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The Viability of China's Wood Furniture Industry



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Abstract

The following paper will discuss the viability of China's wood furniture industry. Though out the paper, the paper will discussed why China is becoming so successful in the industry, what factors will affect the viability of the wood furniture industry and what challenges China is current facing. China is currently more open to international trading than ever before. While China is becoming the biggest exporters of wood furniture in the world they have suffered a few setbacks. Setbacks from upcoming competition from developing countries like Brazil and Vietnam, export tariffs placed by United States, United States' recent economic crisis and increase in the cost of raw material and skilled labours. Despite these setbacks, there are evidences that China is recovering and will continue to upscale their wood furniture products to higher end products. China is also being accused of over relying on trading with United States. There is also evidence that they are starting to trade their wood furniture to other countries but it may be a slow and difficult process. Lastly, there are pressure from other countries and environmental groups that China is not practicing sustainably logging practices. In response, China has goals set up by the State Forest Administration to become more environmentally constructive. With the ability to adapt and the amount of money invested into the wood furniture industry, the industry will be viable for a very long time.

Keywords: Global recession, Eco-labelled, Added-value goods, Competitive advantage, Low labour cost

Introduction

With the economy of China growing stronger and its trade with other countries increasing more than ever, it is important to look deeply at one of China's biggest exports. The wood furniture industry in China is doing very well. This paper will discuss why and how China is so successful, demonstrating how the industry in China may be viable for many years to come, despite economic and environmental challenges. In spite of the economic crisis in United States, the Chinese wood furniture industry will be viable for a very long time. One of the reasons is because of the investment in their wood furniture manufacturing sector by international investors. As China is becoming more open to international trade, it is attracting investors around the world to invest in the manufacturing industry. Another reason is the flexibility and competitive characteristic of the industry. The nature of China's wood furniture industry is set up

to welcome new entrants. This allows many investors and entrepreneurs to easily set up factories and gain market share. It is relatively easy for new entrants to set up factories and gain market share. Competition often leads to improvement of quality and efficiency to gain competitive advantage which is often good for the viability of the industry. Apart from investment and the nature of the industry, an important reason why China's wood furniture industry will be viable for a long time is because of the people in the country. Building factories in China is attractive because of low salary laborers. Low labour cost is one major way for factory owners to make more profit. The people in China are also skilled. With the large population in China, it is expected that there is an abundance of skilled workers to operate the machines. These factors are reasons why the wood industry of China will be viable for many years.

Current trends

China in the past decade has become one of the major producers of wood furniture products (see

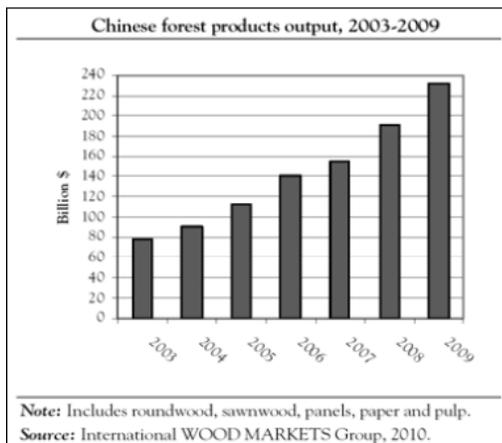


Figure 1: The amount of Chinese forest products that was produced from 2003 to 2009
Source: Dr. David Cohen 2010 Global Trade Lecture

figure 1). It has surpassed many European wood furniture manufacturing countries such as Italy and Germany. A large majority of Chinese wood manufacturing factories, both small and large, are highly automated and highly efficient. In 2009, China had exported 182,831 pieces of wooden furniture and 234,207 pieces of wooden furniture in 2010. In 2010, China's wood furniture export was US\$9,447 which was 42% higher than 2009. {{Global Wood. 2011}}

As stated in Ganguly and Eastin's article, investors are investing large quantities of money on highly efficient factories to produce high end products, in order to compete with Italian and German manufacturers.

Because of Chinese logging quota policy, China is required to import unprocessed or semi processed wood. Their main lumber importing partners are Russia, United States and Canada. British Columbia is currently one of the largest exporters of logs and lumber to China. However,

the amount of export from British Columbia is expected to decrease mainly because of the mountain pine beetle infestation. With the United States housing marketing expected to grow again, they will compete with China for Canada's wood. Before 2007, China relied heavily on Russia for their import logs; however, due to recent increased of export tariff by Russian government, the current number of imports from Russia has decreased.

