

Supplier/Consumer Relationship Study Mid-Atlantic Region Report

By Don R. Taylor
Sustainable Resource Systems LLC
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Executive Summary:

The forest industry has just come through one of the most painful economic recessions within the last 50 years. The solid wood business continues in a trough and immediate relief in housing starts is not imminent. The country as a whole is in a lot of economic pain in all areas of the U.S. All segments of the forest industry have been stressed.

One would expect that during these stressful times that suppliers and consumer procurement people would be working closely together to navigate through a very stressful situation. While there is some evidence of close cooperation between suppliers and consumer organizations, most of the suppliers perceive they have been largely abandoned by their consumer customers and see the relationship as distant at best. Many of the consumer companies have necessarily been in a survival mode reducing their procurement staffs with a cost-control mind-set doing everything they can to keep the mills running at some level until the economy can recover.

The working relationship between suppliers and consumers overall is strained. In general, suppliers express a lack of attention from consumer procurement representatives to work together to manage through the difficult economic times. Suppliers see a lack of concern for the sustainability of the logging and transportation businesses and the result has been significant disinvestment. Consumer procurement respondents tend to agree that there will be a shortage of logging capacity when manufacturing production recovers, or if any prolonged wet weather events inhibit logging operations. On top of the economic strain, the recent long period of good weather combined with mill curtailments has resulted in restricted wood orders that have further weakened logging economics.

The coastal plain areas of North Carolina and Virginia have almost identical issues with the Southeast and Mid-South. However, the inland Appalachian areas including North Carolina, Virginia, and West Virginia are working in an even more stressed situation.

In conclusion it is argued that the industry is at a **critical turning point**. What is known is that the general population of logging-trucking contractors has not been able to replace equipment for several years and each month more logging operations are exiting the business. Supplier morale and outlook is very low. That being true then there is an urgent need for the consumer company and supplier organizations to stabilize the situation or the forest based industry is in danger of inflicting long-term damage to the supply chain.

This paper provides a qualitative assessment of the current state of the relationship and offers recommended actions to improve the supply chain relationship and steps to strengthen logging/trucking capacity looking forward.

Methodology

The objective of this study was to evaluate the working relationship between suppliers and consumer mill procurement. The study was structured to obtain quantifiable data on how routine interactions actually function between suppliers and consumer procurement.

I conducted over 225 face to face interviews across the U.S. with suppliers and consumer procurement people over a seven month period beginning in late spring of 2011 through January of 2012. Each interview had three parts. The first part comprised of set of structured questions that participants selected a range of responses that best described the nature and quality of the interactions. The categories of the interactions were divided into four categories as follows:

- 1. Negotiations**
- 2. Joint-Planning**
- 3. Feedback**
- 4. Problem solving/Communications**

Each category had a set of questions that were designed to measure the quality of those basic interactions. It is important to note that both suppliers and consumer procurement were asked mirrored questions. The rationale was to enable a comparison of perceptions and examine how the relationships were viewed from both sides. If a pattern of significantly different perceptions between suppliers and procurement organizations were detected then a follow-up analysis was conducted. The second part was to allow open-ended comments on how the supplier or consumer procurement participants viewed the working relationship. Comments that I perceived to have impact on the working relationship were recorded and analyzed on a qualitative basis. In the event that a supplier or consumer procurement participant stated a pattern of dysfunctional interactions, a follow up discussion was conducted to explore if that pattern resulted in lost production and therefore caused inefficiencies that could be avoided. If the dysfunctional pattern was determined to be the cause of lost production, then an annual volume was calculated on a conservative basis. Examples had to be provided of the incidents that caused lost production within the last 12 months. Likewise, when best practices were stated and confirmed in actual examples, they were recorded and entered into the database.

All data was entered into a database and reports were generated for analyses. Dr. Brenden Kendall of Clemson University was engaged to provide assistance with the database and analysis of results. The reports were then prepared on a regional basis as follows:

- Mid-Atlantic Region (North Carolina, Virginia, West Virginia)
- North-East Region (Maine, New Hampshire, Vermont, New York)
- Lake States Region (Michigan, Minnesota, Wisconsin)
- South-East Region (Georgia, South Carolina, Florida, Alabama)
- South-Central Region (Mississippi, Arkansas, Texas, Louisiana)
- Western Region (Oregon, Montana, Washington, California)

The interviews were all confidential and entered into the database without names or company affiliations. Each participant was classified in the categories in the table below:

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| Suppliers | Consumers |
|--|-------------|
| Direct Contractor/Operator | Pulp-Paper |
| Dealer | Composite |
| Larger Landowner (TIMO, REIT, Private) | Solid Wood |
| Producer Indirect | Combination |

