

Long-Term Marketplace Trends in the Furniture Industry
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This summer I located a 30-page research report on the future of our industry written by Jerry Epperson - a well-known industry guru – entitled 'A Look into the Future'. The report was written in 1993. It only mentioned leather in the context of using it in conjunction with casegoods as in headboards, never used the words 'imports' or 'China'. What does this say about the nature of predictions? I could add comments about a lot of predictions or lack of them in the marketplace generally. If predictions are to be useful we need to place them in a different framework. For this reason my comments will be in the context of what are the drivers of the trends.

Some Observations about current important features of the market

- 1.1 Most major changes in product, service or innovation emerge from outside the traditional center of any industry including furniture. Think of the Internet, the development of leather furniture (Italians), initiative in importing from Asia (other than the traditional leaders). When industry attempts to force its way into a new paradigm through investment as in the Telecom business it often fails to be nimble enough to avoid the mistakes.
- 1.2 Change can also be based on the adoption of a new business model. A good example is the fresh start of ROOMS TO GO by people with experience or new entrants such as Wal-Mart. Another example is FEDERAL EXPRESS in packages or Ashley who focused on logistics and prompt service in an industry built around long lead times.
- 1.3 With hindsight, most 'trends' or important changes seem rather obvious –but are seldom predicted with any accuracy by industry pundits.
- 1.4 Is success to be found in the middle of a trend, at the leading edge of a trend or by differentiating from the mainstream whatever the trend? Is Ethan Allen part of a trend or rather the exception to a trend? In leather we were at the leading edge of a trend and have done well – but where is the next leading edge?

We would all like to know the shape of the future but it might be a bit easier to identify the features of our industry that are likely to be important continuing or future drivers of its shape. We can then address the question of how do we navigate within those to catch the emerging waves and to avoid the danger of being in the wrong place.

- 2.1 Pricing will remain a central basis of competition and will likely only become more important. This will be driven by imports, by the lack of innovative management and by the nature of the retail furniture industry.
- 2.2 The retail industry will be dominated by strong regional players for the next while. All efforts to build a national brand or to create a financially driven collection of

stores have failed in the past decade. These regional players will dominate their market and be effective in terms of logistics since they can work out of one or a very limited number of distribution centers. They are also well positioned to import product on a bulk basis. These retailers will frequently dominate through low pricing but also through advertising dominance and selection.

- 2.3 Imports will be a driving and shaping force for at least several more years. This will increase and diffuse the number and identity of competitors and will create substantial instability. The Asian producers will gain in size of business and knowledge of the North American market. It is open to question who will dominate this trading relationship. Note that the Italians have been able to control their own marketing of leather and wood furniture into America.

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- 2.4 Imports, aggressive pricing and dominant stocking retailers will combine to encourage more standardized product (because of length of supply line) and correspondingly less emphasis on any kind of customization. The only question is whether this will create a backlash or an opportunity.
- 2.5 Design will become a more important factor in that international production is less limiting in terms of design constraints than the possibilities within any existing plants. On the other hand, offshore production will encourage more and faster copying and the depreciation of the design value and price point of any new item. There is no momentum or even understanding of intellectual property as a factor within the industry.

What does this mean in terms of challenges or opportunities?

- 3.1 If we are within the boundaries of any current trends we need to be 'best of breed' to be successful. For example, in leather we are shifting from being one of the 'early movers' with the benefits that may imply to being a large or possibly the largest player in North America. The strategy for dominance may be different from early innovation and regional importance. Can we shift from being an early leader in a category to a strategic leader in terms of understanding the underlying economics and basis for continuing leadership as changes emerge in design, logistics and production strategy?
- 3.2 Offshore or external production can reasonably be expected to become 60% or more of the American market – but an important part of that statement is that a large volume will still come in one form or another from local production. Another important aspect is that Palliser is essentially 100% driven by external production in that our cost and supply factors in Canada, Mexico and even Carolina are different than full US production. We are already differentiated – the question is whether we can build on the existing differentiation to create future success or whether we need to become more like our emerging competitors to be successful?
- 3.3 The current dislocation in our industry in terms of product and supply lines will also create some tremendous new gaps and opportunities. The emerging leather cut and sew program based on controlled supply and regional assembly may be difficult to emulate by many players. The EQ3 program is also based on unique ideas and skills. Can we develop some degree of uniqueness in each part of the business? Will we be able to determine which unique directions have a chance at success or do we go with trial and error in a number of initiatives?
- 3.4 'Who is our customer' may become a more relevant question. The retailers who position themselves to flow standardized product will develop skills parallel to our own. The historic dependence on the largest retailers may need to shift somewhat to a broader base. This will require a structural and strategic shift but may permit more stability in our business.

- 3.5 There will be counter-trends to every dominant trend. Retailers will seek ways to differentiate themselves based on either product, service, price point etc. Palliser has demonstrated some ability to be different and if these core abilities are identified and nurtured could become the basis for a strategy that is based more on being at the front of the wave or in a counter-trend.
- 3.6 Can we use geography to our advantage. Canada and Mexico are not the US proper. Brazil and Indonesia and other places are different than the current dominant China. Are we at risk by using geography different or can we identify the long term advantages?
- 3.7 Control of the retail floor space will become an important factor in the future. The 'Palliser Rooms' initiative is an important departure in that very few firms have the range of product to take this direction. Is this a risk or an opportunity?
- 3.8 Does culture matter? Palliser has a different history and culture in certain respects. We remain a private company, our Canadian base makes us different, we have an internal culture that has certain strengths. Can we nurture, create and build a culture that enhances our sustainability in the marketplace?

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This analysis indicates a continuity with the past or at least the recent past. History suggests that this is often a dangerous assumption. If there would be a major change – where would it come from?

1. Furniture would become a BIG BOX commodity. This would not destroy the furniture store per se but would take away much of the volume and reduce the margins. The standardization of product through imports and the experience of the Big Box stores with importing could encourage this process.
2. The powerful regional stores could together create the buying and logistic power to replace the role of the manufacturer/importer such as Palliser. We face the risk of becoming “disintermediated”.
3. Dominance of supply through power. Given the advantages of being very large in terms of volume and systems and integrated back into the supply chain – a company such as Ashley could potentially dominate certain standardized items. An accumulation of efficiencies could provide significant selling/supply power to one or several such companies.
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