The Chinese government is very supportive of the way raw materials are imported, and value-added products are exported because this process generates significant investment money. The Chinese government has a variety of subsidies to help the wood industries. For example a 15% export tax rebate on wood product exports.

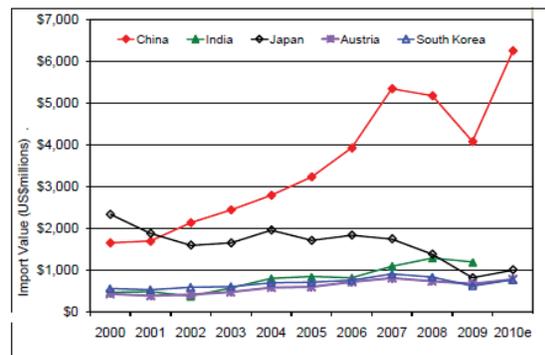


Figure 2: China's log imports exceeded the log imports of the next four countries combined
Source: Ganguly, Eastin. 2011

In 2010 China surpassed United States as the largest lumber importer in 2010. In 2009, China imported a total of 28 million cubic meters of lumber worth over US\$ 4 billion, despite the global recession. The import value was more than India, Japan, Austria and South Korea combined (see figure 2). One reason for this is because the purchasing power of Chinese wood product companies has increased. Second, other countries simply do not have as high a demand for wood. While importing large amount of lumber from other countries, the wood furniture manufacturers must produce them to make money otherwise the lumber may decay. The estimated total of wood furniture exported in 2010 from China is about US\$9.5 billion, which is more than Germany and Italy combined. In the past, China relied heavily on trading with the United States. However, with new legislations and the American economic crisis, China has focused its trading opportunities with other Asian and European countries. By diversifying their trading partners, the risk is minimized. In 2010 only 32.9% of wood furniture was exported to the United States.

With the Chinese trying to diversify their trading partners, other Asian countries are trying to capture this opportunity. {{Ganguly, Eastin. 2011}} For example, since the United States is

suffering an economic crisis, the Chinese wood product industry has been greatly affected as well. Despite the export and value growth the economic depression resulted in high inventories and significant price drops; as a result, it has caused many factories to close down or result in serious financial trouble. Within some provinces in China, a total of 3 million workers were laid off in the forest product industry. During the economic depression the Chinese government passed a 15% export tax rebate for wood product exports.

In contrast, one article from The ACF China Co – Millstone Trading claimed the wood furniture industry is actually slowing down. While the economic crisis is affecting global economy, another reason why the wood furniture industry is slowing down in China is because of Vietnam. {{Roger. 2009}} Vietnam is becoming a greater competitor to China of exporting wood furniture to the United States by increasing its market share from 3.1% in 2004 to an estimated 15.7% in 2010. {{Ganguly, Eastin. 2011}}

With GDP increasing in 2009, the domestic market of China's wood furniture industry has become an important force. Other pushing forces for the growth of the Chinese wood industry include urbanization and growth of housing industry. The Chinese government has made steps to ensure they have a low-carbon economy for all of their industries, which will be able to be competitive in the long run. {{Cao, Eastin. 2010}} A major reason Asian countries are gaining market share in the wood furniture market is because of European countries losing most of its market share.

With the enormous lumber demand of China, China has been criticized for causing woods to be logged illegally and thus causing global deforestation. China has been allegedly importing illegal logs from Myanmar, Congo, Equatorial Guinea, Gabon, Papua New Guinea and Russia. {{Ganguly, Eastin. 2011}} The ultimate source of high demand is from North America. Since most of China's products are exported to the United States and Canada, they are the reason why the demands are so high. With high demand forcing China to produce more wood furniture, then China will require more materials.