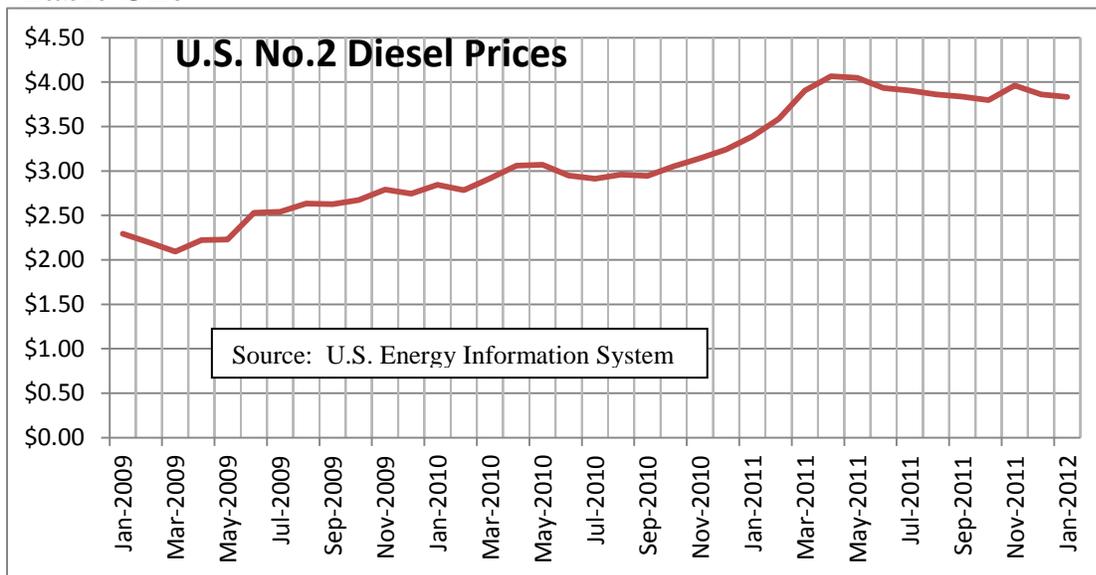
Supplier Perspective

The following issues were identified as the primary factors that are currently impacting the working relationships between suppliers and consumer procurement organizations. They were obtained through systematic confidential interviews with individuals from both sides. The Mid-Atlantic region comprises of forest manufacturing and suppliers in North Carolina, Virginia, and West Virginia.

Number one issue for the Mid-Atlantic Suppliers is that there has been scant recognition of the economic killing effect of rising fuel costs and inflation of all other costs over the last 36 months.

Table#1 illustrates the rise in diesel fuel prices over a three year period from a low of \$2.092 in March of 2009 to a high of \$4.064 in April of 2011. At the time of this writing, prices are rising.

Table One



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Rising fuel costs were not the only cost items that have increased significantly over the last 3 years. Almost all other logging/trucking related costs have escalated partially driven by increased cost of oil world-wide. Logging equipment has steadily increased over the last few years dramatically. Table Two illustrates just a few items as an example.

Table Two

| Item | Price in 2007 | Price Now 2012 | Total Increase |
|-------------|---------------|----------------|----------------|
| New Skidder | \$185,000 | \$250,000 | 35% |
| New Loader | \$150,000 | \$200,000 | 33% |
| New Truck | \$115,000 | \$130,000 | 13% |
| Insurance | \$15,000 | \$25,000 | 67% |

Almost half of the suppliers categorize rate negotiations as “non-negotiable”. Table 3 shows responses to a question that asked suppliers and consumers *“to classify the nature of rate negotiations between suppliers and consumers for delivered wood or cut/load/haul services for large landowners or consumer mills that hold land and/or controlled stumpage.”*

Table Three

Harvesting / Trucking Rates (Negotiations Methods Only)

| Answer Options | Supplier Response Percent | Consumer Response Percent |
|---|---------------------------|---------------------------|
| non-negotiable and may be changed without notice | 26.7% | 11.1% |
| non-negotiable but changed with sufficient | 20.0% | 33.3% |
| conditionally negotiable - good faith discussions | 46.7% | 55.6% |
| fully negotiable and changed only after mutual | 6.7% | 0.0% |
| Other (please specify) | | |

Almost 47% of the suppliers see the negotiations as "non-negotiable and may be changed without notice or with sufficient notice. Consumer responses were in general agreement. 44% of procurement respondents indicated rate negotiations as “non-negotiable. The gap here is not significant with the exception that more suppliers stated they had rates changed without notice. Over 55% of the consumers said the rate negotiation are “conditionally negotiable” with good faith discussion. These were consumer companies that had some level of tract specific pricing policies that is fairly wide-spread practice in the south for suppliers that purchase their own stumpage. A significant number of suppliers reported that the tract specific negotiation was not always committed for the total time required completing harvesting of the entire tract and could be changed at anytime. One large landowner is included in the supplier data and accounts for the “fully negotiable” response.

