

WSRI SUPPLIER-CONSUMER RELATIONS PROJECT:

How Can We Change the Culture of a Supply System in Crisis?

By Don Taylor

The prevailing wood procurement practice in the U.S. forest industry depends on a working relationship with a myriad of supplier business enterprises. The quality of that relationship is highly important to the function and efficiency of the forest industry supply chain. It needs to be clearly understood that the term “relationship” is not about everybody “feeling good” about each other. The overriding focus of the Wood Supply Research Institute’s Supplier-Consumer Relationships Project, which I undertook during the past year, is about the cultivation of a mutually beneficial business environment that translates into operational and cost efficiencies. It is about a dependable and sustainable wood supply chain.

The Project begins with the following hypothesis: that there are significant improvements in the “people part” of supply chain management, in terms of relationships between suppliers and consumers, that can be discovered. If recognized and implemented, these improvements will lead to a more effective supply chain, benefiting all business structures. Further, the proposition is that a trusting relationship among all segments, with each party having confidence in the others’ capabilities and actions, is among the most important elements of a successful supply chain.

The Project defines “effectiveness” in a supply chain application as the optimization of inputs and outputs, eliminating waste of both human and material resources. A Supplier-Consumer relationship is defined as being high quality when (1) each side conducts business with mutual respect, (2) interactions proceed in an open manner, and (3) all parties act in an ethical framework aided by consistent communications. This approach enables all parties to perform their obligations at maximum efficiency. WSRI itself is based on these principles, and its membership believes that they are paramount to the sustainability of the supply chain.

Methodology

Our objective was to evaluate the working relationship between suppliers and consuming mill procurement. We structured the Project to obtain *quantifiable* data on how routine interactions between suppliers and procurement people actually function.

I conducted over 225 face-to-face interviews across the U.S. with suppliers and procurement people over a seven-month period beginning in late spring of 2011 through January of 2012. Each interview had three parts.

First, I asked participants a set of structured questions, asking them to select among 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, 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 would be conducted.

Secondly, the Project collected open-ended comments on how the supplier or consumer procurement participants viewed the working relationship, and I analyzed any comments that I perceived to have impact on the working relationship on a qualitative basis. In the event that a supplier’s or consumer procurement participant’s comments revealed a pattern of dysfunctional

interactions, I conducted a follow up discussion to investigate whether that pattern resulted in lost production and therefore caused avoidable inefficiencies. If I could determine that the dysfunctional pattern actually caused lost production, then I extrapolated an annual lost volume (on a conservative basis). I collected examples of incidents that had caused lost production within the past 12 months.

Likewise, when subjects cited “best practices” and confirmed them in actual examples, I recorded those and entered them into the database.

I worked with Dr. Brenden Kendall of Clemson University to organize the database, generate reports, and analyze results (omitting names and company affiliations from all entries). We prepared reports 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)

We classified participants according to the following categories.

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

Results

Let’s make note, first of all, of the “business context” in which the Project took place. The forest industry has just come through one of the most painful economic recessions within the last 50 years. Currently (early 2012) paper markets are mixed, and the solid wood business continues in a trough with no immediate relief in housing starts in sight. That this study occurred during a time of extreme economic stress for both suppliers and consumers is an important contextual framework to bear in mind.

I would like to focus on three major findings, common in all regions, which I have concluded call for the full attention of the forest industry. If my candor here seems somewhat blunt, please believe that it is not my intent or desire to be provocative—just to be sure that my observations emerge as clearly as possible. (The full Report’s individual region reports contain an expanded listing and region-by-region analyses.)

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Finding Number One – Relationship Damage

In my 40+ years in this business serving the industry in various wood procurement functions, I don't think that I have ever seen supplier morale at a lower level. Based on anecdotal evidence and confidential hard data prepared by accounting firms, almost 40% of the contract loggers/truckers were found to be operating at a loss financially, or at best break-even.

The focus of this Project is not logging or trucking economics; however, the prolonged financial stress under which both suppliers and consumers operate is having an inescapable impact on the working relationship.

Suppliers in general like and respect the *procurement representatives* they work with day to day, but they have come to resent the *procurement system* that many

consumer companies have set in place. Likewise, procurement people have a high regard for the suppliers and are indeed apprehensive that cost-control policies may have damaged the supply chain.