Because there are a limited amount of certified logs in the world, China will have to turn their heads to developing countries. Developing countries usually have lenient enforcement on illegal logging as corruption is a huge problem. On the other hand, once wood furniture is manufactured in China, very few countries are concerned whether or not the wood is logged sustainably. Developing countries do not care if the wood is illegal or not. Price is their deciding factor because people from these countries are mostly living below the poverty line and have limited purchasing power; thus, they will choose wood furniture that is lowest priced. There are attempts from governments of the United States, Japan and European Union to have legislations that combat illegal harvest wood. Their aim is to force the Chinese to use more environmental practices. After 2007 there has been a decrease in export of illegal wood from developing countries and an increase in import of legal wood such as New Zealand, Australia, Canada and United States. {{Ganguly, Eastin. 2011}} This is one of the factors that caused China's wood furniture export to decreased 6.8% compared to the number of exports in September 2007 to September 2008 and a decreased of 8% in September 2008 to September 2009. {{HKFA. 2009}} Yet, there are claims that the Chinese wood furniture industry had recovered in 2009. Detailed export numbers were given at the beginning of this section. {{Global Wood. 2011}}

In year 2000, the number of sustainably certified wood manufacturing companies in China was only 12 and by 2010 there were a total of 1,562. However that is still a small fraction. It is less than 4%. One of the reasons why it is not accepted throughout the whole wood industry in China is because like PEFC, there is still low brand awareness and few wood furniture managers actually understand it. Another reason is because the availability of certified wood is scarce in domestic or international markets. Local forests that supply sustainably certified logs are rare because almost all of China's forests are state owned and therefore it is hard to get the government to set up a sophisticated system that would enforce the requirement of having sustainable logging practices. The forests that actually supply sustainably certified logs are probably far from the actual demand for these logs, which result in logistic issues. Logistic cost would increase if factory owners insisted on getting sustainably certified lumber, which would result in raising their wood furniture price. That would be disadvantageous compared to other wood furniture manufacturers, who do not care about sustainably certified lumber. In China,

people have no regard for whether a product is eco-labelled or not. Similar to other developing countries, they will usually choose the product with the lowest price. {{Ganguly, Eastin. 2011}}

With low demand and the cost that comes with the eco-label, the manufacturers only produce eco-labelled products when requested. It is indicated by wood industry managers that implementing these eco-labelled product is a very time consuming and costly process. It would not be a good business strategy to produce many eco-labelled products and have nobody purchasing them because they are priced higher than their competitors. There is a very small percentage of the population in China that is environmentally aware. Because the majority of managers in the wood industry do not understand the Lacey Act, which requires an abundant amount of information regarding the source and species of the wood used, they chose to stop exporting to the United States all together and began to export to other Asian countries or Europe instead. {{Ganguly, Eastin. 2011}}

Even though the wood furniture industry is slow to adapt sustainable practices, the State Forest Administration (SFA) has set up goals for 2015 that would improve the environment. For example, some of the goals include:

- Expanding the forest cover by 21.66%
- Expanding the forestry land area to 309 million hectares
- Increasing the growing stock of forests to 14,300 million cubic meters

These are all great goals initiated by the Chinese government that would not only be good to the environment but also help the prosperity of wood industries especially the wood furniture. This not only may decrease their over reliance on importing raw materials from other countries but may also decrease illegal logging from developing countries. (Global Wood. 2011)

Why China is so successful?

Before getting deeply into the viability of the Chinese furniture market, it is important to explore why the Chinese have become so successful in the furniture industry. First of all, the Chinese furniture industry offers low input cost to produce their products. They are able to minimize their input cost by mainly hiring cheap labor. The production of furniture is a very labor intensive production and labor is one of the major expenses in the business. By having low labor cost then the product can be produced at a significantly lower cost. {{Hardwood review. 2010}} China's second labor advantage is that it has a massive population that contains a plethora of skilled labor at very low cost. This is a very unique advantage that makes China highly competitive in the global furniture market. {{United Nation, 2009}}

Apart from that, the success of China's furniture industry is the fact that they prefer orders of mass quantities. This guarantees that any sales they make would ensure profitable return. They avoid special design and high-end products because those products are more quality intensive, which require more specific, skillful people and as a result, increase their labor cost. {{Hardwood review. 2010}} Because of the specific ordering requirements, China has distinguished itself as one of the largest manufacturers and exporters of wooden furniture.

China also has a strategic way of producing their products. Instead of spending a fortune in developing industries to obtain raw materials, they obtain materials from other countries such as United States, Canada and other European countries, and then produce these raw materials into finished wood furniture products to sell back to the region. {{United Nation, 2009}}

There are also speculations that China's ability to produce wood furniture at such a low price is by importing illegal timber. According to White's article from UK's Cabinet Maker magazine, China and Japan import about 3.2 million cubic meters of illegal wood a year. White claims that of the 3.2 million cubic meters of illegal woods, almost 100,000 cubic meters is used in furniture. Despite many people in China still living below the poverty line, China has one of the highest purchasing powers in the world at US\$7.592 billion {{8 Hunter, Steve L. 2007}}. It has the

power to purchase raw materials from other countries and turn those materials into added-value goods. As a result, China has been successful in the wood furniture market.