Suppliers clearly understand the current U.S. economic stress in the forest products markets, but frequently stated that their logging/trucking rates were already tight before the downturn. Based on the interviews with suppliers and examining financial statements over half of the suppliers stated that magnitude of the fuel price increases and virtually all other costs has placed them in an impossible economic position. Stumpage markets have also been tight due to the fact that landowners are delaying timber sales. Many suppliers state that they have already gone through a prolonged period of cost

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reductions to stay in business. All suppliers understand that all parties in the industry have to go through economic pain in the recession. However, as some segments of the industry begin to return to profitability, there has been little sign of relief reported by suppliers. In the summer of 2011 many logging-trucking contractors were operating at a loss or break-even at best. Opportunities for further cost reductions are not apparent to the suppliers in the near future. The result; a growing inventory of older logging and trucking equipment that needs replacement which in turn hampers production due to increasing downtime due to break-downs. This business environment is leading to a gradual disinvestment in logging capacity and contributing to a strain on the working relationship.

Number two is the perceived change in the attitudes and procurement strategies toward the suppliers. The suppliers perceive that some of the major consumer companies have taken a “commodity approach” in regard to their suppliers. That approach can be described as let the market forces operate and tends to minimize any joint planning or volume commitments beyond a week to week approach. From the consumer view, cost reductions are the order of the day and the market will determine how many logging businesses survive or fail. It follows that when the economy improves the markets will determine when either new people enter the business, or what survivors will expand to meet market demands. The “commodity approach” is a legitimate business strategy but provides little support to contractors trying to avoid bankruptcy. At least half of the well established logging companies and dealerships that are highly competent in the wood business sense that they are abandoned and morale is very low. Most suppliers would prefer a more collaborative approach that would involve both sides working together through the recession in a way that would allow a managed down-sizing approach to get through difficult economic period along with close coordination to expand as wood demand recovers.

Number three from the suppliers viewpoint, is the perceived disconnect between seasoned front-line procurement personnel and the consumer company policies and management control. That perception is illustrated by suppliers in the following points:

- Procurement personnel have markedly reduced authority to make decisions based on their judgment and experience.
- Most significant pricing and volume decisions have to be cleared by distant senior managers.
- Most decisions have to do with quarterly cost targets imposed on the front-line procurement personnel.
- Many mills have unreasonable low inventory mandates or have eliminated remote storage yards and are therefore forced to go on quota when production conditions are most favorable.
- Many mills have delayed improvement or even major maintenance for their woodyard wood handling facilities resulting in frequent break-downs that create weekly havoc in the trucking capacity. What is apparent to the suppliers is the “whip lash” effect that is created by outages at the mill yards often in the middle of the week. What is normally described as a minor woodyard unloading failure at some of the large paper mills creates huge impacts throughout the supply chain and significant loss of production.

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Number four is the absence of firm and longer-term wood orders. The non supply- agreement suppliers work under a system of essentially no firm commitments that in turn provides very little planning. At best they have a gentlemen’s agreement on how much production they can deliver to each mill location. The only exception to that approach are verbal promises made when inventories are low of which the commitments last only as long as the inventory is at dangerous levels. Beyond that, they work on faith week to week. When suppliers negotiate their business with the consumers, they are provided a consumer company standard contract confirmed by interviews. Table 4 illustrates the contract legal structure as follows:

Table Four
Contract Structure

| Answer Options | Supplier Response Percent | Consumer Response Percent |
|---|---------------------------|---------------------------|
| protection for both parties - supplier and consumer | 30.8% | 25.0% |
| mostly protects consumer interests | 69.2% | 75.0% |
| mostly protects supplier interests | 0.0% | 0.0% |
| Other (please specify) | | |

Suppliers and consumer procurement agree that the legal construct of the standard contracts favor the consumer company. There is a case to be made that some of the requirements for suppliers in the contracts are good for both parties, but they are basically designed for the legal protection of the consumer companies. Most of the standard contacts may have a period of time and targeted volumes but they are not considered binding on either party.

Another issue is the volume commitments in terms of amount and scheduling. Table 4 and Table 5 below show responses from both suppliers and consumers related to production commitments across the population interviewed.

Table Five
Volumes

| Answer Options | Supplier Response Percent | Consumer Response Percent |
|-------------------------------------|---------------------------|---------------------------|
| clearly committed and performed | 26.7% | 0.0% |
| generally committed and performed | 33.3% | 66.7% |
| generally committed but not honored | 13.3% | 22.2% |
| no firm commitments - week to week | 26.7% | 11.1% |
| Other (please specify) | | |

The response patterns between the suppliers and consumers are varied, but when "clearly" and "generally" committed responses are combined they are in agreement. 60% of the suppliers responded that they have volume commitments from their consumers although it is predominantly verbal. Almost 67% of consumer procurement stated that they provide suppliers with volumes "generally committed and performed". The general commitment is usually verbal based on mutual trust and not documented. The only gap is in terms of those suppliers (26.7%) that responded that they have no volume

