

Wood Supply Research Institute

Supplier/Consumer Relationship Study Northeast Region Report

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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. All segments of the forest industry have been stressed since the early 2009. Although the Northeast Region has maintained a generally positive relationship between suppliers and consumers there are definite areas for improvement.

The two most important supplier issues found in this study are:

1. Inability to obtain a return on investment
2. Lack of joint-planning that would stabilize their business

The two most important consumer issues found in this study are:

1. Need for better communications
2. Concern about adequate logging capacity into the future

In conclusion it is argued that the industry is at a **critical turning point**. What is known is that the general population of logging contractors has not been able to replace equipment for several years and each month more logging capacity demand is increasing. Logging company morale and outlook has been very low. There is an urgent need for the consumer companies and logging/trucking company organizations to stabilize the situation to create a more viable business environment so the forest based industry can avoid long-term damage to the supply chain. 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

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.

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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 described 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, Oklahoma)
- Western Region (Oregon, Montana, Washington, California)

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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:

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

Introduction of Results

The bulk of this report will focus on issues discussed with suppliers and consumers related to the forest industry in the Northeast Region that need improvement. It is important to understand the state of the industry in early December of 2011 when the fieldwork was conducted. The forest industry has been struggling in the Northeast in the last decade. Both the paper and wood products business were severely impacted at the onset of the economic recession in 2008. There has been mixed improvement in the paper business since that time but housing and the wood products business is still depressed. Paper manufacturing in the Northeast has several mills suffering cash flow problems. Continued weak markets for some paper product lines are still evident. Biomass markets have been spotty as well. It is in that environment that this study took place.

In spite of the economic strain on the industry, the relationship with suppliers is more positive compared to other regions in the country. To be clear, the supplier community is hurting economically and the consumer mills are in danger of losing additional logging capacity. The point is that the forest industry is struggling in this region and yet they appear to be trying their best to keep the mills viable and at the same time provide some level of stability to their suppliers. Several best practices are cited in the body of the report and appendix.

Supplier Perspective

The objective of this study is to provide a straightforward evaluation of the current state of the business working relationship between suppliers and procurement organizations. Based on that evaluation, there will be some conclusions as to overall quality of the working relationship. Following is a prioritized listing of the most prevalent and common thread issues that were consistently stated by the Northeast suppliers in Maine, New Hampshire, Vermont, and New York:

- **Number one issue** cited by the Northeast Suppliers is the inability to obtain a consistent return on their investment under the current rate negotiation environment. Both delivered roundwood suppliers and harvesting/trucking service contractors either have very tight margins or operating at a loss. There is broad recognition from the suppliers that the forest products industry has been under severe economic pressure and that all had to suffer pain. Through anecdotal information, a significant number of suppliers have exited the business. However, the surviving suppliers know that there have been some sectors of the forest industry that have experienced some level of recovery but have not seen any significant easing in negotiations for logging-trucking rates. Many of the procurement representatives offer tract specific delivered rates to regular suppliers that purchase stumpage that has helped significantly. But the suppliers see rates as not adequate to purchase stumpage at the current market and have a realistic logging margin. Suppliers that have made it through the recession are close to being as efficient as they can get under the current market conditions, but much of their equipment is well beyond the replacement cycle. Older equipment is hurting productivity and adding stress to already tight margins. Suppliers and Consumer procurement interviewees were asked *“how would you characterize the negotiation for rates with your procurement representatives (or your suppliers)?”* The responses to the nature of rate negotiations tabulated in Table #1.

Table One

Harvesting / Trucking Rates (Negotiations Methods Only)