Market competition

In order to understand more fully the Chinese market this paper will discuss the competition forces in China's furniture market. According to Steve L. Hunter's article "Market competition forces: a study of the Chinese case goods furniture industry," he breaks down the Chinese wood furniture competition forces into 5 competition forces based on Porter's Five-Force Approach (Porter 1980).

The five forces that drive China's competitive furniture industry are:

1. Bargaining power of suppliers
2. Rivalry among existing firms
3. Threat of potential entrants
4. Bargaining power of domestic and international customers
5. Threat of substitute products

In the article, Hunter shows in the order the forces that have the greatest impact to the least impact on the Chinese furniture market.{{8 Hunter, Steve L. 2007}}

Bargaining power of suppliers

According to the article Hunter wrote, there are many reasons why he believes the bargaining power of suppliers to be the force that may have the most impact on the Chinese furniture market. With large population and many existing companies, there is tremendous competition over raw materials and labour. In seeing the potential of the Chinese furniture market, many international investors have invested copious amounts of money into building cutting edge technology machineries in the Chinese factories to increase efficiency and quality of the

products. According to David Cohen a University of British Columbia professor, most of these international investors are Taiwanese. {{Cohen. 2011}} With all of these investments, it is important to have materials to produce these products. This is why there is a high demand in raw materials. With high demand of products in a short time frame, Chinese manufacturing companies are pressured to attain wood for production.

The abundance of Chinese manufacturing companies fighting over these raw materials creates a major competitive force. Companies that have higher bargaining power will win over smaller companies that do not because the smaller companies simply have nothing to produce or have to get raw materials at a very high cost. {{8 Hunter, Steve L. 2007}} To make matters worse, the price of raw materials is getting higher and higher. The rise of raw material prices is mainly due to inflation, pollution and deforestation. There are also speculations that there will be a ban in domestic raw materials and that means the price of wood for wood furniture will increase. {{Roger. 2009}}

Another asset the companies are competing over is skilled workers. Without skilled workers it is impossible to produce good products. Although China has a huge population, the number of skilled workers who can operate these machineries is scarce because of the various manufacturing companies. With skilled workers, companies in the wood furniture industry have to fight over companies from other industries for these workers. To attract these workers, companies will offer raises or higher salaries and travel incentives. {{8 Hunter, Steve L. 2007}} Another reason why Chinese labour costs are becoming higher and higher is because of a new labour law that was passed in 2008 that prevents companies from underpaying their workers. This will result in higher production costs, which could result in companies becoming bankrupt because of that. With the higher cost of workers, many companies will move to more rural areas to find workers because they cost less. Lastly, the cost of energy has affected manufacturers too. With the increase of energy cost, the cost of production will increase and smaller companies may not be able to withstand this increase in their operating cost. {{8 Hunter, Steve L. 2007}}

Rivalry among existing firms

With a huge population it is inevitable that there will be an abundance of merchants running

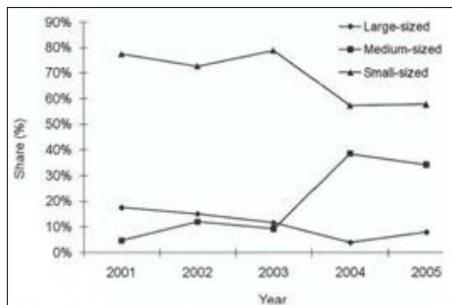


Figure 3: Furniture production by company size
Source: 8 Hunter, Steve L. 2007

wood furniture manufacturing companies. Every household has a demand for furniture. Wood furniture has been a traditional product that civilization has used for many years. In seeing the potential of the market, there are many companies trying to make money from this enormous market. In addition, China becoming more open to trading with other countries has caused the industry to skyrocket. From 2001 to 2005, the middle size wood

furniture manufacturing factories with an average of 300 to 3000 employees had increased by more than 400 percent. In 2005, there were a total of 30,000 furniture companies registered in China. The majority of these companies were small factories with fewer than 300 employees (see figure 3). These small factories have average assets of US\$0.63 million. {{8 Hunter, Steve L. 2007}} However, in another article, the author claims the current amount of furniture manufacturing factories as “overcapacity”. {{Roger. 2009}} He stated that the current industry is overproducing and only stronger factories will survive. On the other hand, with much rival competition for gaining market share, it can be a good thing for the industry. In order to gain market share, companies usually attract customers by lowering price, improving quality or improving service. All of these improvements will attract customers from around the world which greatly benefit the country, the industry and the locals. Unlike a monopoly industry where everyone is forced to pay high prices for what they want, customers have a choice. This motivates companies to improve and try to gain an advantage edge on its competitors.