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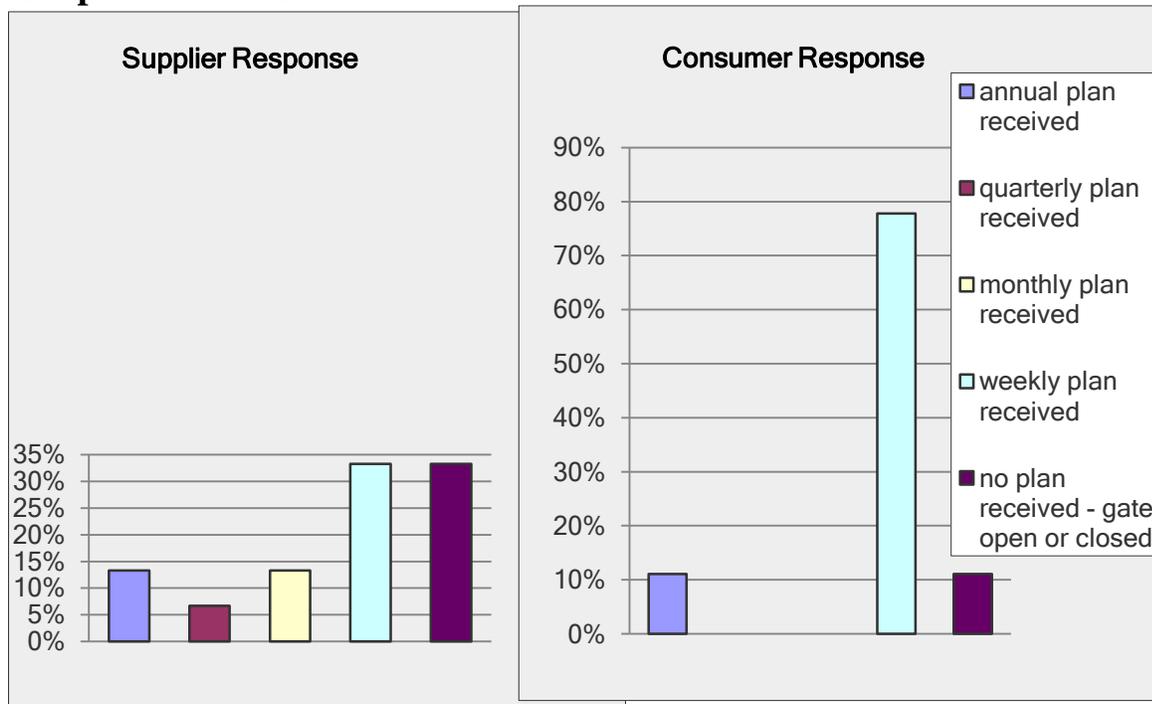
commitments - just go week to week. Analyses of these data show that these are mainly loggers in the mountainous areas of Western North Carolina, Virginia, and West Virginia.

In terms of “joint planning” the suppliers and consumers responded as illustrated in Table Six and Graph 1. The question posed for this response was as follows; *“What is the window of time that is committed for your agreed production volumes?”*

Table Six
Delivery Scheduling

| Answer Options | Supplier Response Percent | Consumer Response Percent |
|--|---------------------------|---------------------------|
| annual plan received | 13.3% | 11.1% |
| quarterly plan received | 6.7% | 0.0% |
| monthly plan received | 13.3% | 0.0% |
| weekly plan received | 33.3% | 77.8% |
| no plan received - gate open or closed | 33.3% | 11.1% |

Graph Number One



Graph # 1 shows a wide difference in the perceptions between supplier and consumers for delivery scheduling. Consumer procurement (79%) indicated delivery scheduling to be a weekly wood order. Suppliers that purchase their own stumpage see firm commitments primarily on a weekly basis. Other suppliers that source their stumpage from large landowners may have quarterly or monthly commitments that they consider firm. Perception ranges across the spectrum indicates some confusion about volume commitments. 33% of the supplier respondents said they receive no commitment - only

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gate open or closed. Analysis of the supplier respondents show that many of the mountain area suppliers in Western North Carolina, Virginia, and West Virginia work on the gatewood system. Suppliers on a week to week basis have to find multiple delivery markets outside their normal delivery range so they can have enough options to deliver products on a consistent basis and work a full week.

Another issue of for the suppliers is the inconsistent and arbitrary cull factors administered by some solid wood products facilities. These practices were reported to take significant tonnage away from each load unless the consumer mill inventories are very low. There seems to be no transparent explanations for how those cull factors are calculated and when they will be activated. Suppliers tend to see the practice as a stealth price reduction. Table 7 illustrates the responses from both suppliers and consumers.