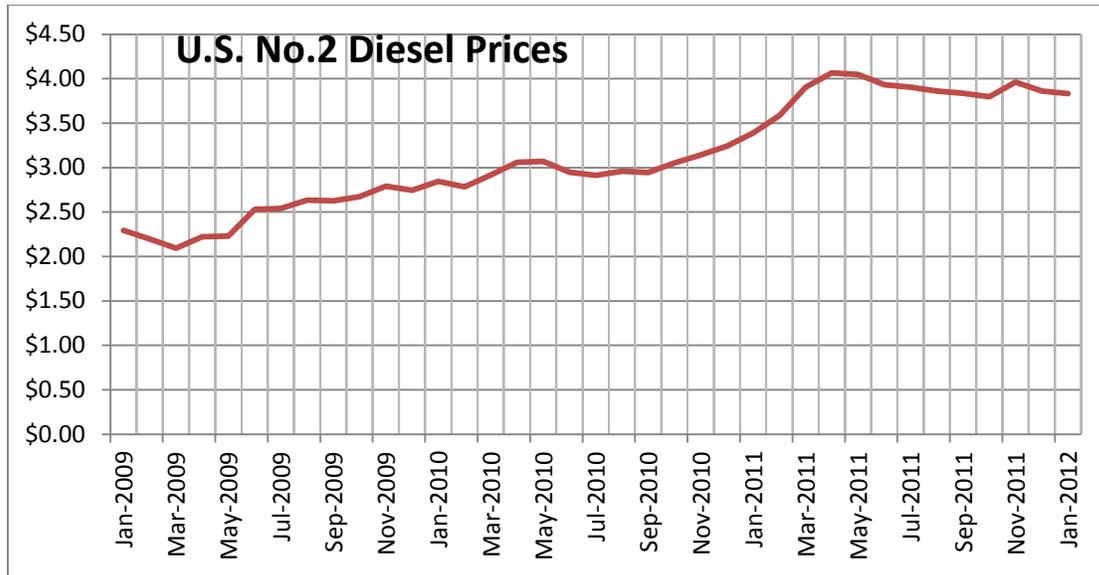
Answer Options	Supplier Response	Consumer Response
non-negotiable and may be changed without notice	13.3%	0.0%
non-negotiable but changed with sufficient	26.7%	28.6%
conditionally negotiable - good faith discussions	46.7%	71.4%
fully negotiable and changed only after mutual	13.3%	0.0%

A contrasting patterns of responses in Table #1 between suppliers and consumers related to the *“nature of the rate negotiations”*, indicates a perception gap between the parties. 40% of the suppliers responded that rate negotiations are non-negotiable compared to over 71% of the consumer procurement response that rates were conditionally negotiable with good faith discussions.

Logging and trucking contractors stated that only a few major consumer companies provided any relief for rising fuel prices over the last few years. If that is true then the economic impact continues to be problematic as illustrated in Table #2.

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Table Two



Currently, diesel prices continue to rise through 2012 without much hope for easing in the near future. Logging and trucking operations are obviously very fuel intensive. From data provided from actual operations diesel fuel along with other petroleum consumables amounted to 28% of total cash outlays in 2010 and 35% of total cash outlays in 2011. In-woods chipping would be at a higher rate.

Professional logging/trucking company owner/operators have additional challenges. That is the steady increase in equipment, parts prices, tires, and insurance that has occurred over the last few years in spite of the recession. Many of the logging contactors cite similar examples tabulated in Table #3.

Table Three

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%

Financial institutions in many of the areas across the country are requiring profit/loss statements from business owners before approving major loans regardless of past credit history. The implications are obvious. If the profit margins are not supporting the loan application then equipment replacements will not happen. Banks and financial institutions are also requiring higher down payments some stated as much as 20% to 30% before approval.

The situation is not helped by the legal construct of the Supplier Master Contracts or Service Contracts (cut and haul) provided to logging contractors. It is universally agreed from both suppliers and consumers that the contracts issued to the suppliers favor the consumer's legal interests. Standard contracts are prepared by the consumer legal departments and are not negotiable except

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for an occasional volume target that is usually not enforceable by either party. From the viewpoint of bankers or financial institutions, there are basically no firm commitments for the suppliers. It was also noted that most of the contractors working under dealerships or brokers work with no contracts. Table #4 tabulates the responses to the question *“Are the contracts received from your consumer customers (or contracts provided to suppliers) written in a way that protects both parties – supplier and consumer, mostly protects consumer interests, or mostly protects supplier interests?”*

Table Four
Contract Structure

Answer Options	Supplier Response	Consumer Response
protection for both parties - supplier and consumer	30.8%	66.7%
mostly protects consumer interests	69.2%	33.3%
mostly protects supplier interests	0.0%	0.0%

69% of the suppliers responded that the contracts provided mainly protect the consumer company's interests. Consumer procurement makes the case that it protects both parties (67%) since providing insurance, compliance to all laws and regulations are beneficial to all businesses within the supply chain.