The consumer companies have necessarily focused on cost reduction to keep the mills running, and all segments of the supplier community understand that the forest industry is experiencing a deep recession and that suppliers had to suffer as well. However, a large part of the suppliers stated that they perceive that consuming mills have "abandoned" them. The recession has put a deep divide in the relationships. Rather than working together to manage through the crisis, most of the suppliers say they experienced increased isolation.

Some consumer procurement policies may be described as the "commodity approach." That approach may be characterized as "let market forces decide the survivors." It sends a clear message that relationships don't count.

For example, many consumers abruptly cancelled pre-recession commitments and placed all production orders on a week-to-week basis, providing no security in terms of volume or delivered pricing. Across the South, there was typically no recognition given to sharply rising fuel prices or any other rising expenses presumed to be recession-proof. In the West, many consuming mills and large landowners implemented bidding policies on harvest and transportation services, effectively breaking any long-term relationships. Suppliers that had inventories of stumpage purchased ahead found themselves at the mercy of falling stumpage prices and reduced delivery prices.

More recently, there is additional stress due to another spike in fuel prices. I can say confidently, having been in the bowels of the wood business, that almost 40% of today's logging-trucking capacity is at risk of business failure.

Many consumer procurement organizations pulled back in relationships at a time when the suppliers needed a *managed capacity reduction* to match reduced wood demand so they could stay viable through the downturn. Supplier company owners stated a common sentiment: "we know the mills had to survive, and we needed them to keep running, but why couldn't consuming mills and large corporate landowners just work with us to minimize the damage?"

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There were, however, some consuming companies that did take a more supportive approach and worked closely with suppliers to navigate the recession. Some consuming mills and large corporate landowners worked with loggers and truckers to downsize to minimize the damage as all suffered through the recession over the last three years. Several Northeast and Lake States consuming companies have implemented longer-term commitments over the last two years that have resulted in improved relations with their suppliers and stable supply chains.

But more than 66% of the suppliers throughout the South and Western regions expressed dismay and hurt. *Bottom line:* it will take some dramatic changes before the logging-trucking community can rebuild an acceptable level of confidence that the forest industry cares about the sustainability of its services.

Finding Number Two – Logging Capacity Disinvestment

The economic strain has resulted in significant disinvestment in logging capacity. Disinvestment may happen in any of three ways.

1. Close the business, and sell equipment.
2. Downsize to adjust to lower market demand, and sell excess equipment.
3. Keep running, but hold off on normal equipment replacement, and minimize any investment in stumpage (i.e., burn up business equity).

It was clear that the majority of the suppliers are in a “hunker down” mode if they are still operating. At least half of loggers nationwide have delayed normal equipment replacement schedules. Interviews with several logging equipment regional sales managers confirmed that sales of new equipment have been at 25% to 40% of normal levels during the last three years. Trucking capacity in the Western states and in spots across the South is classified as “very tight.” Maintenance costs rise and downtime increases as equipment gets older, exacerbating logging economics.

Although the generally mild weather conditions across the U.S. and periodic mill outages have not really tested the wood supply system in most areas for the last two years, most (75%) of the procurement people I interviewed expressed concern about the adequacy of logging capacity once building products markets recover or some long-term inclement weather systems occur.

To be sure, past history shows that the logging business has been able to recover in down economic cycles and bounce back. However, today there are serious barriers that cast doubt about the recurrence of that pattern. The reasons for this doubt are obvious:

- Tight money for logging equipment due to more restrictive banking regulations
- High cost of new equipment
- Doubts about consuming mills’ economic viability
- Aging ownership of logging businesses, that tend to be risk-averse
- Concern about future timber supply
- Concern about getting and holding reliable labor
- Training requirements for certification

Again, I must point out that nationwide production capacity is in serious danger of being damaged beyond a quick recovery. Those of us that have been around for a while have seen logging capacity go through tough times and then consistently bounce back, with adequate people willing to invest in the business when the situation stabilizes. My opinion is that this time is different. Even people who are willing to invest will not be able to get the capital from traditional sources.

Finding Number Three – Productivity Leakage

The issues this Project raises have impacted working relationships and resulted in a loss of trust in the system. That observation alone is important, but the more critical factor is that breakdowns in relationships often result in lost productivity.