Table Seven
Wood Specifications

| Answer Options | Supplier Response Percent | Consumer Response Percent |
|---------------------------------|----------------------------------|----------------------------------|
| clear and consistent | 66.7% | 66.7% |
| some variation | 13.3% | 11.1% |
| constantly changing or flexible | 20.0% | 22.2% |
| Other (please specify) | | |

There is strong agreement with 33% of the suppliers and consumer respondents indicated some level of variation in terms of the enforcement of the wood specifications.

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Number Five Issue is the loss of production as a result of break-downs in the various aspects of the working relationships was studied. The interview questions were divided into four sections as follows; (1) Negotiations, (2) Joint Planning, (3) Feedback, and (4) Problem-solving/Communications. After each section the respondents were asked the following question:

“Can you quantify any significant level of production volumes lost on an annual basis due to break-downs in the working relationship?”

These annual volumes are obviously rough estimates. They were requested to err on the conservative side and only recorded if the respondent could cite specific examples of lost production and the frequency in which they occurred. Below in Table 8 is a tabulation of annual lost production attributed to business relationship failures in the eyes of the suppliers:

Table Eight Lost Production due to Relationship Breakdowns

| INTERACTION AREA | TOTAL TONNAGE REPORTED | AVG/SUPPLIER |
|--|------------------------|---------------|
| Negotiations | 299,000 | 19,933 |
| Planning | 66,800 | 4,453 |
| Feedback | - | - |
| Problem Solving and Communications | 770 | 700 |
| Annual Totals | 366,570 | 25,086 |
| Total Sample Production | 4,301,000 | 286,733.00 |
| Loss Percent of Sample Tot. | 8.5% | 8.7% |
| Approx. Total Estimated Mid-Atlantic Production (Green Tons) | 50,000,000 | |

The total loss of production of suppliers interviewed in the Mid-Atlantic represents 8.5% of the total sample production. For the suppliers sampled (includes 1 TIMO/REIT organizations), the production impacted by failures of the relationship functions were a total of 366,000 tons annually for an average of 25,000 tons per supplier. If that sample were considered to be an adequate sample for the total supply chain in the Mid-Atlantic Region (it is not), then the projected 8.5% of the total sampled production in the Mid-Atlantic region applied to the total of approximately 50 million tons of roundwood logged annually, it would calculate to approximately 4 million tons of lost production annually. The highest impact area for production loss was reported to be in the areas of in negotiations and to a lesser degree - joint planning. According to suppliers interviewed the problem is an inability to negotiate firm commitments of production volumes on more than a week to week basis. Therefore the lost production is due to frequent variation in wood orders and frequent cutting-off production sometimes in the middle of the week. A major point here is that there are so many uncontrollable natural factors in logging that impact productivity, there must be every reasonable effort made to minimize the controllable impacts.

This analysis begs the question, what if the relationship functions for negotiation and planning was stabilized to the point that only one half of the lost production could be avoided. That would enable a theoretical 4% increase in productivity. The working relationships are about making the supply chain

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more efficient. Inefficiencies are being injected into the supply chain due largely to various failures in the working business relationships around negotiations, planning, feedback, and communications. Getting the relationship right is not just about everyone feeling good. In fact the quality and functionality of the relationships has much to do with how efficient the wood supply chain operates and therefore has real value to all parties.

General Supplier Related Observations

The foregoing are problem areas stated by the vast majority (approximately 66%) of suppliers. However, there are exceptions to the majority sentiments expressed in the Mid-Atlantic Region. A minority of suppliers have worked hard to get themselves in a favorable position with their customer consumer mills. They tend to be very proactive and somewhat successful in building strong “alliance relationships” with key procurement personnel that could be termed a prime supplier position. In addition there are some of the “large landowner management organizations” that have nurtured and developed a cadre of highly skilled logging contractors to move the land company’s wood with maximum efficiency and value extraction. Why do they have this relationship in contrast with most of the other suppliers? - is still a subject of further study. There will be more to come on that subject because it is of highly important and a best practice of how the whole system could work.

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Consumer Mill Procurement Perspectives

Interviews were conducted with procurement professionals across the region with an attempt to obtain a broad perspective across manufacturing product lines. The procurement interviewees were classified as (1) front-line with daily interaction with suppliers, or (2) senior procurement managers that had front-line procurement representatives reporting to them. The following are some of the most frequent issues that were mentioned that directly impact the relationship from the confidential interviews:

Number One is that almost all of the front-line and senior procurement people interviewed are concerned about the economic health of the logging/trucking contractors. They are concerned that normal equipment replacement is not taking place and that has been confirmed by the equipment sales people. One large equipment dealer in the Richmond area confirmed that from 2009 through the last quarter of 2011, their sales level for the Forestry Equipment Sectors was 25% of their long-term trend. Other equipment dealers said the forestry related sectors have been in a depression as of mid-2011. Many procurement people have noticed increasing loss of production due to equipment breakdowns and most all predict there will be serious production problems in a time prolonged wet weather or when the solid wood business improves significantly. Some procurement organizations do work with suppliers that purchase all or most of their stumpage deploying some level of “tract specific” rate commitments. That practice has been very helpful to suppliers in creating some stability in their markets.