The bottom line for these issues expressed by many suppliers are (a) working relationship is becoming more and more strained as consumer mills continued the restrictive rate negotiations, and (b) there is no consideration for their business sustainability. Suppliers typically stated that procurement negotiation policies have significantly impacted their confidence in the future of their business and therefore their willingness to invest in new equipment.

It should be noted at this point that over the last several months, several consumer companies have implemented some longer-term volume commitments to their key suppliers. The results of those initiatives are having a positive impact on a limited percentage of suppliers. It is also important to note that some of the Northeast region and Lake States are clearly ahead of other regions in providing more stability to wood orders and is beginning to address logging capacity issues.

- **Number two Issue** is that service contract loggers cite a significant lack of joint planning that could be beneficial to both their business and the consumer companies. Suppliers point out that there is little consideration given to their equipment configuration and/or crew locations and harvest block assignments. The question for harvest unit planning and assignment was *“Are your harvest tract assignments (Service Contractors) selected to fit your logging operation configuration?”*

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Chart One

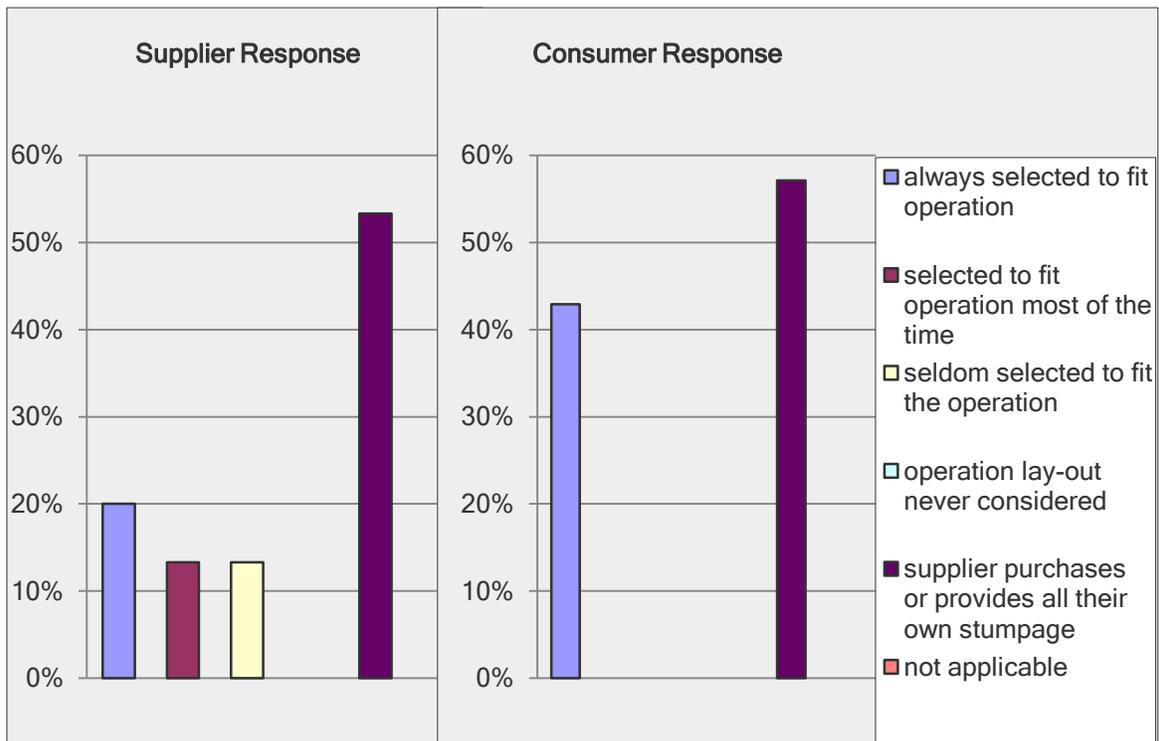


Chart #2 illustrates a wide perception gap between consumers (with controlled stumpage), landowners, and logging service contractors. Service contractors move a large volume in the Northeast. 43% of the consumer procurement staffs interviewed controlled either land or stumpage tracts. All of the contract administrators responded that harvest units were “always” matched with the appropriate logging service contractors. Service contractors were less positive and said they had to work a lot of marginal tracts with many sorts. Their comments were in the following vein:

- “We don’t mind working the small or marginal tracts if we were compensated accordingly – but when we get in situations that our production is cut in half and we have the same average service rates, we cannot overcome the losses.”
- “We have a hard time getting our contract administrator to reveal our next unit is until just before time to move”
- “The landowning company usually does the road-work, but with budget cuts, roads are not adequate or completed on a timely basis.”
- Some logging contractors said they had all their logging units 12 months in advance that really was a huge help in planning the units (Best Practice)
- Much of the time we are caught between the landowners and the mills with tight merchandizing and the mills degrading our logs or refusing our trucks.

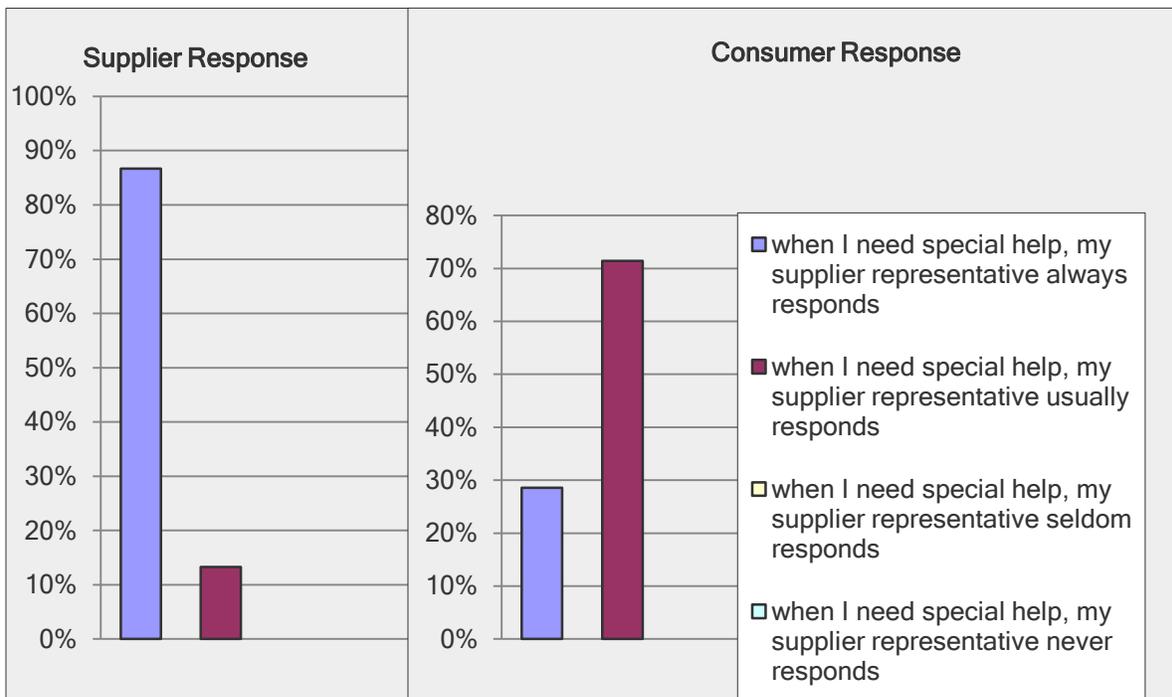
In summary, the working relationship with service contractors is in need of improvement in the areas of more flexible rate structure negotiations and better coordination of wood specifications with their customer mills.

Consumer Procurement Perspective

- **Number one Issue** from consumer procurement is classified as communications. One of the basic premises of this study was to test the level of communications that is so critical to the working business relationship between all parties in the supply chain.

