators

Consumer spending for furniture and bedding

Annual rate in billions

Source: U.S. Dept. of Commerce

Nov '02	Percentage change	
	from Oct 02	from Nov 01
\$68.6	1.6%	3.8%

Existing single-family home resales

Annual rate in millions of units

Source: National Assn. of Realtors

Nov '02	Percentage change	
	from Oct 02	from Nov 01
5.56	-3.5%	5.9%

Sales of new single-family homes

Annual rate in thousands of units

Source: U.S. Depts. of Commerce and Housing & Urban Dev.

Nov '02	Percentage change	
	from Oct 02	from Nov 01
1,069	5.7%	14.0%

Privately owned housing starts

Annual rate in millions of units

Source: U.S. Bureau of the Census

Nov '02	Percentage change	
	from Oct 02	from Nov 01
1.697	2.4%	5.8%

Furniture producer price index

Household furniture, 1982=100

Source: U.S. Bureau of Labor Statistics

Nov '02	Percentage change	
	from Oct 02	from Nov 01
157.8	0.0%	1.4%

Furniture factory employment

Annual rate in thousands

Production workers; household & contract

Source: U.S. Bureau of Labor Statistics

Nov '02	Percentage change	
	from Oct 02	from Nov 01
486	-0.4%	-1.8%

Furniture factory capacity utilization

Percentage of capacity used

Household and contract furniture combined

Source: U.S. Federal Reserve Board

Nov '02	Percentage change	
	from Oct 02	from Nov 01
70.1%	-0.7%	-3.2%

Appendix B: Public Company Acquisitions (1999 – Present)

Acquirer / Target	Date	Value (millions)	Operation	Type
Chromcraft Revington				
Korn Industries	Sep-99	\$8.5	Manufacturer	Bedrooms
Furniture Brands International				
Lifestyle Furnishings Int'l divisions (1)	Dec-01	\$287.0	Manufacturer	Casegoods
Hooker Furniture Corp				
Bradington-Young LLC	Jan-03	\$24.5	Manufacturer	Upholstered
Triwood	Jun-00	\$1.9	Manufacturer	Materials
La-Z-Boy				
LADD Furniture, Inc.	Jan-00	\$190.0	Manufacturer	All
Alexvale Furniture, Inc.	Dec-99	\$17.0	Manufacturer	Upholstered
Bauhaus USA, Inc.	Jun-99	\$59.0	Manufacturer	Upholstered
Rowe Companies				
Storehouse	Aug-99	\$24.4	Retail	All

(1) Includes Henredon Furniture Industries, Drexel Heritage Furnishings, and Maitland-Smith

Source: Public filings