Number Two is that many front-line procurement people feel that logging/trucking rates are somewhat negotiable (see table 3) but they have very strict guidelines imposed on their decisions. Some procurement organizations are not allowed to negotiating logging/trucking rates that they know are currently needed. However, they also recognize that some of the mills could not be running at higher wood cost levels. Currently they are highly focused on keeping their mills running full which will provide the most important help to suppliers at this time.

Number Three is that most mill locations operate under a system where the receiving mill woodyards are managed and controlled by the mill organization. While there are exceptions to this situation, the procurement people feel they sometimes do not get the necessary attention in suggesting actions to facilitate more efficient truck unloading and maintenance/break schedules to maximize truck turnaround. They also suffer from lack of notification or timely communications from the mill personnel related to manufacturing changes or mill yard downtimes that are scheduled. This situation prevents them from providing adequate and timely communications to their suppliers. Bottom line – there are very significant improvements in the supply chain productivity and costs when the mill woodyards are controlled by procurement management or have an extraordinary working relationship with the mill/woodyard organization.

Number Four is that senior consumer company procurement managers are generally concerned about inadequate logging capacity when the economy recovers. Some have the impression that they have firm commitments to their key suppliers and provide tract specific pricing to stabilize their stumpage purchases. They generally perceive that there are adequate communications and planning provided to the suppliers on a regular basis. Some are focusing on making the suppliers more efficient in their logging/trucking operations as a partial solution to the logging capacity problem. Based on observations of both consumer procurement and suppliers there is some level of positive negotiations and regular joint planning with a limited number of suppliers, but the majority of suppliers that purchase their own

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stumpage are not experiencing that relationship. It is interesting that there appears to be no pattern in supplier size-class in what suppliers enjoy a positive working relationship with consumer procurement.

Number Five is an issue of consistency in receiving timely and responses from their suppliers.

This issue was tested through the interview process due to the high importance communications and problem-solving to the working relationship between consumers and suppliers.

The question was asked “do your suppliers (always, usually, seldom, or never) respond when you have special operational problems?”

The exact same question was posed to suppliers with exception of asking them if their procurement representatives responded when they had an operational problem. The responses are tabulated in Table 9:

Table Number Nine

Operational Issues

| Answer Options | Supplier Response | Consumer Response |
|---|-------------------|-------------------|
| when I need special help - always responds | 53.8% | 28.6% |
| when I need special help - usually responds | 23.1% | 71.4% |
| when I need special help - seldom responds | 23.1% | 0.0% |
| when I need special help - never responds | 0.0% | 0.0% |

On the surface this may not appear significant but by the overwhelming “usually” response from procurement respondents shows a degree of disappointment indicating a deeper problem in the relationships. This is especially true when compared to over 54% of supplier indicated their procurement contacts always responded. Based on comments from procurement staff, there is definitely a disappointment in how suppliers respond to their operational issues such as weekend deliveries or change in species mix.

One other communication issue from the consumer perspective was a general lack of communication from their regular suppliers when their production was dropping below normal, or the supplier moved their production to another delivery point without notification. This issue is reflected in the following responses from the question **“are your communications from your suppliers (always, usually, seldom, or never) open and honest?”** Table 10 provides some insights to this issue.

Table Number Ten

Communications Interface

| Answer Options | Supplier Response | Consumer Response |
|--|-------------------|-------------------|
| communications - adequate and honest | 53.8% | 33.3% |
| communications - usually adequate and honest | 23.1% | 55.6% |
| communications - seldom adequate and honest | 23.1% | 11.1% |
| communications - never adequate and honest | 0.0% | 0.0% |

Here again 56% the consumer procurement respondents interviewed stopped short of saying that communications were always adequate and honest. Consumer procurement did not cite any

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dishonesty in communications but rather a problem of not always getting communications in a timely or adequate manner from their suppliers.

General Consumer Observations

It is clear that there is some level disconnect between what the quality of the business relationships between suppliers and consumer companies. This should not be surprising since there are wide differences in how each side views its situation. Part of the problem is that most procurement people have to function in a structured hierarchical organization with unique corporate cultures and politics. There is a pattern of high turnover and down-sizing due to the economy especially in the larger companies. Therefore adequacy of communications is a problem in dealing with their suppliers. In contrast, the suppliers operate in a more local or family based business situation. Suppliers work long hours and have to deal with numerous daily aggravations that are all part of timber harvesting and operate in a totally different culture. They have everything they have on the line every day and heavily rely on a trusting relationship with their consumer procurement contacts. Given the contrasting work environments, both sides have to invest a strong effort to rebuild a trusting and functional relationship.

Undoubtedly the recession has put the forest based industry in a survival mode and seems to have undone some historical procurement practices that have disrupted long-term relationships. The shift in land ownership, complications of supply agreements, industry consolidation, and corporate level financial driven mandates have all together changed the face of the consumer companies. Everyone is trying to adjust to the changes. Some are more successful than others.