Consider, for example, a breakdown in communication related to a mill outage. The result is trucks being dispatched to the closed mill and then having to return to the woods, be reloaded to go to another destination, losing several loads that day. Another example: the procurement organization decides to take wood from a non-regular source to surge inventory levels, and the following week places all regular suppliers on quota. Apart from these two examples, there are numerous other situations resulting in lost production that cannot be regained. Lost production hurts suppliers’ bottom lines and ultimately adds cost to the consuming mills.

The following table shows a nationwide estimated annual lost production tonnage designated by suppliers, on a conservative basis.

Lost Production Summary – All Regions

INTERACTION AREA	TOTAL TONNAGE REPORTED	AVG/SUPPLIER
Negotiations	1,707,900	11,090
Planning	1,963,100	12,831
Feedback	126,000	846
Problem Solving and Communications	806,300	5,485
Annual Totals	4,603,300	30,252
Total Sample Production	65,927,000	425,335.48
Loss % of Total Sample	7.0%	7.1%

As the table shows, relationships have quantifiable monetary value to the supply chain. Suppliers I interviewed reported a total annual loss of production of 4.6 million tons, representing seven percent of the total sample. I calculated an average annual loss of 30,000 tons for each supplier sampled.

This data contains some large dealerships and large landowners. A more typical logging company that is capable of producing 75 loads per week would stand to lose 270 loads annually at the 7% rate. Logging has plenty of unavoidable production losses such as:

- Inoperable ground conditions due to inclement weather
- Equipment breakdowns
- Moving between tracts

But when the relationship is dysfunctional, the following factors, theoretically controllable, fall out of control:

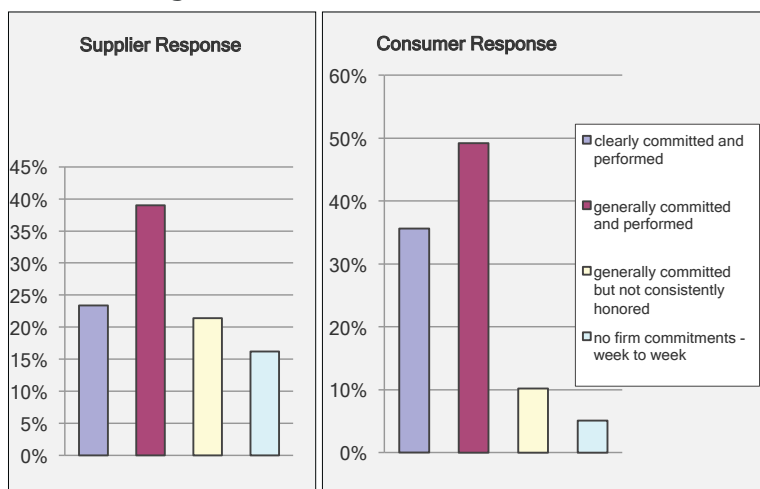
- Frequent variable quotas
- Truck delays due to poor woodyard management
- Poor communications
- Poor planning

According to this study, losses due to controllable factors can amount to 4% to 15%, depending on the region. Approximately 45% to 50% of logging costs are fixed in nature. A small percentage of loads per week, compounded by the effects of uncontrollable natural events, can have a huge impact on margins and cash flow.

Suppliers need consistent base commitments from their customer mills to be able to have some reasonable planning horizon for their business. A large percentage of the suppliers nationwide basically work week to week with no firm commitments beyond the following week. Is it reasonable that highly professional people, dealing with that kind of uncertainty, would continue to stay in the business?

Procurement staffs point out that a large percentage of their roundwood supply is set up through “tract-specific transactions” that recognize the need for stability in stumpage purchases. That practice has really helped suppliers that purchase stumpage. The following Chart provides a summary of how Suppliers and Consumer Procurement people view volume commitments.

Negotiated Volume Commitments



What is significant in this response summary, across all the regions, is that 63% of the suppliers interviewed stated that they had verbal volume commitments that were dependable. In contrast, 85% of the consumer procurement stated that they provided dependable volume commitments. Part of the response disparity may be from logging contractors interviewed that worked within a dealer structure and did not directly receive solid volume commitments.