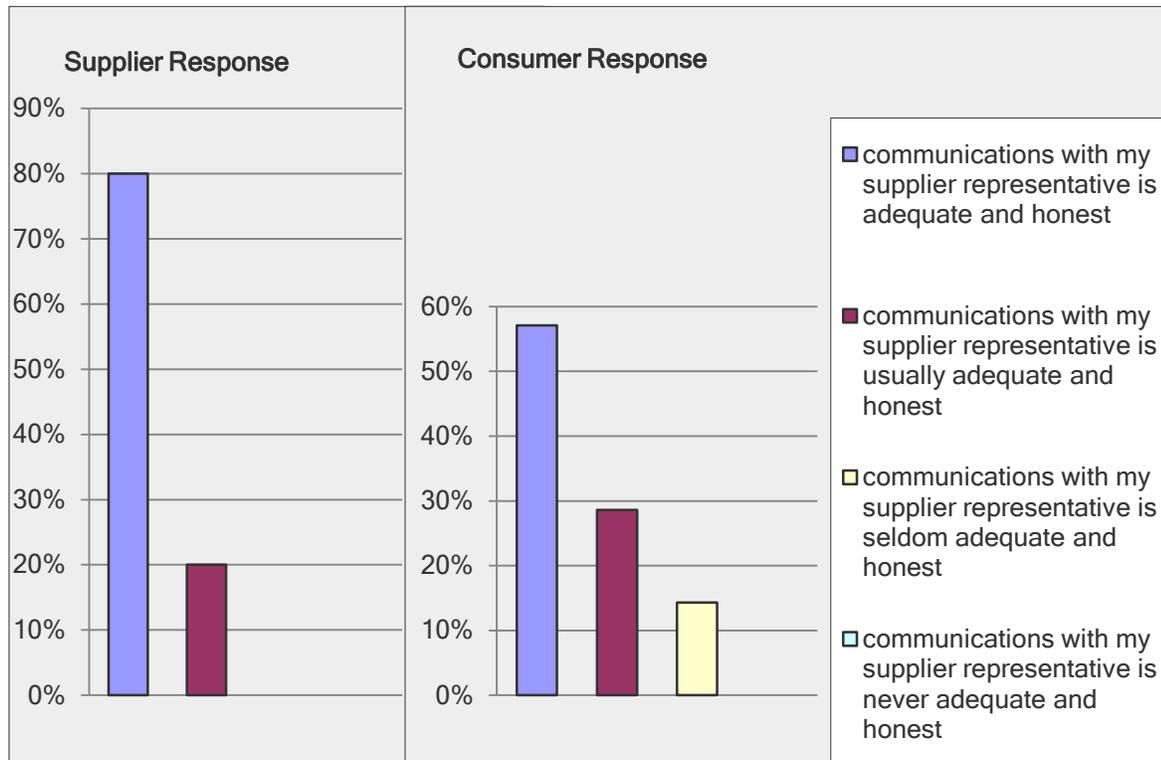
Evaluation of the interview responses in the category of “communications/problem-solving, the suppliers gave high marks in the area of “good response to them when they needed help with operational problems” or “how both parties handled disagreements (see appendix). However on the question “*when I need special help from my suppliers (procurement representative do they always respond?*” the response from consumer procurement was somewhat less positive as compared to the suppliers. Chart #2 below tabulates the responses:

Chart Two



All of the suppliers were very positive and stated that when they needed special help, procurement or contract administrators was overwhelmingly – always responded. In contrast consumer respondents were less positive with 70% of respondents - usually responded. This data may seem like just a nuance of difference. However, when suppliers and consumers were asked “*do you have adequate and honest communications from your suppliers (procurement representatives) to function properly?*” a pattern of less positive responses repeated in Chart #3.

Chart Two



Adequate communications is highly important to the supply chain efficiency. The timeliness and openness of communications is critical to the logging/trucking operations in order to avoid lost production. Conversely, communications from the suppliers to procurement in regards to moves, changes in product-species mix, etc. is highly important to forecasting deliveries and inventory management. Based on the open-ended comments from consumer procurement staff, they were being kind in their answer selections. Procurement people in general would like to have more response from their suppliers when they have operational needs such as week-end deliveries or species change. They would like to have more communications from suppliers than they are currently receiving. Some examples of recorded comments from procurement interviewees below:

- “When a new mill opened - many suppliers bolted to the new buyer with no notification and we lost a lot of production very suddenly - we had to move some wood out of Quebec.”
- “A perfect situation would be if we could have adequate staffing to spend more time with our suppliers and enjoy better communications.”
- “Sometimes we find out late in the month that a supplier will not be putting in their volumes and that creates real problems for us. Some of them will withhold information from us.”