Special Issues for Western North Carolina, Western Virginia, and West Virginia

There are two distinctive regions within the Mid-Atlantic state groupings. One sub-region could be classified as Coastal and Piedmont North Carolina and Virginia. Wood supplier companies operate very similar to the Southeastern and Mid-South Regions and have virtually the same issues. On the other hand the mountainous sub-region of western North Carolina, inland Virginia, and most of West Virginia has a distinctively different wood supply structure. The primary difference for mountain areas is the absence of the dealerships and large high production logging operations. The typical logging companies are smaller and have to be adapted to steep terrain in mainly hardwood stands. Their operations call for longer skids and careful complex haul roads. Another distinctive feature is the private stumpage purchasing has been dominated by sawmill procurement (especially hardwood). Sawmills contract with the loggers primarily on a cut & haul basis with smaller diameter stems, tops, and off-species manufactured for pulpwood. Saw timber has been the primary revenue for the loggers until the recent recession. The recession has created a dramatic change in the solid wood economy. The mountain area wood suppliers now find themselves more dependent on pulpwood for their primary revenue. Sawmills have either ceased running or curtailed. Landowners in turn are holding back on timber sales, especially the better saw timber tracts that in turn have resulted in a huge distortion in the logging economy. Reduced residual chip production has resulted in an increase demand for round-wood and primary chips but the historical margins for the loggers have been depressed. To add to the distortion is a real shortage of labor in Western areas of Virginia and West Virginia due to mineral development and large construction projects. It is difficult for loggers to compete in these markets and many are exiting

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the business.

What does this have to do with relationships? The mountain loggers are on the edge economically and the future is not bright. Again, there are exceptions to be found as some logging companies have worked closely with the pulp mills and selected sawmills to work out a transition plan to manage the situation but they are in the minority. Others have managed to diversify their business away from logging into other related contract activities.

One “Best Practice Model” should be noted. Some consumer company procurement organizations provide forestry expertise to landowners to help the direct contract loggers purchasing stumpage. The consumer company foresters are available to lay out land lines, mark timber, and other services that really helped the wood suppliers.

Another situation discovered in Western North Carolina chip mills was a strong feeling of insecurity in their business due to the lack of consistency in wood orders they receive from customer mills. They are experiencing significant closures of logging operations that in their opinion will not come back into the business when the economy recovers.

Is There a Problem?

The contrasting operating environment on both sides can result in a naturally strained relationship. Given the last two years of the recession and solid wood industry depression, the relationship has become especially strained. A large percentage of suppliers have sensed a hard-edged cost control attitude from the consumer companies that sends a strong message. The message is that suppliers have no value to their customers and are a replaceable commodity. Many suppliers would exit the business if they could. If procurement policies do not change within the months ahead the supply chain system could be damaged to the point of no return. Based on information received during interviews, the dealership suppliers have reduced their stumpage inventories from 90-120 days to less than 30 days due to more short-term commitments from the consumer companies. The “commodity approach” is working well in terms of short-term cost reductions for the consumer companies. However, there is definitely a sharp decline in the business confidence and a serious economic strain going on that will have longer-term consequences. When and if the solid wood business recovers, or a prolonged weather system sets in, the disinvestment will be apparent in terms of weak production capability and lack of surge capacity. The situation in the Mid-Atlantic over the last several months of stable weather patterns and reduced market demand for solid wood has masked the underlying situation. In the past, emergency low inventory situations have triggered panic pricing and moving wood from extremely high freight areas to continue running the mills. Those incremental costs are reported to be very significant and tend to last many months beyond the crisis period. Yes there is a temporarily concealed problem that is hard to quantify that could be manifested under the right conditions.

Can all that be avoided? In my opinion, the answer is no. However, if action could be taken now and a well planned strategy implemented, a significant amount of emergency expenditures and longer term capacity problems could be avoided. But a well planned course of action that is appropriate for each consumer company and the situation in their wood basins should be seriously considered.

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POSSIBLE SOLUTIONS:

Assuming that the Mid-Atlantic supplier/consumer relationship assessment presented in this paper is generally accepted, below are some recommendations offered to begin to stabilize the wood supply situation:

- **It is strongly recommended that the first step is for the senior procurement managers to clearly communicate a factual account of the state of the independent wood supply situation to the company's top management.** This is a business strategy, not a feel good mission. The suppliers do not need charity or risk-free protection from the economic environment that all businesses have to experience. They need a chance to work together with their customer companies toward raw material supply security for the consumer plants. The operating mills are the future of all the stakeholders and must stay viable. Viability in the logging and transportation operations are necessary part for that to happen. Senior management for the forest industry must have a true assessment of the supply chain situation and actions needed to begin to rebuild the system.
- **It is highly important for procurement organizations to build an awareness throughout the corporations that the independent wood supply contract system is an essential asset to the forest industry that contributes clearly to the industry's global competitiveness.**
 - The continuation and value of ethical and competent suppliers that have good management skills is as much a part of viable manufacturing as having experienced/competent employees and state-of-the art manufacturing equipment. If the raw-material supply chain asset is seriously damaged or killed off, then there is a huge price to pay to replace it. These remaining suppliers who have survived one of the worst downturns in our history have had to become as efficient as possible.
 - In addition, there are few younger supplier owner/operators who are willing to make a career in the business. Don't forget that the contract suppliers have critical skills to purchase stumpage, maintain credibility with landowners, and provide certifiable logging systems. These attributes are not replaced without years of careful development and capital investment.
 - The quality of the people in the business is still very high and these calibers of people need a healthy working relationship with their customers. The independent wood suppliers in the Mid-Atlantic are producing a commodity in raw wood but the complex function and organization of procuring stumpage and managing compliant harvesting/trucking systems is a very specialized function and is not a commodity. It is an asset to the industry and should be treated accordingly.

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- When the economy recovers it will be incumbent on the U.S. forest industry to have adequate harvesting and transportation capacity to take full advantage of a profitable cycle. If the logging capacity is not there to meet demand it could put the industry in a non-competitive position.

Provide a more stable operating environment to your key suppliers. It is absolutely amazing that the bulk of the suppliers work with no security, no firm volumes (except week to week), and arbitrary decisions made from on high, under increasingly restrictive regulations, and huge risky capital investments of standing timber and equipment. That is not to mention the huge impact of changing weather conditions. It is highly recommended that alliances with key suppliers could be established in terms of strategic planning for stumpage purchases, careful maximized wood yard storage plans, and a focused effort to revive the economic health of a significantly larger sector of capable suppliers.

Evaluate dealerships to insure that they are functioning in a way that sustains the logging contractors.

In the course of conducting interviews with both dealerships and logging contractors working within those organizations, it became apparent that there are some valuable services that the dealerships provide that are positive to the logging contractors and related transportation. Procurement needs to make sure that dealership suppliers and their contract loggers are being a positive force in developing and maintaining logging capacity. Following is a short list that would serve to evaluate the function of value-added dealerships:

- Dealer has solid knowledge of logging costs and works with logging contractors to assure that they are economically viable and successful.
- Dealer provides stumpage on a consistent basis that is compatible with the logging contractor's equipment configuration.
- Dealer maintains solid relationships as a valued supplier with multiple consumer customers to insure a steady market for harvest tracts that his logging contractors are operating.
- Dealer coaches and advises logging contractors on good business practices.
- Dealer provides administrative services for the logging contractors and required monitoring to ensure quality harvesting and conformance to wood specifications and certification requirements.
- Logging contractor is able to stay on site and manage the operation for high efficiency.
- Logging contractor is able to have stumpage assigned in advance and schedule road preparation and operational lay-out.
- Logging contractor makes sure that he has dependable and trained crew members.

For the supplier community, you need to move toward more positive attitudes. Yes it has been a very tough period of time for all businesses and there have been some procurement policies that have not been supportive. But there is a strong need for a positive supportive attitude so any initiatives from your consumer customers to improve the working relationships can be successful. They have pressures on them from stockholders and other business forces through the recession that have dominated the business environment. Maintaining the surviving manufacturing and moving them back to profitability

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has been an essential focus. A positive non-threatening approach will be critical to a successful rebuilding of the relationships. Put the past behind you and focus on the future.

The industry is at a turning point and must respond to the reality of the situation or face some severe cost pressures. The manufacturing companies and suppliers that have survived the last few difficult years have all gained tremendous efficiencies. It is time for each consumer company to take a fresh approach to their wood and fiber supply system on how it can be stabilized and take an intentional look forward. That will involve moving away from the current reactive stance to one of well planned strategies of working with its suppliers to nurture the system by planning ahead.

Rebuilding trust between suppliers and consumer organizations must be a priority. There needs to be basic cultural change on both sides in order to make a lasting structural change in the system. Contracts need to be of value to both the consumer companies and the suppliers. Contracts need to have credibility to the financial institutions and for business succession purposes to build a stable supply chain for the future. Suppliers of all sizes and all business structures need to adjust their attitudes to let the past go and focus on building a positive working relationship to do everything they can to make their customers successful.

In Closing:

This is a great industry and it is the focus of the Wood Supply Research Institute to bring straightforward issues to the table that is in the interest of a healthy and sustainable Wood Supply System. It is not the intent to offend anyone but rather provide real data that can aid in developing intelligent approaches in working toward how the supply chain optimization. We will continue to face real and current issues that are important to all the stakeholders. Then each individual participant can develop sound business strategies based on the best data available.

Don R. Taylor
Sustainable Resource Systems LLC
For
Wood Supply Research Institute
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