Threat of potential entrant

Hunter believes the third greatest factor that impacts China’s furniture industry is the threat of potential entrants. With a relatively low-level entry barrier that allows new competitors to easily

join the competition, it is not hard for new entrants because small companies can easily set up factories that can quickly compete with similar factories. Researches show that with similar technology and management systems for both small and medium sized companies, production outputs are similar. {{8 Hunter, Steve L. 2007}} The reason this is the case is because wood furniture are somewhat a commodity. The basic design of chair is the same among other factories. Since this is the case, a smaller factory and a bigger factory will have very similar machinery. Designs are also easy to copy because copyrights or patented designs are hard to protect. This encourages smaller investors to create smaller factories so they can easily gain a part of the market share. It only becomes harder when a wood furniture factory decides to produce different products. Design of products may complicate the process. Also, the government also has lenient legislatures on the industry, which becomes easy for new entrants to set up factories anywhere they want. It is definitely easier to set up a factory in China than in Canada with all the regulations. Lastly, to enter the industry is easy due to its low requirement on capital. There is no need for large amounts of money to set up a wood furniture factory.

Bargaining power of domestic and international customers

Bargaining power of domestic and international customers is the fourth most important factor. Wood furniture is not a necessity product. People do not need it to survive. However, wood furniture is a product that is common in every household. Every company's focus should be its customer. As a successful merchant once said, "A company would not survive without its customers." The success of the Chinese wood furniture industry is because of the attractiveness of their price in their products. Chinese wood furniture is known for its low quality but at an exceptionally low price. The industry will continue to grow as long as the wood furniture from China is continually priced lower than wood furniture from other parts of the world. However, other countries such as Mexico, Vietnam, Brazil and countries of the Middle East will start to rise as they are becoming more competitive in the wood furniture market. Apart from having low average income, they each have special strengths such as special raw materials. {{Roger. 2009}}

Because of allegations that China has been importing illegal wood and also harvesting woods illegally in other countries, the US has posted heavy antidumping tariff on China. This, however, did little to slow them down. In 2006, America still has US\$1.7 billion of Chinese furniture in their bedroom. In 2006, there is also a 60% and 112% increase for Europe and Canada respectively. However there are some challenges in the market. {{8 Hunter, Steve L. 2007}}

With the recent economic depression and culture change of China, even though the average income of China has risen, the Chinese are saving the majority of their money to buy houses. The impact of this is not huge because on average, once a Chinese person buys a new house he or she will usually buy new furniture. At the moment, small and medium sized companies are limited to local markets. Only bigger companies can sell nationwide and they are uncommon too. It is hard to sell nationwide because the Chinese market are not a single market due to different areas in China having different labour rates. In more urban and heavily industrialized areas of China, the labour rates are higher, whereas in more rural areas the labour rates are lower. {{8 Hunter, Steve L. 2007}}

Threat of substitute products

There are legislations from other countries that try to limit the importation of China's furniture. Despite these obstacles, China's furniture export still has grown steadily. The least significant factor that would impact China's furniture industry would be the threat of substitute products. Throughout the history of mankind people have been using wood as furniture. Hunter feels wood furniture will not be replaced by some other materials in the foreseeable future. {{8 Hunter, Steve L. 2007}} It is especially hard for any product to substitute wood furniture because the Chinese are a culture that likes to keep its traditional culture. Wood furniture has been around China for almost as long as history has noted China's existence; thus, the appreciation of wood furniture in China will not fail in the foreseeable future.

Who do they export their furniture to?