Another factor mentioned by procurement interviewees is with various levels of down-sizing procurement staffs. They simply do not have the time to spend with their suppliers that would really help the both communications and joint-planning. That pattern of much smaller procurement staffs is typical U.S. wide. Most procurement organizations are operating with 30% to 50% less staff as compared to five years ago.

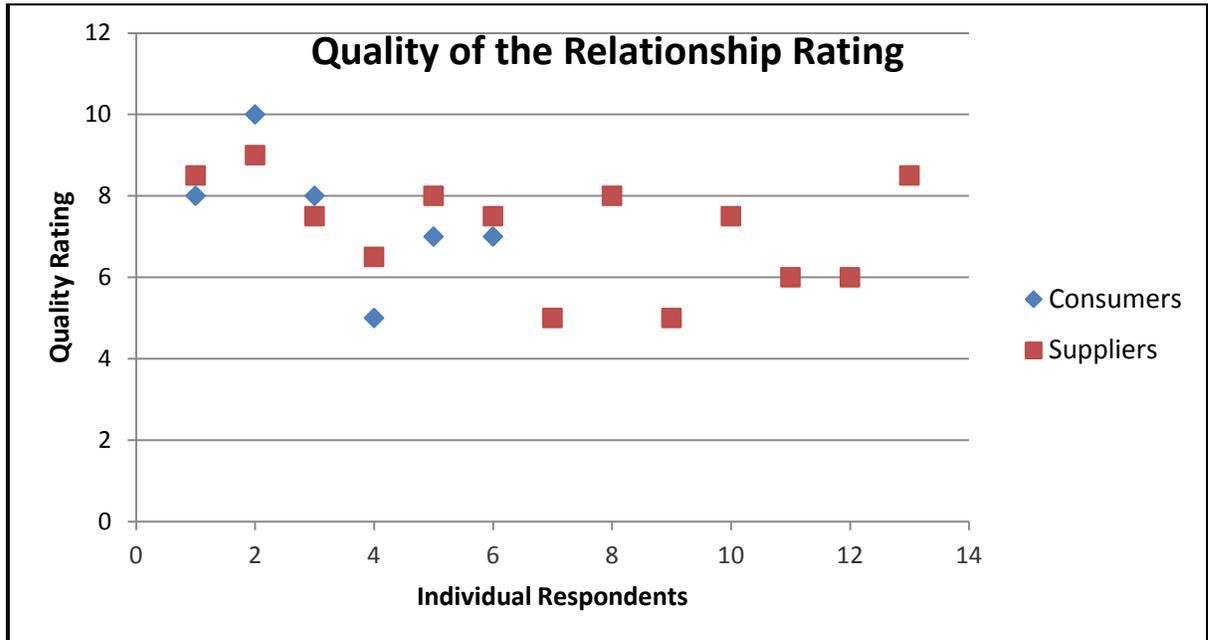
- **Number Two Issue** is the concern from consumer procurement about adequate logging capacity. Logging capacity in the Northeast is difficult to gauge due to the seasonal nature of the operations. In the 2007 Logging Capacity Study by WSRI, logging capacity utilization in Maine was at 82.3%. It was classified to be at or near maximum (85%) at that time. It was strongly recommended that the industry implement some actions to strengthen the capacity at the time of publication in 2008. Early in 2009 when the economic recession was in its fullness, it is unknown how much capacity was lost but it was significant. Then the recession has lasted so long that it can safely be said that further erosion in logging-trucking capacity has occurred. Currently (early 2012) there have been spot shortages in capacity reported throughout the Northeast. When the building products business recovers along with some level of bio-fuels demand, the logging capacity situation will be exacerbated unless strong actions are taken.

During my travels in the Northeast in early 2012, and talking to suppliers and procurement staffs, there is strong evidence that the logging capacity and mill demand is at best in balance. Some areas may actually be in a deficit and consumer mill procurement staffs are having a hard time finding enough logging and trucking contractors to meet the demand. Procurement managers are all very aware of the situation and have various strategies to address the issue and they understand the economic pressures on the suppliers. It is clear to me that there needs to be a higher awareness of the real situation at the senior levels of the forest products industry.