Recommendations

Assuming that the Supplier/Consumer relationship assessment presented in this paper is accurate, the following are some broad recommendations offered to set strategy to stabilize the supply chain relationship. I would strongly urge all procurement organizations to address these issues energetically. The consequence of letting a large portion of loggers-truckers drop out of the supply chain would be more damage than consumers can absorb. Each individual company will have to assess the status of its relationship with suppliers and then develop appropriate actions to follow. It is important for all procurement personnel to step back and take an honest assessment of the real situation. Here are some broad first-step actions to be considered:

- ***I strongly recommend that the first step is for the senior procurement managers to communicate the real situation clearly to the company's top management.*** This is a business strategy, not a “feel good” mission. The suppliers do not need charity; they need a chance to work with their customer companies toward raw material supply security for the consuming plants. The operating mills are the future of all the stakeholders and must stay viable. Viability in the logging operations is necessary for that to happen.
- ***What seems to be missing is awareness that the independent wood supply contract system is an essential asset to the forest industry that contributes clearly to the industry's global competitiveness.*** Consider the following points.
 - Promoting the continuation of professional and ethical suppliers with good management skills is as much a part of viable manufacturing as having experienced/competent employees or state-of-the art manufacturing equipment. If the raw-material supply chain asset in its current form is seriously damaged or goes extinct, 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, build credibility with landowners, and provide certifiable logging systems. These attributes are not replaced without years of careful development and huge capital investment.
 - The quality of the people in the business is still very high, and these people need a healthy working relationship with their customers. U.S. independent wood suppliers are producing a commodity in raw wood, *but the complex function and organization of procuring stumpage and managing compliant harvesting/trucking systems requires very specialized and critical skill sets not easily duplicated in any other systems.*

- **Provide a more stable operating environment to your key suppliers.** It is absolutely amazing that many of the suppliers work with no security, no firm volumes (except week to week), under arbitrary decisions made from outside their influence, under increasingly restrictive regulations, and bearing the burden of huge, risky capital investments of standing timber and equipment—apart from constantly changing weather conditions. In developing this stable operating environment, I recommend establishing alliances with key suppliers in terms of strategic stumpage purchases, careful planning to maximize woodyard storage, and a focused effort to revive the economic health of the suppliers.
- **For the supplier community, you need to move away from a negative attitude.** In spite of the tough times, clinging to a negative attitude will only discourage initiatives from your customers. Your customers are not the enemy. They have pressures on them, from stockholders and other business forces through the recession that have dominated the business environment. Maintaining the surviving manufacturing base and moving it back to profitability has been an essential focus. A positive, non-threatening approach will be critical to a successful rebuilding of the relationships. Put the past in the rear-view mirror 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 company and supplier capacity that have survived the last few difficult years have all gained tremendous efficiencies. It is time for each consuming company to take a fresh approach to its wood and fiber supply system, focusing on how it can be stabilized, by means of a deliberate look forward. “Reacting” is not enough. Procurement organizations need well-thought-out strategies for working with suppliers to nurture the system by jointly planning ahead. Rebuilding trust between suppliers and consumer organizations must be a priority. I am calling for 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 focus on building a positive working relationship, to do everything they can to make their customers successful. If firm commitments are offered and accepted, then suppliers need to understand that performance of those commitments is not optional.

In Closing

This is a great industry, and WSRI’s purpose is to bring straightforward issues to the table that are in the interest of the Wood Supply System. This Project’s intent, in line with that purpose, is to provide real data that can aid in developing intelligent approaches to working toward supply chain optimization.

We will continue to face real and current issues that are important to all the stakeholders. It is important for each individual participant to develop sound business strategies based on the best data available.

THE AUTHOR

Don Taylor currently owns and operates **Sustainable Resource Systems LLC**, specializing in strategy and organization of all aspects of wood supply systems. Don has over 40 years in the forest industry, beginning with Champion International serving in regional operations to Vice President of Forest Resources in Stamford, Connecticut. After retiring from Champion he joined PricewaterhouseCoopers in their Forest and Paper practice. He lives in Greenville, South Carolina, working in his consulting business, and has conducted research projects in two nationwide Logging Capacity projects and this project. He holds a bachelor and masters degree in forest science, and an MBA.



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