With China's growing economy and the nation becoming more open to world trade, countries around the world have rushed to trade with China because of the price of its products and its ability to mass produce. The United States is one of the biggest trading partners of wood furniture. {{Cao, Xiaozhi. 2008}} Europe and Canada are also major trading partners with China for wood furniture. {{8 Hunter, Steve L. 2007}} With the United States importing great amounts of Chinese furniture to their country, consumers, retailers and traders have more choices and are able to choose a product that is suitable to them. They are also able to buy their wood furniture at a lower price because it is usually more economical to choose Chinese wood furniture than local ones. However, with the recent economic crisis in United States, there are less people buying wood furniture from the Chinese as often the Vietnamese can produce wood furniture that is cheaper. {{United Nation, 2009}}

What current challenges are the Chinese facing to preserve the industry?

Despite having enormous growth in export of wood furniture in the past decade, the Chinese wood industry is now facing some challenges. One example is the recent economic depression. With United States being in economic crisis, the exports of China's wood furniture has decreased as well. {{United Nation, 2009}} With people in United States being tight on money, it is expected that there will be fewer people buying new furniture. It is likely that people will reuse or buy pre-owned furniture to minimize spending. With fewer customers there will be fewer people shopping around furniture retailers and as a result the retailers will order less wood furniture from the Chinese wood furniture manufacturers. With the demand of these products decreasing, the production of the wood furniture will have to decrease to prevent an over-accumulation of products. This would create stress in China as many labours rely on their job to feed their family.

Although China has been slowly starting to trade with other countries instead of United States for wood furniture, there is still a big percentage of China's export that goes to the United States.

Fifty Percent of China's wood furniture export goes to the United States and China's wood furniture industry heavily relies on export. {{United Nation, 2009}} If China were able to attract diverse clients from other parts of the world, then they would suffer less impact from the economic depression of the United States.

In the five forces that impact China's wood furniture industry, one competition force that is not discussed is the bargaining power of international competition. Vietnam is becoming a major competitor with China for exporting wood furniture to the United States. Vietnam has a lot of the advantages that China has. They have skilled labours that are about to work at a lower cost and their government have lenient legislations on setting up factories to manufacture wood furniture. {{United Nation, 2009}} According to David Cohen, China is moving towards producing high end wood furniture because they can no longer compete with Vietnam for producing cheap low quality wood furniture. As China's average income is increasing their production cost will increase. The Chinese are forced to upscale and produce high end wood furniture because Vietnam has a lower average income and therefore can produce wood furniture at a lower cost and price their products lower. In time, Vietnam will follow China's path and another developing country will take over Vietnam. {{Cohen, 2011}} In order to compete with Vietnam, China has to improve efficiency and quality to compete with Vietnam. China still has a bigger population than Vietnam so they are able to train more skilled workers. China can also gain competitive advantage by providing more services than Vietnam producers. For example, China is able to provide longer and better warrantee services. China wood furniture manufacturers must find ways to accomplish better quality, efficiency and services while keeping their price competitive with Vietnam.

Conclusion

In studying many articles from different experts from different fields we can conclude that China's wood furniture industry will be viable for a long time. Their wood furniture industry is currently growing at a rapid pace and their imports and exports have surpassed many other countries such as the United States and many of the European Unions. Domestically, the Chinese

wood industry will continue to be strong due to the fact that the country's GDP is raising and people are living better lifestyles, earning higher income than before. More people in China are able to buy commodity products like wood furniture. As discussed above, the majority of the people in China are currently saving most of their income to buy houses. They do not move often, but when they move, they usually purchase new furniture.

Internationally, China will continue to be strong due to its wood furniture usually being priced lower than their competitors, due to low labour cost. Current wood furniture factories in China are highly efficient and high in quality. With major investments from outside of China, the current trend of the wood furniture industry is to produce high-end products to compete with European wood furniture manufacturers such as Italy and Germany.

Although there are many positives, there are also challenges that the Chinese wood industry may have to address if they want to continue to capture more market share around the world. For example, they are currently facing new competitions from other Asian countries. Vietnam is currently a strong competitor in manufacturing wood furniture for the United States. Vietnam like China has skilled labour at a low cost. With time and with major investors, Vietnam may be closer to China's level in the wood industry.

Another challenge China is facing is sustainably logged wood. They are currently facing allegation of importing illegal wood from developing countries. Many countries such as the United States, Japan and European Union are passing legislations to force China to start changing their current unsustainable practices. China is currently in a transitional phase to have more of their wood furniture manufacturers to have their products eco-labelled; however, the process is costly and the demand is not high. The Chinese wood product industry will have to weigh what is more important: the planet they live in or the money they want to make. Hopefully the Chinese will make a decision to ensure that the industry will be viable in the long run.

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