Is There a Problem?

Without a doubt, there are definite improvements that are needed in the relationship between suppliers and consumer procurement. Having said that, compared to other regions of the country, the Northeast has made significant progress. For example, in most of regions the interviews were ended with a request to provide a simple rating of 1-10 (1=very bad to 10=cannot get any better) on the quality of the relationship. Chart #3 below provides the individual responses from both suppliers and consumer procurement interviewees.

Chart Three



The relationship quality rating between suppliers and consumer procurement was almost identical with supplier’s average rating of 7.2 and consumer procurement average of 7.5. Most other regions had a much wider spread of consumer procurement from 7 - 8 and suppliers at 4 - 6. The follow up questions was – **“what would it take to get to a 9 or 10?”** Some of the best comments came from that follow-up that should serve as strong indicators on what areas need work below:

Consumer Procurement Remarks

➤ Perfect system would need higher rates per ton that would carry the replacement of the kind of equipment that we have - must move away from the concept that one price fits all.
➤ Perfection would be the consumer companies providing rates that would enable a reasonable return.
➤ Be able to negotiate realistic service rates (cut and haul)
➤ The perfect system would enable the loggers the compensation rates that would provide a return on their investment.
➤ To be perfect - need better planning related to weather
➤ Less uncertainty about the future of the forest industry
➤ A business environment that would encourage equipment replacement
➤ More communications from the logging consumer mills on a monthly bases
➤ Attitude of the people in the woodyards and turnaround times would be constantly improved - treat people like humans
➤ The only change to make it perfect would be better unloading systems at the mills with more efficient management and better equipment
➤ A perfect system would have better long-term planning with the mill - procurement - suppliers that would translate into a more stable and committed system. We know we will have to be willing to risk longer term commitments to achieve that objective.
➤ Wood receiving systems would be much improved - - Would like to have the ability to lengthen the contract system and more flexibility in pricing logging services - all to get more stability in the supply chain.

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The working relationships between suppliers and consumers are not just about feeling good about each other. All participants generally like and respect each other. What is more important is that the working relationship has an impact on the productivity of the supply chain. When suppliers described patterns of events that caused lost production related to the working relationships they were asked to quantify the number of lost loads on an annually that the events occurred. I recorded the lost volume only after carefully determining the frequency of lost loads on a very conservative basis. Table 4 is a tabulation of volume reported.

Lost Production due to Relationship Breakdowns

INTERACTION AREA	TOTAL TONNAGE REPORTED	AVG/SUPPLIER
Negotiations	11,000	733.33
Planning	57,000	3,800.00
Feedback	-	-
Problem Solving and Communications	-	-
Annual Totals	68,000	4,533
Total Sample Production	4,062,500	270,833.33
Loss Percent of Sample Tot.	1.7%	1.7%
Approx. Total NE Production	26,000,000	

Total production lost by suppliers interviewed in the Northeast region represents 1.7% of their annual estimated production. For the suppliers interviewed, the production impacted by failures of the working relationship was a total 68,000 tons on a 4 million ton sample. For the average supplier the data indicates over 4,500 tons per year or approximately 150 loads per year. The highest volume loss occurs in the area of “break-downs due to planning. These estimates are very subjective and cannot be statistically projected to the total population. Not all the suppliers credited any lost volume due to failure of the working relationship and one large landowner is in the data. The point is that anything that can be done to eliminate production losses is important to the supply chain in monetary value. Again the percentage in the Northeast of lost production is less than many other regions but still needs improvement.

General Logging/Trucking Related Observations

It is difficult to make a general statement on a summary level to properly characterize the state of the working relationships for this region. The major issues cited in the body of the supplier section above are generally negative. It is important to point out that the data also indicates some very good practices that are happening between the supplier-consumer relationships. They can be seen by perusing the open-ended comments in the attached appendix.

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POSSIBLE SOLUTIONS:

Assuming that the Northeast supplier/consumer relationship assessment presented in this paper is generally accurate, 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 in a collaborative way 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 is a 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 awareness throughout the corporations that the independent wood supply contract system is an essential asset to the forest industry and contributes 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. The 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 independent 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 Northeast 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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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 strongly 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.

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.

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